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The Path Dependency of former monopolists

A case study of Scandinavian Airlines System

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Abstract

Title: The Path Dependency of former monopolists

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Five key words: Monopolist, Path dependency, Strategy, Competition and Deregulation

Purpose: To explain how path dependency is affecting the strategies of former monopolists after that their markets are deregulated.

Methodology: For this thesis research we have mainly applied an inductive approach based on a qualitative research method including unstructured interviews.

Theoretical Framework: To analyze path dependency from a strategic and industrial perspective Porter's Diamond, the Path dependency theory, SWOT-analysis and Porter's Generic Strategies have been selected. These models and theories have been chosen because of their explanatory advantages and inbound relations.

Empirical material: The Empirical data primarily comes from five interviews and 20 annual reports. These sources have been presented together in order to provide a covering background for the analysis.

Conclusions: This thesis suggests that former monopolists continue to be affected by path dependency after that their markets are deregulated. The structures and strategies of monopolists operating in a regulated market are built on the belief that they are not facing competition. Therefore overall efficiency particularly in terms of cost structure is not emphasized during regulation. Once the market is deregulated new entrants enter with cost structures based on markets with free competition. The new entrants, not being strategically path dependent, may also implement new business models. The former monopolist is challenged by limited strategic space because of its path dependent structure. This limited strategic space caused by path dependency negatively affects its relative competitiveness.

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Abbreviations

Airline alliances: strategic agreements between airlines typically regarding agreements of code sharing, bonus programs and customer lounges.

Cabin Factor: The rate to which the airline manages to fill a plane with passengers on a given leg.

Code sharing: a strategic agreement between airlines allowing them to sell seats on each other's flights under their own designator code.

Consolidation: the reduction of market players through mergers and acquisitions. Firms remaining in the market achieve market concentration.

EuroBonus: SAS frequent-flyer programme. Allowing customers to receive points from their travel that can be exchanged for new tickets.

Flag Carrier: state owned airline enjoying special state based concessions e.g. a monopolistic route network and favorable domestic regulatory that hinders new entrants from competing.

Hub-and-spoke networks: an airlines operating structure where its main operations originate typically from one but also potentially several airports. The hubs are fed with traffic from secondary operations, spokes, which are offer customers connection flights to other destinations.

IATA: International Air Transport Association, the most influential global airline association including the majority of the world's airlines.

Interlining: a formal agreement between airlines enabling the carriage of passengers and luggage on behalf of other airlines. All airlines involved are obliged to service tickets issued by all participants.

Long-haul flight: transcontinental flights lasting at least 7 hours.

Lounge: a separate waiting room for business, first-class or customers who have reached high levels in bonus programs offered by an airline and/or an alliance.

No-Frills: An airline strategy that removes all free onboard services and instead seeks to increase customer value by decreasing fares.

Open Skies agreement: An air transport agreement between the EU and the United States allowing United States and EU based airlines respectively to fly between two intercontinental points. It further allows United States based airlines to fly between intra European points.

Point-to-point route: a fixed route between two secondary airports.

Primary Airports: Large airports handling at least 10 000 passengers/year.

Secondary Airports: An airport that provides secondary relief and service to a larger airport.

Unit cost: The same as CASK (Cost of available seat-kilometer).

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1 Introduction

This chapter will introduce the fundamentals of this thesis with regards to its topic, background, problematization and purpose.

1.1 Disposition

Chapter 2 - Methodology

The methodology chapter introduces the reader to the general research approach applied. In this chapter we also present the collection of data including respondents, case study and motivation of theoretical selection. The chapter is concluded with a discussion regarding the quality of research.

Chapter 3 – Theoretical Framework

This theory-based chapter individually presents the selected theories and conceptual models together with their respective criticism. The theories and conceptual models are ultimately presented and described in the context and respective functions of this thesis theoretical framework.

Chapter 4 – Empirical

In this chapter we introduce our readers to the market conditions, competitive strategies, historic and present development of our case study.

Chapter 5 – Analysis

This chapter analyzes the empirical material based on the theoretical framework presented in chapter three. In practice this means that the analysis is conducted in separate sections, one for each theory, where opinions and conclusions are provided sequentially.

Chapter 6 – Results

In this chapter we present the answer to our problematization and indicate the thesis practical, theoretical and methodological findings. Furthermore the chapter states our suggested generalizations and implications for managers and regulators facing market deregulation. The chapter is ultimately concluded with implications for future research.

1.2 Research Background

During the months prior to this thesis being initiated both authors have been closely following the societal debate concerning the role of former monopolists presently competing in deregulated markets. The role of these companies is debated and particularly questioned is their ability to compete in a free market.¹ This debate, in our opinion, offers two fronts. Firstly there are those who argue that there is a difficulty for entrants imposed by the strong position held by the monopolist. Secondly there is the debate concerning the difficulty for the monopolist to adjust to free market conditions in strategic terms. In our opinion the second front, compared to the first, offers a highly interesting strategic challenge that we feel is a subject bound for further research. These monopolists, originally established to serve the interests of the state, have after the introduction of market economy been forced to adapt their strategies to new conditions. Their strategies that once were established to serve a monopolistic market, are no longer as applicable. The power of changed market conditions is however not easy to adapt to, as companies are dependent and influenced by historic strategic decisions.²

The authors' common interest in this subject led us to the aspiration of investigating the matter more thoroughly in an academic format. The thesis targets readers who strive to gain more knowledge of the implications of a change in market conditions following deregulation. The main objective with this thesis is to investigate what happens to the strategies of former monopolists when they depart from acting in a monopolistic position to a position where they are subjected to competition. We aspire to explore whether there are generic conclusions to be drawn from these events. As students of business strategy we are interested in extrapolating the strategic implications when firms are forced to adaptation. In this thesis we will further attempt to create a model, which is based on a self-chosen theoretical framework of generic theories that are currently taught at Lund University. We also aim to investigate how path dependency and historic events have shaped the contextual conditions of companies coming from a monopolistic position into to a deregulated market. Among these contextual conditions are the facts that these companies, as a result of their state-monopolistic situation, firstly, are flag-institutions in their respective nation and secondly, their respective government have a big owner stake. By flag-institution we mean that the companies in question are a kind of national monument as a result of them historically being the sole

¹ European Commission, ec.europa.eu, (2012).

² Konkurrensverket, (2013).

provider of a service or good. This has made them into symbols of national identity, which may undermine rational decision-making. As for the high stake of governmental ownership, it may have a blocking effect when there is a need for swift action, e.g. letting go of employees when crisis occur.

Since this thesis will examine markets, which are subject to regulation and state monopoly, there is a need to define and explain the concepts regarding free competition, monopoly and deregulation.

1.2.1 Regulation and monopoly

Regulation is defined as limiting or constraining a right, creating or limiting a duty or allocating a responsibility.³ In this thesis, the markets that are going to be investigated are subject to a regulation imposed by government authority. As far as the definition goes, there are many other implications of regulation, such as self-regulation and contractual obligation, which henceforth will be excluded from this thesis.

Continuing, this thesis will as has been indicated, focus on regulated markets and more specifically a market with historic monopolistic regulations. Starting out we considered which state monopolist that, based on our ambition with this thesis, would be suitable for serving the purpose of this thesis. We initially considered various types of monopolies e.g. state-, natural-, technological- and geographical monopolies. From this discussion we concluded that state monopolies, compared to the other alternatives, offer highly interesting dimensions in terms of managerial, regulatory and societal complexity. This while the other alternatives necessarily do not stem from governmental decisions or market interruptions. Further, the objective and general perception concerning the necessity of preserving state monopolies have changed in recent years. Several markets where state monopolies have been operating historically are now deregulated. The deregulation adds tough challenges to the management of these companies which products are and have been established and developed based on the original monopolistic position.⁴ Serving the thesis' purpose we find it very tempting to investigate how these companies product heritage is affecting their competitiveness in a deregulated market. This as their strategies, including original product offerings as already

³ Ha-Joon, C., (1996). p. 703.

⁴ Jordahl, H., (2008). p. 9-10.

mentioned, have not been established and developed based on free market conditions.⁵ We argue that there are interesting aspects in the complexity and societal impact offered by former state monopolists now operating under free market conditions. The phenomenon serves the purpose of this thesis to the highest degree.

