

VERTICAL INTEGRATION: A CASE STUDY OF SCANDINAVIAN AIRLINE SYSTEM IN

1988

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Introduction

The Scandinavian Airlines System (SAS) applied vertical integrations strategic management approach as a way of overcoming the challenges it faced especially in the 1980s. The threats in the aviation environment such as competition from other major airlines caused the profitability of the airline to decline steadily. Because of the new management, which began with Jan Carlzon as the company's CEO, there was complete company restructuring and thus the airline began to grow steadily through vertical integration with the hotel, reservation, credit card, and the catering sectors of the aviation industry. This paper gives a critical analysis of vertical integration approach of strategic management with a special focus of the SAS as the case study.

Background

The establishment of the Scandinavian Airlines System came just after the Second World War and its operations began in September 17 1946. Ghoshal et al (1988, 35) say that the airline system was formed as a collaboration of three airlines from Sweden, Norway and Denmark. The partnership of the airlines, which formed the SAS aimed at taking control of the intercontinental air travel in the Scandinavian countries. Late in the 1970s and in the 1980s, the SAS experienced many challenges, which led to disagreements within its management, owners, and the staff. The stakeholders of the airline disagreed on the causes of the big losses incurred by the company and the ways, which would help the company to cut its costs. There was dire need for a turning point at this time, which would save the airline from collapse.

Following the appointment of Jan Carlzon as president of the airline in 1981, the change of management began which led to the improvement of the airline in the subsequent years. The changes relate to the charismatic leadership and management reputation of the new president and his record of transforming airlines. Vertical integration adopted as a strategic management strategy of the airline and as a result, SAS is currently the largest airline system in the Scandinavian region. The airline has its bases in Denmark, Stockholm, and Oslo and it serves about 23 million travelers every year within the domestic, European, Intercontinental, and Scandinavian routes. The SAS Group is the larger organization within which the SAS operates. The SAS Group owns many airlines, hotels, and air travel services.

Vertical Integration

Vertical integration in the aviation industry is the merger of various companies, which provide services and products along the same path in air travel such as airlines, hotels, and travel agents with a central control. It aims at achieving greater success in terms of quality of services, products, and increased revenue. Peyrefitte, Golden & Brice (2002, 218) assert that the application of vertical integration as a strategy in strategic management by airlines is due to the advantages associated with this strategy. The transaction cost in air travel is reduced owing to central management and communication among the subsidiary companies. Additionally the vertical integration strategy is used by airlines so that an airline would monopolize the aviation market. Furthermore, a common system of quality control in a vertically integrated airline system enables the subsidiary companies to guarantee quality of service. However, the vertical integration in airline industry may lead to high organizational cost which is related to the management of its complex organizational structure as explained by Peyrefitte, Golden & Brice (2002, 223).

Strategic management of SAS

During the period of 1988, the SAS underwent a phase of vertical integration in which the SAS Group acquired travel companies such as airlines, ground services, travel agents, and hotels. As a result, the airline has grown enormously in terms of revenue and passenger traffic and hence making the airline to be a major participant in the airline market globally as illustrated by Ghoshal et al. (1988, p. 33). Good management especially by the company's former CEO Jan

Carlzon who saw the company through the worst of challenges during the 1980s enabled the success of the airline. The CEO maintained that businesspersons had to travel both in the good and bad times. The motivation behind the vertical integrations a management strategy by the airline stemmed from the need to increase its share in the air travel and leisure market. This was after the realization that the market trends at the time were very competitive hence there was a need to use proper management strategies so that the airline would stay in the market.

The advantages of vertical integration came in handy in the period around 1988 by the SAS, which is a product of a difficult collaboration of three fleets from Norway, Denmark, and Sweden. Ghoshal et al. (1988, 44) say that the difficulties in structure of the airline resulted from the fact that the airline became a consortium and control was distributed among respective governments. The need for vertical integration was thus motivated by the need for improving decision making and reducing the inefficiency of everyday operations of the airline.

Additionally, there were problems in the route system of the airline, which needed immediate attention. SAS faced stiff competition from airlines in Europe, which use an efficient hub that is controlled from a central point in a single airport. On the other hand, there was lack of central control of the SAS consortium with three hubs the national airports in Stockholm, Copenhagen, and Oslo. Due to lack of central control made control scheduling, passenger, and aircraft movement a nightmare.

The challenges, which the company faced, started to improve with the dramatic turnaround, which is attributed to effective management. The new management of the airline made strategic

choices such as decentralization of various responsibilities. The aim of this choice was to ensure that the operations of the company were completely reorganized in order to enable customer focused service delivery. Because of the prioritization of the customer, the company began to achieve tremendous growth in its revenue.

Because of the vertical integration and good management, the airline began to gain competitive strength. For example, the market presence of the SAS became stronger within the Scandinavian region.