A state monopoly (same as government monopoly) is defined by Cambridge Dictionaries as: "a form of coercive monopoly where the government, or more definitively a government agency, is the sole provider of a particular good or service and where competition is prohibited by the rule of law".⁶ This differs from government-granted monopoly where a state grants monopoly to an individual company. The term state monopoly usually refers to monopolies run by the national government. Other types of government monopoly may imply local or regional monopolies.⁷ In this thesis we will focus on nationally oriented state monopolies.

1.2.2 Competition and deregulation

Competition in an economical sense is described as the rivalry that occurs between two parties in a market economy when offering a good or service to a third party.⁸ The Financial Times Lexicon defines deregulation as a substantial easing of government restrictions on an industry, normally justified to promote competition and innovation.⁹

1.3 Motivation and problematization

Our research and definition of state monopolists suggests that these companies share a history of exclusively determining the conditions of an industry and have adjusted their strategy accordingly. When these companies are subjected, in the event of deregulation, to new forces affecting the industry's conditions they continue to be affected by historic strategic decisions based on past market conditions. The mechanism behind these events, occur both consciously and subconsciously, as complex forces continuously hindering them from adapting to the new market conditions. We consider that a general explanation of this mechanism offers both high complexity as well as a challenge. However, it also offers the possibility for us as authors to explain its general reasons. Such explanation would not just provide greater overall

⁵ OECD, (2010).

⁶ Cambridge Dictionaries, (2013).

⁷ Cambridge Dictionaries, (2013).

⁸ Nationalencyklopedin, NE.se, (2013).

⁹ Financial Times Lexicon, (2013).

understanding but provide valuable lessons for future state monopoly deregulations. Based on the interest of the thesis the problematization has therefore been formulated as follows:

"How does path dependency generally continue to affect the strategies of former monopolists after that their industries are deregulated?"

Answering how the path dependency affects former state monopolists' strategies provides useful insight to the mechanisms behind the continuous influence of historic decisions. However, to provide our readers with a more practical view of the monopolists present market strength based on their path dependency we want to indicate its effects on their relative competitiveness. The former monopolist, now operating in a free market, is facing competitors who have been established post deregulation. The post deregulation competitors, unlike the post state monopolistic companies, are not tied to historic strategic structures. Instead their structures are based on free competition. This fact requires attention as it implies that market actors, depending on their history; long or short, will have different prerequisites to compete. It also indicates the complexity when going from a regulated to a deregulated market. The strategies of former monopolists have been based on certain characteristics of monopolistic industries. As such strategies include certain long-term structures they cannot be phased out of an organization even if it goes through a fundamental re-structuring imposed e.g. by deregulation. As we find this discussion closely related to path dependency our analysis will, to a large extent, be conducted in a pre and post deregulation perspective. The emphasis will be put on the formation of strategy due to changes in the structural and competitive environment.

1.4 Purpose

The purpose of this thesis is to present how the strategies of former monopolists are in general affected by path dependency following industrial deregulation. Based on these path dependent characteristics our thesis further seeks to draw generalizations indicating how such characteristics are in practice affecting companies present strategies compared to post deregulation entrants.

2 Methodology

In this chapter we present our research foundation including the selection of case study, process for collecting data and theoretical approach. The chapter is completed with a discussion regarding the reliability and validity of our study.

2.1 Research Approach

2.1.1 Inductive strategy

For this thesis' problematization regarding how path dependency continues to affect the strategies of former monopolists after their markets are deregulated the applied research approach has played an important role. Based on the problematization of this thesis we initially gathered and sorted an amount of empirical material that we found sufficient to provide a covering representation of its nature. This subsequently allowed us to analyze the empirical material, which laid the foundation for our conclusion of the problematization and enabled generalizations.

Based on the above, we found the inductive strategy to be in most harmony with our ambition. This since the fundamentals of inductive strategy is the initial open-minded collection and systematization of relevant empirical data and secondly the systematization enabling the foundation and creation of new theory and conclusions.¹⁰ Critics of the inductive strategy claim that it is impossible for anyone to collect data with a 100% open mindset as they, consciously and/or subconsciously, will be affected by their own prejudices.¹¹ This critique has been useful for our writing particularly for collecting empirical material, as it has served as a reminder of the importance of assisting each other in maintaining an open-mindset.

Since the aim of inductive strategy is the creation of new theoretical conclusions the use of a case study is considered useful.¹² Based on this we argue that our selection of a case study has enhanced our ability to exemplify the evolvement of strategically related path dependency of our chosen former monopolist. As we have found this discussion central for the thesis it has been further elaborated upon in the case study section 2.1.3.

¹⁰ Jacobsen, D.I., (2002), p. 35.

¹¹ Jacobsen, D.I., (2002), p. 42.

¹² Backman, J., (2008), p. 55.

An additional research approach that we have discussed for this thesis is the deductive strategy. In brief the deductive strategy derives a hypothesis within a specific research area, which is tested on empirical material and ultimately subjected or rejected.¹³ The deductive strategy is criticized for the risk of scientists creating hypothesis that are self-fulfilling and based on limited facts.¹⁴ Due to the purpose of our thesis we found the inductive strategy to better serve our purpose. Since our research question required exhaustive explanation and answering, it was more reliant on being able to draw new conclusions than on testing a pre-stated hypothesis. However, given the nature of the path dependency theory being built on fixed original decisions, bearing a deductive character, the deductive strategy has been used when analyzing the empirical material. Taking this discussion into consideration we conclude that our academic strategy has been primarily inductive but containing deductive elements.

Continuing our discussion of research strategy the differences between the inductive and the deductive approach, as is stated in academic literature, are not to be considered as explicit and should therefore serve predominantly as indicators.¹⁵ We have therefore taken into account that it can be challenging to sort information into a specific category. Consequently we have not locked our academic approach to empirical material based on a specific approach even though concluding that the inductive strategy is our primary tool.

Having decided on the inductive strategy our research was initiated with the collection of empirical material with focus on primary data as it in general enhances the substance of the thesis.¹⁶ After having spent an initial period of collecting data we found it to be sufficient and had given us a comprehensive representation, describing the most central development for our problematization.

As our research has relied heavily on empirical material we found the inductive strategy to be very useful also for our interviews. In spite of this we have, for natural reasons, applied questions of deductive nature in order to extract basic facts from our respondents.¹⁷ This is further discussed in section 2.2.4.

¹³ Bryman, A. & Bell, E., (2005), p. 25.

¹⁴ Jacobsen, D.I., (2002), p. 42.

¹⁵ Bryman, A. & Bell, E., (2005), p. 25.

¹⁶ Jacobsen, D.I., (2002), p. 42.

¹⁷ Bryman, A. & Bell, E., (2005), p. 135.

Summing up our research discussion we have mainly applied an inductive approach but with strains of deductive elements. In practice this approach has meant that we initially spent time gathering and sorting empirical material connected and related to our research question. This since our concluding principles have been largely based on empirical material. Examining these strategies and adding strategic issues addressed in literature and experiences from central decision makers have contributed to this fundamental oversight. Secondly this oversight has been central to the formation of our ultimate principles equaling the suggestion of generalizations and answering our main problematization.

2.1.2 Qualitative research

Based on our selection of the inductive strategy we have selected the qualitative research approach as these are generally linked together. The general linkage is due to the fact that the qualitative approach, like the inductive strategy, seeks to establish fundamental knowledge of the reasons behind certain behavior in a specific area by being open towards new information. They also share the same critique regarding the problem of gathering sources with an open mindset.¹⁸ In our case we have found this approach to be suitable as it allowed us as researchers to investigate and describe the strategically related path dependency of a monopolist resulting in desired generalizations. Further, the qualitative approach also emphasizes the scope of the research and focuses on comparatively small but detailed samples of research material.¹⁹ This emphasis on small but detailed samples was useful for us as it enabled us to focus and generalize on our findings. The qualitative research also includes unstructured interviews, which enables the author to modify our research questions according to our respondent's expertise and experience.²⁰ In accordance with our problematization, we have applied the qualitative research approach. This has ultimately resulted in written formulations generating theoretical concepts of data.²¹ Applying the qualitative approach and exploiting its parallels to inductive strategy was useful for our study of the specific case and ultimately making the concluding generalizations.

In addition to the qualitative research approach we have considered the quantitative research approach. This approach focuses on quantity when collecting and analyzing data by applying math and statistics. The approach generally uses structured interviews, requires reliable and

¹⁸ Jacobsen, D.I., (2002), p. 42.

¹⁹ Bryman, A, & Bell, E., (2005), p. 297.

²⁰ Bryman, A, & Bell, E., (2005), p. 360.

²¹ Backman, J., (2008), p. 42, 57.

unambiguous data and predetermined theoretical concepts before collecting data.²² The quantitative research approach is commonly criticized for overemphasizing the relation between its research and the researched reality.²³ Even though it is not the primary scope of this thesis, our research does include elements of quantitative data, particularly numerical statements. It does therefore play a background role for this thesis.

Given these characteristics and considering the nature and purpose of our thesis it will mainly be based on qualitative research but include strains of quantitative research. Such a mixed approach is scientifically natural since qualitative research can be complemented by quantitative research in order to fill unwanted gaps.²⁴

2.1.3 Case Study

Taking into account the pedagogical benefits of a case study, making our research more approachable to our readers, we chose to perform a case study on a former monopolist. Having further studied related literature discussing this type of study we found it to be a useful tool for drawing general conclusions of events that are occurring in similar cases.²⁵ In this context the conclusions drawn from our case-study-based analysis laid the foundation for the generalizations that we have found to be applicable to former monopolists of other industries.

The indicated main problem with drawing generalizations from a case study is the lack of quantity that is needed to ensure accuracy.²⁶ We have respected this potential problem and we recognized the necessity to apply caution and avoid generalizations that are too strong and bear the risk of lacking substance.

At an early stage of our writing we decided that we wanted to base the case study on one of Sweden's deregulated industries since our primary interest is in former Swedish monopolists. For our selection we have also weighed in our own personal industrial interests and perception of the industry's actuality in media and society. This since we wanted our thesis to contribute to the present societal debate.

²² Bryman, A. & Bell, E., (2005), p. 85.

²³ Bryman, A. & Bell, E., (2005), p. 105.

²⁴ Bryman, A. & Bell, E., (2005), p. 507.

²⁵ Jacobsen, D.I., (2002), p. 104, 266.

²⁶ Jacobsen, D.I., (2002), p. 268.

2.1.3.1 Motivation of Case Study

For our case study we recognized the need to put the significance of path dependency of our former Swedish monopolists in a context since it in our opinion further enhances generalizability and understanding. We initially discussed whether this context should be applied by comparing our choice of company with an additional former Swedish monopolist. From this we concluded that by applying a framework we risked drawing the reader's attention towards market based differences in terms of individual characteristics. We also discussed the possibility of comparing the path dependency of a former Swedish monopolist to a foreign counterpart from the same industry. This type of comparison would have its benefits in terms of shared initial market position post deregulation and also certain structural characteristics. However, the differences between two states in terms of geographic market structures e.g. distances and in consumption culture would aggravate and -in our opinion- question the applicability of our desired generalizations. In addition, the access to relevant material in languages that we are not proficient in, would cause challenges that could limit us from answering the problematization.

The third alternative we discussed regarded the possibility to compare our monopolist of choice to post deregulation entrants. After having performed research of this opportunity we found that this study would be very distinct for pointing out the impact of path dependency affecting relative competitiveness. We also discovered that in some cases these new entrants share certain strategic aspects making them distinctive from the monopolist. Therefore, instead of choosing one specific company for our comparison, we have selected a general group of post deregulation entrants. This group represents a set of similar business models compared to the one operated by the monopolist. Another reason that we chose a group instead of a single post deregulation competitor is that a group provides a larger base of empirical material. The gathering of empirical material was also something that we struggled with when initially trying to address a single competitor. Focusing on a group also allows us to talk about a general post deregulation concept instead of individual and potentially non-generalizable circumstances.

Having already stressed the need for geographic and consumption-wise coherence, we decided that the group representing the post deregulation entrants had to operate in the Nordic

countries. This as we regard the consumption pattern of the Nordic countries, in our desired terms, to be comparatively similar compared to other states. As has already been stated it is the authors' common belief that such a comparison would stand the best chance answering the thesis problematization and enable generalizations.

Summing up this section the thesis problematization will be answered by an exemplifying case study of a chosen former monopolist, focusing on one of its main strategies in comparison to a group of post deregulation entrants.

2.1.4 Industry

For the selection of industry we initially considered well-known former Swedish monopolists like Scandinavian Airlines System (SAS), Telia, and SJ. We found that they would all be adequate. In order to decide on the most adequate monopolist we chose to put the former monopolists against each other and compared the factors that we regard to be most important to fulfill our purpose: access to material, topicality and our personal interest. After having applied the ranking we found that the access to material was fairly equal. The decision would instead come from current topicality and personal interest. From our perception formed by reading newspapers on a daily basis we found SAS with its financial difficulties to be currently most discussed followed by Telia and its recent corruption scandals.^{27, 28} Adding our own personal interests to this, both authors being highly interested in the airline industry since many years, we ultimately chose SAS.

Our selection of SAS has meant that we have been obliged to discuss the character of its home market. SAS being an airline joint venture of the Scandinavian states would normally lead to the conclusion that its home market is Scandinavia. However, after having studied empirical material discussing the European airline industry we have concluded that SAS is most commonly placed in what is described as the Nordic market. The Nordic market is not a fixed set of countries as it, in addition to the Scandinavian countries and Finland, sometimes also includes additional other states sharing coast to the Baltic Sea. From these insights and discussion we have decided to describe SAS home market as the Nordic market emphasizing the competition in the countries of Sweden, Norway, Denmark and Finland. The character of the Nordic market will be further introduced in section 4.1.2.

²⁷ Mannheimer, L., (2012).

²⁸ Alestig, P., (2013).

Having decided upon SAS as case study we decided to look among its Nordic based and post deregulation established competitors sharing similar business models. From this research we promptly concluded that the strategy of the group of low cost carriers (LCC) would serve our thesis best. This as they play a major role in the Nordic competitive environment, share similar business models and have all been established post deregulation. Concluding, in terms of geographic location and fields of operation the LCC group, in our opinion, brings us the closest to a relevant and useful group of SAS post deregulation competitors. The concept of LCCs will be further elaborated in section 4.1.2.

2.1.5 Strategy

Having concluded that the thesis would focus on one of SAS' specific strategies and how its path dependency affects its relative present competitiveness to the LCCs, we discussed which strategies would be applicable. We wanted our choice of strategy to contain something that triggers competition and could distinctly highlight the contrast between SAS as the historic monopolist and the LCCs, the post deregulation entrants. From this discussion we concluded that customer strategy would be highly suitable and interesting. This as it would allow us to attain desired academic and practical depth in our discussion of the subject of comparing the two models. We also found that this subject would be possible to describe from a path dependency perspective. However, continuing our discussion we found the term "customer strategy" to be too unspecific. Since this could constitute threat towards fulfilling the thesis' purpose we decided that we would need to take on a more specific focus in order clarify the message; path dependency related generalizations of former state monopolists. Having studied the term from an airline perspective focusing on the industry's general value creation we decided to narrow our spectrum to three different angles. We wanted them to be central to our airline's general customer strategy and enable us to point out differences between them. Based on this we chose:

- Segmentation
- Strategic alliances
- Loyalty programs

We found these angles to be precise and understandable compared to other angles discussed, e.g. ground-handling and supplementary service. Focusing on these three angles has enhanced

our possibility to compare the level of competitiveness between a strategically path dependent airline: SAS with the LCC group applying a customer strategy based on present regulations.

2.2 Collection of Data

2.2.1 Primary Data

Primary data is characterized by often being collected by the researcher himself by directly assessing the primary information source.²⁹ The primary data for this thesis has been collected to serve its direct purpose. It has mainly been gathered through five interviews that have all been recorded in order to minimize the risk of misquotation. To this section we have also included 21 of SAS annual reports (1992-2012).

2.2.2 Secondary Data

Unlike primary data, secondary data has not been created to serve the direct purpose of the research in question. Instead it has been created for other purposes.³⁰ We have thereby concluded that the secondary data applied for this thesis has not been initially created for answering its problematization. In spite of this we have found it to be both applicable and useful as complementary sources to our primary data. We have collected data from articles of our applied research period that have discussed and described strategic events involving the selected monopolist and the LCC group.