According to Ghoshal et al. (1988, 37), the strength of SAS was due to a new strategy of making the company businesspersons' airline. The new strategy led to increased frequency of flights and reduction of fares. Moreover, the first class was dropped by the airline and a EuroClass was introduced. The intention of the management in regulating the travel classes was aimed at ensuring that high quality amenities were provided at the same low cost prizes. However, the company continued to face stiff completion from airlines in Europe. This can be attributed to the operation costs of the airline, which were deemed the highest in the aviation industry at that time. The management therefore had no option but to come up with a strategic plan which would see the company to have strong brand equity.

A corporate cultural revolution was necessary to overcome the challenges faced by the airline. The company thus had a choice between doing a complete restructuring of its business operations and using the old inefficient system. Ghoshal et al. (1988, p. 39) asserts that the initial need for restructuring would have stemmed from emphasis in technology, fixed assets and

centralized control. However, the company opted for vertical integration. As a result, the SAS International Hotels became a separate entity of the SAS Group, which provided accommodation services for the travelers of the airline. It is notable that this defied the norm in the business operations, which followed the procedures and manuals of the company strictly. In addition, the normal operations of the company were characterized with a great deal of bureaucracy. By running the SAS International Hotels as an independent entity of the SAS Group, all bureaucracy was overcome.

Ghoshal et al. (1988, 37) shows that in 1984, the SAS Group introduced the SAS Reservation System. This was to run parallel to the operations of the airline but as an independent entity. As a result, the vertical integration of the company as a strategic management plan of the airline was achieved. This can be attributed to the current strengths of the SAS Airline, which include its strong network and links within the aviation industry. Moreover, the bilateral relationships of the SAS have been established with other airlines such as Lufthansa. The SAS Reservation System has contributed to the strong linkups with other airports, which is a form of Star Alliance. It can be concluded that through vertical integration with the Reservation System, the SAS airline has been able to realize its current strengths especially in having strong networks, linkups, and alliances in reservation. Because of this reason, the airline has been able to maintain its core customers in addition to the increasing number of new customers.

The weaknesses of the SAS airline such as inability to reach the target profitability margins can only be overcome through strategic management. The vertical integration with the SAS

Reservation System for example was a way of increasing the number of customers through linkages and alliances so that the target profitability margin of the company would be reached efficiently. Moreover, the weaknesses in the company, which are demonstrated by the decline in the passenger yield, would only be overcome through vertical integration of the airline with the reservation system.

The opportunities which are available to the SAS airline such as sponsorship of football games in the Scandinavian region and internationally are only exploited if vertical integration was applied in the company's strategic management. In 1986, the SAS Group acquired the Diners Club Nordic. This was a strategic management plan to enable vertical integration, which led to the acquisition of the Diner's club card. Within Scandinavia, Iceland and Finland, the Diner's Club Card had more than 150 000 holders at the time. This was a perfect way of utilizing the opportunities within the aviation industry. The vertical integration with the credit card sector has thus enabled the customers of the airline to efficiently pay for the air travel services in addition to the accommodation services provided by its subsidiary hotels.

The vertical integration strategy in management was used by the SAS airline in its integration with the SAS Service Partner (SSP) as demonstrated by Ghoshal et al. (1988, p. 41). This is a subsidiary of the company in the catering department, which is run in several countries in the world with more than 7000 workers in its kitchens, which are distributed in over 100 locations globally. This was a good way of overcoming the weakness of the declining market share within the Nordic and international aviation industry. The company thus uses the catering subsidiary as

a way of dominating the air travel industry by being the provider of both commuter and catering services in major airports in the world. Moreover, the use of the vertical strategic management approach is a good way of utilizing the opportunities available to the airline such as the chances for lowering the operation costs.

According to Ghoshal et al. (1988, 40), most of the Nordic passengers travel internationally; it is recommended therefore that the SAS airline review its corporate strategy which mainly focuses on the Scandinavian market. This could lead to the strengthening of the airline's presence in the international aviation industry. Moreover, it is recommended that the company utilize the opportunity of using the informal networks and links such as Twitter and Facebook as a way of fostering its alliances with customers and travel agencies across the world. This recommendation is motivated by the need of making the company to increase its customer base hence help it to reach its target profitability margin efficiently.

Conclusion

The SAS Company faced many challenges especially in the late 1970s and within the 80s. There were declines in profitability, company presence in the aviation industry and reduction in the customer base. The new management, which was initiated by the appointment of Jan Carlzon as the SAS president, caused a major turnaround of the airline. Strategic management was acquired through vertical integration with the catering, credit card and reservation sectors of the aviation industry. This enabled the company to face the weaknesses and threats it faced. As a way of

facing the future, the company's position in 1988 was aimed a complete restructuring and focusing its activities on the customer and vertical management.

Bibliography

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