2.2.3 Selection of Respondents

For the selection of respondents, based on the problematization of our thesis, we established a list of respondents with valuable experience from our selected strategies. As we chose to apply the qualitative research approach we have not been dependent on a certain quantity of respondents but rather on the quality of their insights. We consequently chose to set up four main criteria's:

- Availability.
- Respondent validation.
- Supposed strategic insights.
- The level of position held.

²⁹ Jacobsen, D.I., (2002), p. 152.

³⁰ Jacobsen, D.I., (2002), p. 153.

Ranking-wise: position, strategic insights and availability were equally balanced while the validation criterion was deemed as the most important. This was mainly due to the fact that respondent validation is considered particularly important to secure the thesis factual correctness when making a qualitative research.³¹ We therefore emphasized the difference between a respondent's opinions and answering a question dishonestly. For securing this matter we used our personal perception of the respondent's relative honesty when performing background checks and exploring our personal networks. We ultimately concluded the following list:

Table 1- Respondents

Name	Time of employment	Interview Date	Occupation
Jan Carlzon	1981-1993	2013-03-05	CEO of SAS and therefore highly involved in SAS customer strategy during the years of pre and during deregulation.
Mats Lönnkvist	1988-	2013-03-05	Incumbent Senior Vice President and General Counsel.
Elisabeth Bylund	1983-2007	2013-04-14	Worked 24 years for SAS with experience from holding several leading positions e.g. responsible for an intercontinental branch.
Peter Forssman	1991-1998	2013-04-26	Public relations manager at SAS 1991-1998 with experience from the company's strategy formulation.
Mats Mitsell	1991-2003	2013-05-06	Holder of several leading positions within SAS between 1981-1991 such as head of SAS Cargo and later head of all in-flight service, all personnel and flight-safety. 1991-2003 he was head of the Amadeus booking system.

Having concluded the list, we immediately started to schedule the interviews. Our early scheduling provided us with a time buffer, useful if we were to experience scheduling conflicts or other unforeseen events. Since such an unforeseen event took place during the process of this thesis, we have concluded that this was a fortunate move.

³¹ Bryman, A, & Bell, E., (2005), p. 308.

2.2.4 Unstructured interviews

In accordance with our inductive research approach, we have chosen to apply the unstructured interview method. Applying unstructured interviews allows the interviewer to adapt and formulate questions according to the respondent's personal skills and experience. The respondent then answers the questions unreservedly and without the interviewer looking for certain answers of specific nature.³² The application of unstructured interviews has proven to be important, as it has enabled us to gain depth and insights in the respondent's personal experience. It has also given us further understanding for matters where our respondents have described events differently but have had the same conclusions. We think that applying structured interviews would have limited the potential of gaining such insights, as they are harder to disclose in standardized formulas.³³ However, as has been indicated, we have applied questions of deductive nature for practical reasons. They regard:

- Positions held
- Years in the company

In spite of these fixed questions we have in general not looked for deductive answers from our respondents. Instead our interview questions have encouraged the respondents to be open and express their own personal thoughts. They have mainly focused on guiding the respondent to discuss our area of interest and allowed the respondent to choose what experience he or she has found relevant. Since we have performed comparatively few interviews, the open interview is suitable in order to gain a sufficient amount of data.³⁴ As a consequence we find our approach being mixed, with emphasis on the inductive strategy. The reason for this choice has been that we, after having studied the alternatives, have found it to be the most effective in order to fulfill our thesis purpose since both approaches are required.

Regarding the form for interviewing we have strived to execute them in person, as we have perceived the possibilities of getting our respondents to share personal thoughts as bigger in this format.

³² Bryman, A. & Bell, E., (2005), p. 371.

³³ Jacobsen, D.I., (2002), p. 159.

³⁴ Jacobsen, D.I., (2002), p. 160.

2.3 Theoretical selection

For answering our problematization regarding the path dependency of former monopolists the selection of theories has been important. For the writing process we realized that this selection would be an important tool particularly for analyzing the empirical material of our case study. In order to establish optimal prerequisites for our desired generalizations regarding path dependency we concluded that our theoretical selection could not be based on the specific empirical characteristics of a particular industry. Our opinion is that such specific characteristics might not be viable to other industries in general. With respect to this opinion however, it would not have been possible to analyze path dependency without considering the general background of the industry representing our case study. In order to enhance the understanding of the relation between industrial background and path dependency we therefore concluded that we were required to cover certain areas. These areas included the economics of the industry, which is important in order to understand how value can be created. We also wanted this area to include external factors that contribute to shaping the supply and demand emphasizing the impact of deregulation. Another area that we found important was the competitive environment as it is important to understand the pace and need for strategic development and innovation. The final area that we found important was the relative competitiveness of our former monopolist represented by our case study in relation to its competitors. This area particularly focuses on how historic strategic decisions are continuously affecting the monopolist's relative competitiveness. Summing up this discussion the selection of areas that our theories need to cover are:

- The general economics of the selected industry.
- The competitive environment.
- The effects on the company's competitiveness.

The initiation of our research for potential theory primarily stemmed from our personal academic experience, which includes a vast collection of managerial theories and models. From this we did not locate a single theory able to exclusively cover all the required areas. We considered this to be a positive finding as it meant that we had to seek a combination. Our chosen combination has enlarged our spectrum and enabled us to include additional perspectives on path dependency.

Our choice of theoretical combination could also have been viewed as problematic as theories could share certain factors and aspects creating the risk for repetition. However, we instead found it positive due to the fact that as long as the repetition is not exaggerated the theories are in fact supporting each other and thereby strengthening our views and arguments. Because of this the slight repetition that occurs in our analysis, does not imply a problem stirring circumstance.

As a result of the theoretical considerations and requirements constituting this discussion we selected the following theories and models: Porter's Diamond, the Path dependency theory, SWOT-analysis and Porter's Generic Strategies. Further, with reference to their respective structures, we have identified a need to apply Porter's Diamond and Generic Strategies for two periods: pre/during deregulation (1985-1997) and post deregulation (1998-present). This while the Path dependency theory is applied solidly and the SWOT analysis is performed based on present situation. The path dependency will be analyzed based on factors of the empirical findings that we found to be bearing path dependent characteristics.

The above theories are further introduced in terms of general structure and common criticism in the theory-based chapter (3). In chapter three we also present this thesis theoretical combination named "theoretical framework". The theoretical framework section includes a graph illustrating its composition and a text that further elaborates on its internal relations. To back up our theoretical framework the thesis is also influenced by theories concerning perfect competition, monopolies and regulation. However, as these theories are not as directly linked to our problematization compared to those constituting our theoretical framework they should be regarded as of supportive nature, therefore they will not be specifically addressed.

The theoretical framework and its components are discussed following the presentation of our selected theories. The discussion could be viewed as having a methodological character and are therefore more suited for this chapter. However, we consider the logic of first describing the individual theories and secondly adding them together in our theoretical framework explaining their internal relations creates larger for the thesis underlying reasoning. Keeping these parts closely tied also provides a clearer disposition and facilitates the reader's understanding of the discussion.

2.3.1 Excluded theories

One model that we have excluded is the Value Chain model describing a company's customer oriented value creation. It was initially a part of the framework with the purpose of analyzing a firm's competitiveness. However, we found that it includes too many details that are not relevant for the thesis purpose. The final theory considered but not applied is Porter's Five Forces. We recognize that this theory is useful for analyzing an industry. When discussing it we put it in relation to Porter's Diamond in the context of an industry's competitive environment. From this discussion we concluded that the latter in detail included more relevant aspects.

Regarding the discussed theories that we have excluded from the theoretical framework, we have found them all to be relevant but to a less extent compared to those of our selected framework. We also want to emphasize that an overuse of theories would risk disorienting the message of this thesis and actually not assist us in answering our problematization.

2.4 Quality of the research

2.4.1 Reliability

The reliability factor has been very important for this thesis. It generally discusses whether our conducted research is solid and would endure testing.³⁵ It further states whether the research is affected by random factors or has got the potential of being repeatable.

Repetitiveness indicates whether it is possible for another researcher to reproduce the findings.³⁶ Considering the reliability criteria we recognize that our conclusions are all exposed to subjective measures. Particularly the interview conducted with Mats Lönnkvist who is a present SAS employee as well as the applied annual reports have an internal perspective. However, we have not found this a problem as our research has included complementary materials, which have balanced these statements. We find that the most important criteria's for increasing the thesis reliability has been to work in close cooperation in order to avoid non-open mindedness towards new information.

It should be mentioned that we have conducted our interviews in Swedish while the findings are presented in English. This might in some cases imply a problem with regards to translation and subsequent factual errors. As a response to this we as authors have actively

³⁵ Bryman, A., & Bell, E., (2005), p. 93.

³⁶ Jacobsen, D.I., (2002), p. 256.

taken part in the interviews and their presentation within the thesis, all have been recorded and transcribed. We argue that this has ensured a coherent interpretation of the facts. To further strengthen the reliability, our respondents have read a preliminary version of the thesis allowing them to ensure that we have made correct interpretations of their statements.

2.4.2 Validity

The validity of research discussion generally indicates whether the empirical data used for the research is to be perceived as relevant and valid to serve its purpose.³⁷ The term validity is expressed and explained in multiple fashions. The one that we have found most important to this thesis is "face validity" as it indicates whether the data collected should be perceived as sufficient.³⁸ Research validity has been very central for whether our desired generalizability could be achieved. To fulfill our desire of achieving validity we have deliberately strived to apply as much relevant primary data as possible. This has e.g. included former CEO Jan Carlzon and present senior vice president and general counsel Mats Lönnkvist. Our notion is that the five interviews have provided few examples of discordance; instead there have been several examples of unanimous answers. This has strengthened our belief that we have gained a correct notion of the major events of our case study.

³⁷ Jacobsen, D.I., (2002), p. 256.

³⁸ Bryman, A, & Bell, E., (2005), p. 96.

3 Theoretical framework

In this chapter we present and describe the theories and models constituting the thesis' theoretical framework. As has been stated in the methodology chapter the selection includes Porter's Diamond, Path Dependency, SWOT Analysis and Porter's Generic Strategies. The reader is ultimately introduced to the structure and functions of this thesis theoretical framework.

3.1 Porter's Diamond

Porter's Diamond represents an accurate and transparent tool for understanding how industries and their companies create national prosperity. The relative competitiveness of a nation is dependent on the capacities of industries to upgrade and innovate. The companies competing in all industries do, according to the model, gain advantages towards global competitors from pressure and challenge. They therefore benefit from a competitive and demanding domestic market environment. An industry's relative competitiveness is also dependent on its productivity. The model further emphasizes the need for a supportive home base and is composed by six factors, four interrelated components and two exogenous parameters where the latter influence the primary. These factors are conceived as fundamental for understanding the prerequisites of an industry and the domestic market environment in terms of competitiveness.³⁹

3.1.1 Interrelated components

Factor Conditions

The model's factor conditions are constituted by labor, capital and infrastructure. These factors are, unlike general factors e.g. raw materials, created and not inherited. The key factors are considered as specialized resources for a firm, they are therefore also conceived as hard to imitate. By addressing these factors firms are more likely to understand how to increase their relative competitiveness.⁴⁰

³⁹ Porter, M.E., (1990), p. 78.

⁴⁰ Porter, M.E., (1990), p. 78.

Demand Conditions

Demand conditions describe how companies can create competitive advantages by listening to the customers of their home markets. The demand conditions are affected by customers' general expectations. Therefore, the higher expectations are the faster the companies have to be able to innovate and improve the quality of their products.⁴¹

Related and supporting industries

This component measures how the related and supporting industries assist the companies of an industry in their innovation process. These industries offer potential new ideas e.g. in terms of potential cost reductions or by stimulating product development and upgrades.⁴²

Firm strategy, structure and rivalry

This component indicates how companies are established, organized and managed based on national circumstances. The component also characterizes domestic rivalry, the level of domestic rivalry is also considered to be more important than rivalry among foreign competitors. To find sources of competitiveness this component refers to the fact that different industries in different countries have different productivity and innovation rates.⁴³

3.1.2 Exogenous parameters

Government

The government parameter has the possibility of affecting all the interrelated components e.g. with consumption taxes affecting demand and enforcement of anti-trust regulation affecting rate of competition. Therefore the government can function as a catalyst for innovation by influencing and triggering the competitive environment.⁴⁴

Chance

This parameter represents such events that are outside the control of an industry and its firms. It has little or nothing to do with national circumstances. These random events are essential

⁴¹ Porter, M.E., (1990), p. 78.

⁴² Porter, M.E., (1990), p. 78.

⁴³ Porter, M.E., (1990), p. 78.

⁴⁴ Porter, M.E., (1990), p. 79-85.

since they give advantageous competitive positions to some actors while others actors experience them as disadvantages.⁴⁵

Figure 1 - Porter's Diamond⁴⁶

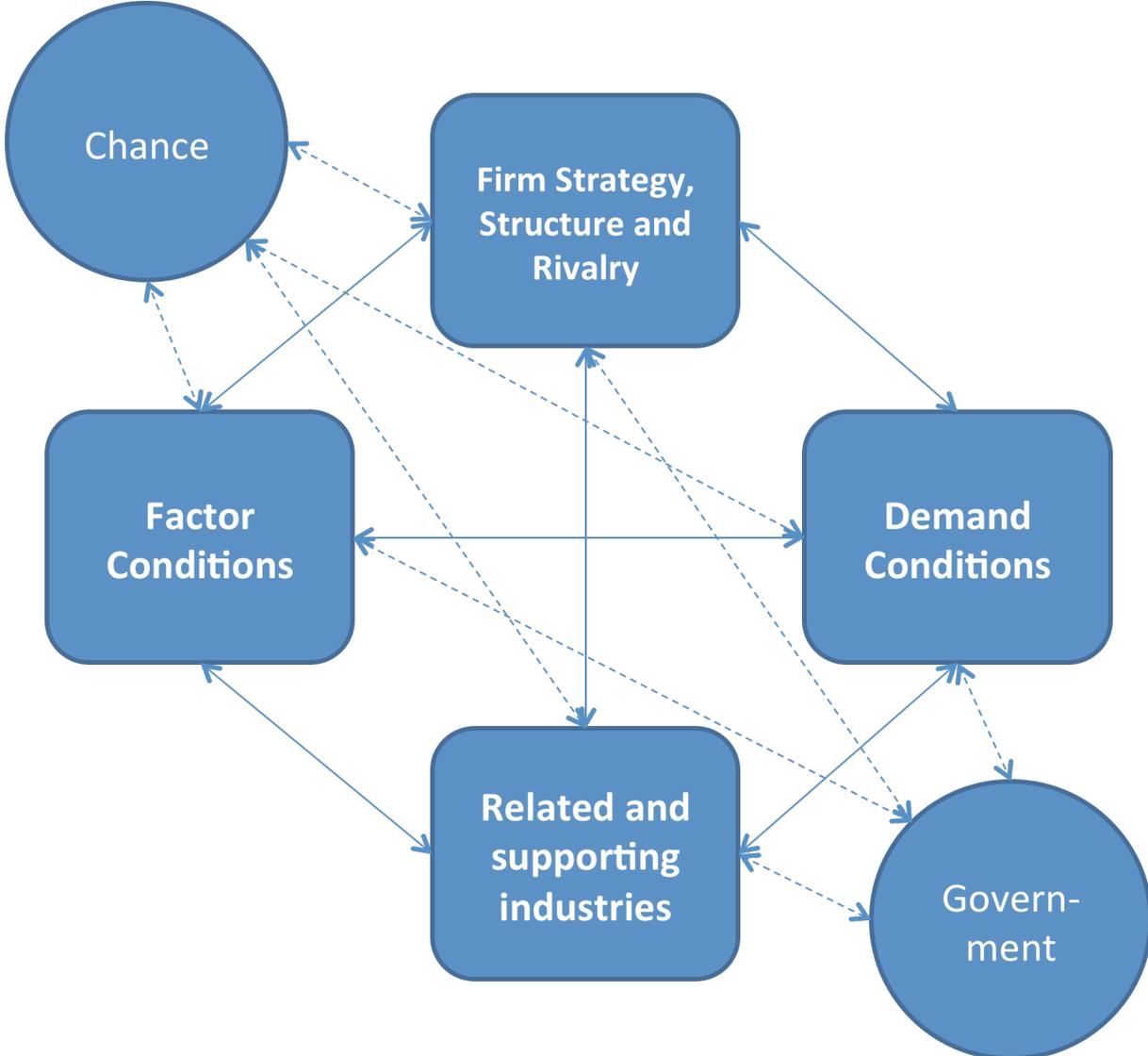


Figure 1 - Porter's Diamond: The figure describes how the interrelated components and exogenous parameters are interconnected. Chance and Government are circular and in normal font to highlight that these are exogenous parameters.

⁴⁵ Porter, M.E., (1990), p. 79-85.

⁴⁶ Porter, M.E., (1990), p. 78.

3.1.3 Criticism of Porter's Diamond

Porter's Diamond is most predominantly used in order to study the development of different nations. The single home-based approach of the model has been criticized since it deems a firm's capability to make use of the locational advantages of other nations as limited, which arguably is not true in all cases.⁴⁷

3.2 Path dependency

The path dependency theory suggests that past events, the impact of chance and subsequent decision-making, have self-reinforcing effects on future decisions and their outcomes since decisions are often made upon bounded rationality or habits. Arthur describes how first mover advantage and *chance* or *specific events* determines the economic development of a system, technology or company.⁴⁸ An alternative view of the subject is that it refers to "property of contingent, non-reversible dynamical processes". It serves to describe the connection between processes and their consequences affected by stochastic events.⁴⁹

In relation to the path dependency theory, the notion of lock-in effects is often discussed. It describes how a technology or a system is forced into a trapped state that only can be loosened through an external shock. Lock-in is caused by small historical events.⁵⁰ With regards to decision-making, lock-in occurs when sub-optimal strategies are used as a cause of path dependency (chance or specific historical events).⁵¹

The theory also depicts the notion of positive feedback named or self-reinforcement. This suggests that if an industry attracts more firms to a certain location, the probability that it will attract more firms increases. Furthermore, Arthur discusses selectional advantage meaning that technologies that improve more rapidly as more people adapt to them stand a better chance of survival.⁵²

3.2.1 Common criticism of the path dependency theory

Critics imply that path dependency is only useful when looking at a system in retrospect since it serves to explain a chain of related events that have occurred. The theory is weak in explaining specifically what mechanisms drive change from here on. Secondly, the theory is

⁴⁷ Rugman, A.M., (1992).

⁴⁸ Arthur, W.B., (1994), p.1-11.

⁴⁹ David, P.A., (2000).

⁵⁰ Arthur, W.B., (1994), p.1-11.

⁵¹ Margolis, S.E & Liebowitz, S.J., (1995), p. 205-226.

⁵² Arthur, W.B., (1994), p.1-11.

criticized for assuming that a lock-in implies a fixed condition (stability) that is immune to further specific events when reached.⁵³

3.3 SWOT Analysis

The SWOT analysis is a tool for analyzing a firm's strengths and weaknesses and its opportunities and threats. The model is used to identify internal and external factors that are of constructive or poor nature. It is constructed for analyzing a firm's ability to reach a specific goal and how to increase competitiveness⁵⁴:

- Strengths: internal factors which are advantageous in relation to competitors.
- Weaknesses: internal factors which are disadvantageous in relation to competitors.
- Opportunities: aspects in the environment that the firm could leverage in order to gain competitive advantage.
- Threats: aspects in the environment that are hazardous and threatening to the firm.

3.3.1 Common criticism of the SWOT analysis

The SWOT analysis arguably has two major shortcomings. Firstly, it is common that those performing the analysis put a lot of trust in pinpointing strengths and weaknesses instead of formulating strategies for what needs to be done to improve. This of course is a negative aspect if the objective of the SWOT is to achieve a goal. Secondly, the SWOT analysis commonly does not prioritize in the listing, giving the image that there is a balance between e.g. opportunities and threats even though the threats in reality outweighs the opportunities.⁵⁵

3.4 Generic Strategies

Michael Porter states in his 1980 book, competitive advantage, that the fundamentals of long-term, above-average performance in an industry is gaining sustainable competitive advantage. Furthermore he states that there mainly are two types of competitive advantages that a firm can have, either differentiation or through cost leadership.⁵⁶

⁵³ Kay, A., (2005).

⁵⁴ Humphrey, A., (2005), p. 7-8.

⁵⁵ Valentin, E., (2005).

⁵⁶ Porter, M.E., (1980), p. 35.

3.4.1 Cost Leadership

The cost leadership strategy strives to appeal to price-sensitive consumers by being a low-cost producer. A cost leader generally has a broad scope, reaching out to multiple segments.

Gaining cost advantage can be done through several means.⁵⁷

Firstly, the firm may aspire to attain economies of scale. This usually means attempting to spread fixed costs over a large number of units in order to lower the unit costs. This requires a high level of output, given the applied input. Scale advantages can evidently be reached by producing a large number of units but also through quick turnover in production, which is done by quickly shifting, continuing production once a product is finished.⁵⁸

A second measure in order to achieve cost leadership is reducing operating costs. Commonly, this is achieved by providing big quantities of standardized products and services and by limiting customization and personalization of services - offering no-frill products. By using few, standardized components - production costs can be minimized. It is also necessary to keep overhead costs low, which is done by reducing labor costs through lower wages or increased operational efficiency. Operational costs may also be minimized by locating bases for operations in areas with low rents and lastly, establishing a culture of cost-conscious mindset among employees. These types of cost reductions may be managed through the use of outsourcing and extensive control of production costs. A cost-leader must also strive to reach a high level of distribution in order to reach the required segments and keeping productivity high.⁵⁹

3.4.2 Differentiation

Another way of gaining competitive advantage is by differentiating the company's offer so that it is perceived as distinct. Differentiation is traditionally made through a varying range of tools. Some of which could be: design, image, unique technology, features, additional experiences, customer service etc. Porter states that superior differentiation is often acquired through the simultaneous use of different tools. Continuing, this should result in increased margins, making the company strive away from being in a low-cost position, reaching out to

⁵⁷ Porter, M.E., (1980), p. 35.

⁵⁸ Porter, M.E., (1980), p. 35.

⁵⁹ Porter, M.E., (1980), p. 35.

customers who are less price-sensitive. Thus it is in some cases likely that differentiation strategies undermine the ability to gain a high market share.⁶⁰

3.4.3 Focus

Finally, the Generic Strategies are divided by their degree of focus. This means focusing on a specific segment, both with regards to production and buying group. It also includes which geographical market should be approached. The previous Generic Strategies are aimed at serving the entire industry where the firm is acting. The focus strategy, however, is aimed at providing a superior offer to a specific target. In essence, this means that the firm must be more efficient in serving the specific target than competitors who are competing at a broader scale. Thus, a successful focus strategy achieves above-average return in either differentiation or cost leadership or both, within the specific target group. A firm that has been successful in its focus strategy may reach above-average performance and profitability.⁶¹

3.4.4 Stuck in the middle

According to Porter, a company that falls short in developing a strategy that is biased towards at least one of these directions is "stuck in the middle". This suggests a bad position for gaining competitive advantage. It can neither develop strength through differentiation nor does it have the ability to be a low cost leader. The company loses the high volume of price-sensitive customers where margins are low. At the same time, it loses the game of high-margin, frill-seeking customers.⁶²

⁶⁰ Porter, M.E., (1980), p. 37-38.

⁶¹ Porter, M.E., (1980), p. 38-39.

⁶² Porter, M.E., (1980), p. 39-40.

Figure 2 - Matrix of Generic Strategies.⁶³

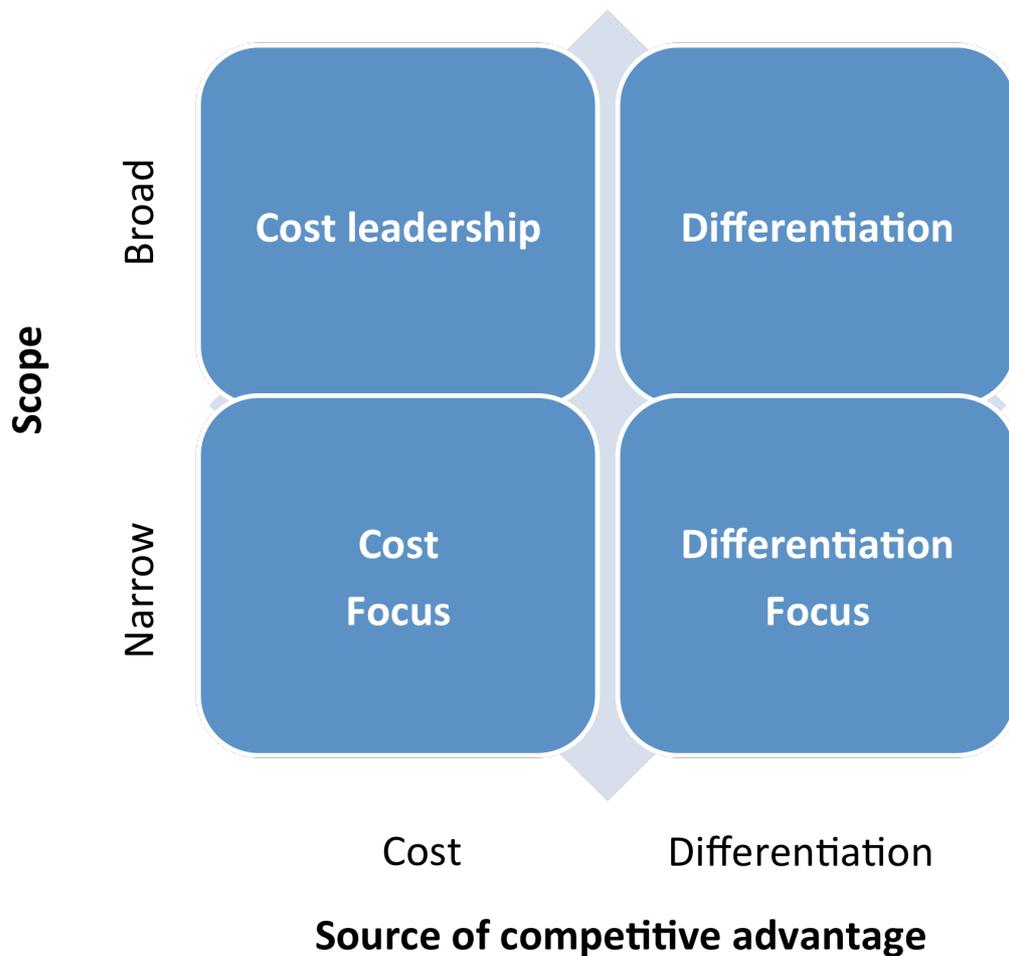


Figure 2 - Generic Strategies: The matrix of how differentiation and cost leadership is interconnected with focus and market scope.

3.4.5 Common criticism of Generic Strategies

Porter's Generic Strategies has mainly been criticized for inflexibility and lack of specificity. Also, it is questioned whether a firm that fails to adapt to at least one of the strategies really is "stuck in the middle". This is sprung from studies that have shown successful practice of more "hybrid strategies".⁶⁴

⁶³ Porter, M.E., (1980), p. 37.

⁶⁴ Hambrick, D., (1983).

3.5 Framework

The framework of this thesis, based on the previously described theories, enables us to cover the most important dimensions of the economics of an industry. By applying Porter's Diamond model we will be able to cover the most relevant characteristics of the case study's competitive environment. Regarding the effects on the monopolist's competitiveness we will, by applying the path dependency theory, be able to describe how it has and is still affecting its ability to formulate strategy. Further, this will allow us to compare the monopolist initial strategy used in a regulated market with its present strategy applied in a deregulated market.

The monopolist's present competitiveness in relation to competitors will be indicated by the SWOT analysis and analyzed through Porter's Generic Strategies. In this case the monopolist will be put in relation to a group of post deregulation entrants without a similar strategic heritage. By making this comparison we can explain the major differences and indicate how path dependency affects the monopolist's relative competitiveness.

Concluding, by applying the selected theories as brick-stones for this thesis theoretical framework, we will be able to conduct our analysis and answer the thesis problematization. With the theoretical frameworks underlying logic and disengaged industrial orientation it is a model applicable also to other industries and which thereby enables the desired generalizations.

Figure 3-The Theoretical Framework

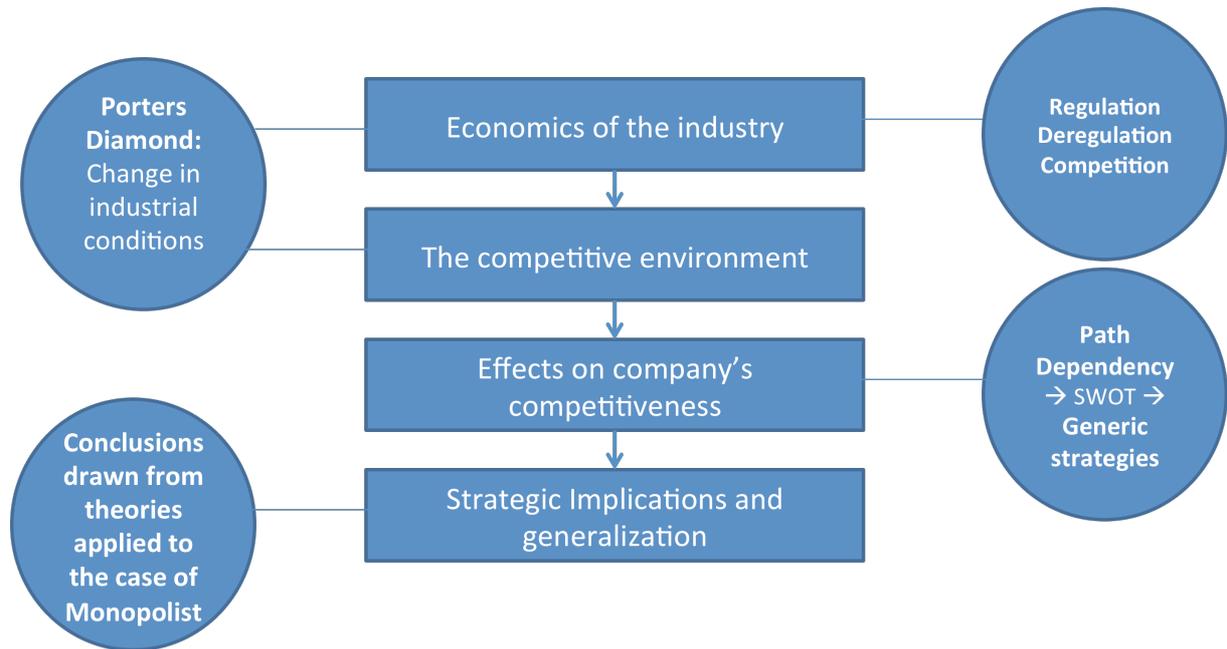


Figure 3 - Theoretical Framework: The figure shows how we have positioned the selected theories into a framework that is applicable for analyzing the empirical findings of our case study.

4 Empirical data

This chapter starts off with a presentation of the different business models and strategies applied within the European airline industry with emphasis on the Nordic market. Based on our selected case study, we will particularly highlight the concept of legacy carriers and low cost carriers since these are the most important of the new entrants to the market. This is followed by our case study of Scandinavian Airlines System where the airline's history, strategic development and current strategic position are described.

4.1 Airline strategy

According to the main sources applied in this research we have found that airlines, from a strategic perspective, are generally divided into four main strategic business models. The four business models are the Low-cost model, the Legacy model, the Charter model and the Long-Haul Low-cost model.⁶⁵ The strategic models that are most relevant for this thesis are the low-cost model and the legacy model.

4.1.1 Legacy Model

The legacy model is the label applied by traditional airlines, former flag carriers such as Air France-KLM and SAS. These airlines are also called full-service carriers and have enjoyed financial support from their respective states. They have therefore historically not been forced to adapt to a competitive market environment.⁶⁶

Strategically these airlines have traditionally targeted both leisure and business travelers from their respective home country dividing them in different class segments e.g. business class and economy class. Their offer is constituted by a full-service solution including extensive service e.g. luggage and loyalty programs.⁶⁷ Airlines applying the legacy model commonly have access to exclusive airline networks via strategic alliances from primary airports, this including intercontinental flights. The primary airports have generally been the heart of a country's aircraft infrastructure and before deregulation faced little or no competition from

⁶⁵ Wensveen, J.G. & Leick, R., (2009).

⁶⁶ Holloway, S., (2008), p. 47.

⁶⁷ Mats Lönnkvist, Interview, (March 5th 2013).

secondary airports. This is also known as hub-and-spoke networks.⁶⁸ The full service offer has traditionally set them with a higher price compared to the low-cost model.⁶⁹

Airlines applying the legacy model generally share these characteristics⁷⁰:

- Formed in a regulated market.
- Commonly have a burden of costly labor contracts.
- Ineffective organizational structures and processes compared to new entrants.
- Different aircraft types.
- Extensive route network.
- Hub-and-spoke network.
- Operate from primary airports

4.1.2 The Low-Cost-Carrier model – LCCs

When the European airline industry was gradually deregulated and finally opened for competition during the years from 1992 to 2000 LCCs, inspired by the development in the American airline industry, entered the market.⁷¹ The LCCs most prominent tool for conquering market shares was to appeal to price sensitive consumers. The idea was that the acting standards, emphasizing enhanced service and customer experience, were not necessarily of general interest.⁷²

The LCCs achieve economies of scale by operating a fleet with homogenous aircraft and reducing time on ground which increases the average yield per seat. They have also reduced procuring costs by purchasing big batches of infrastructural systems and other production factors. LCCs have managed to serve a broad scope by offering a vast distribution network flying to both business and leisure destinations.⁷³

The LCCs have become strong and effective in reducing operational costs mainly by negotiating on effective labor conditions that imply dramatically lower costs compared to those of the general legacy carriers. Labor costs have been further reduced in recent years by using staffing agencies and by employing personnel from regions with lower salary-levels.⁷⁴ The organizations are streamlined which means that only the core operations are performed

⁶⁸ Seristö, H., (1993), p. 83.

⁶⁹ Mats Lönnkvist, Interview (March 5th 2013).

⁷⁰ Holloway, S.,(2008), p. 47.

⁷¹ Economist, (2004).

⁷² Klopheus, R., (2012).

⁷³ Aydemir, R., (2012).

⁷⁴ Mats Lönnkvist, Interview (March 5th 2013).

in-house, the rest is outsourced or procured - e.g. food and beverages and ground handling. Some LCCs have also applied the method of placing their operating bases in areas with lower rents, stationing at secondary airports that are located outside major cities.⁷⁵

LCCs have successfully managed to apply a customer strategy that differs much from former legacy carriers. LCCs have been steadfast in their strategy of reducing customization and personalization in the customer experience - the adaption of a no-frill offer. The traveler must do a bit more of the "work" him-or-herself before getting from A to B.⁷⁶ The check-in is to a large part performed electronically by the customer. Baggage rules and allowances are severely toughened with regards to weight and size. The in-flight experience is very reduced; squeezing seating rows, limited service, no free drinks, movies or food etc.⁷⁷ All of this has allowed the generic LCCs to have a cost base that is roughly half that of legacy carriers, making them gaining a bigger and bigger share of the market.⁷⁸

LCCs are generally characterized by⁷⁹:

- Flying point-to-point.
- Single aircraft type.
- Use of secondary airports (However, some LCCs fly to primary airports).
- One-way fare per flight.
- One class.
- No complementary offerings or loyalty programs - No frills.

4.1.3 The charter model

This model is not as common as the two mentioned above and is mainly applied by charter companies. It is basically a model focusing on the segment of low-price conscious leisure travelers flying on a point-to-point basis during periods of demand equaling desired volumes in order to fill chartered aircraft.⁸⁰

⁷⁵ Klophaus, R., (2012).

⁷⁶ Mats Lönnkvist, Interview (March 5th 2013).

⁷⁷ Klophaus, R., (2012).

⁷⁸ Jan Carlzon, Interview (March 5th 2013).

⁷⁹ Klophaus, R., (2012).

⁸⁰ Wensveen, J.G, & Leick, R., (2009).

4.1.4 Long-Haul Low-Cost Model

This model being the newest of the industry but also the least applied, it is basically a low fare offer for longer flights particularly on intercontinental flights. The model shares the main characteristics of the low-cost model being that the primary focus is on keeping costs down focusing on leisure, time and price sensitive business travelers flying point-to-point.⁸¹

4.2 European airline industry

The European airline industry is today characterized by fierce competition. The fierce competition regards both intra-European flights but also, following the "Open Skies agreement", allowing increased competition between Europe and the US. The sources applied in this thesis indicate that European airlines are generally divided into three segments depending on size, strategy and operation. The one tier segment includes Europe's "big three carriers" Lufthansa, Air France-KLM and British Airways-Iberia (large former national carriers), second-tier composed by SAS, TAP Portugal etc. (medium size former national carriers) and the third segment includes the LCCs e.g. Ryanair and Norwegian Air Shuttle (Norwegian).⁸²

The most vulnerable segment has proved to be the "second tier". Following the deregulation of the European airline industry this segment has in general struggled to adopt their strategy to face the shift in competition and consumer behavior.⁸³ This change in behavior can basically be described as a transformation from perceiving flying as a luxurious experience into being just a general public transport.⁸⁴ The entrance of LCCs whose main competitive tool is low pricing has fueled the change rate of the competitive environment.⁸⁵

In particular the airlines of the second tier segment have failed to adapt their cost structure.⁸⁶ Instead this segment has, in numerous cases, heavily relied on governmental aid stretching the European competition rules for national subsidy. In recent years however governments have become increasingly reluctant in granting such funds. This has led to a consolidation of the market, voluntarily or involuntarily. A good example of a "voluntary merger" was in 2004

⁸¹ Wensveen, J.G. & Leick, R., (2009).

⁸² Flottau, J., (2012).

⁸³ Elisabeth Bylund, Interview (April 14th 2013).

⁸⁴ Mats Mitsell, Interview (May 6th 2013).

⁸⁵ Jan Carlzon, Interview (March 5th 2013).

⁸⁶ Flottau, J., (2012).

when Dutch KLM merged with French Air France.⁸⁷ An example of an "involuntary merger" is Austrian Airlines, which because of financial difficulties was sold to Lufthansa by the Austrian government in 2009.⁸⁸

Even though Austrian Airlines illustrate the opportunity of struggling second tier airlines to be acquired by larger competitors this is not always an applicable solution. For example in the case of Spanair, which went bankrupt in 2012, no investor was willing take over. Another recent example of a financially struggling national carrier is SAS whose struggle will be further elaborated upon in this thesis.⁸⁹

In addition all airlines are exposed to macro economic factors. These factors include e.g. economic crises, volatile fuel prices and political decisions including comparatively high European taxes and fees. Further stressing the vulnerability of the airline industry are external risks e.g. terrorist attacks like 9/11 and environmental impacts e.g. volcano outbursts of Eyjafjallajökull in 2010.⁹⁰

4.2.1 The Nordic airline industry

The Nordic airline industry is a battle for its approximately 25 million inhabitants living in a dispersed geographic area. During the deregulation of the early 1990s Sweden's domestic market was the first in Europe to be open for competition.⁹¹ The result of deregulation was that fare prices in Sweden dropped with 15-25 % and frequencies increased on routes where new competitors entered.⁹² The Nordic market is today unique compared to the rest of Europe as it is home to three airlines: SAS, Finnair and Norwegian which are all independent, ownership wise, from Europe's "big three carriers".⁹³

Scandinavian Airlines and Finnair, being the region's former flag carriers with government held controlling stakes are both applicants of the traditional legacy model. They are both experiencing an intensifying battle for market shares. The intensifying battle primarily comes

⁸⁷ Airfranceklm.com, (2004).

⁸⁸ Flottau, J., (2012).

⁸⁹ Flottau, J., (2012).

⁹⁰ Flottau, J., (2012).

⁹¹ SAS Annual Report (1992), p. 3.

⁹² Randøy, T, & Pettersen Strandenes, S., (1997).

⁹³ CAPA, Center for Aviation, (2013).

from the entrance of prominent low-cost airlines such as Ryanair and Norwegian who, by applying the low-cost model, has gained increased competitive influence in the region.⁹⁴

The LCC entrance in the Nordic market and the Norwegian in particular, has not been unproblematic were there were initial capacity problems after deregulation. As the capacity of Norway's main airport Fornebu was limited and lacked a substitute, new entrants struggled to reach competitiveness. These problems were solved when Gardermoen replaced Fornebu in 1998. Gardermoen had a greater capacity that allowed new entrants to establish themselves and create the strong position held today.⁹⁵

With the present economic climate the battle is not only involving leisure travelers but as companies seek to cut back on traveling costs it also involves business travelers.⁹⁶ This segment has traditionally has belonged to the flag carriers.⁹⁷

⁹⁴ CAPA, Center for Aviation, (2013).

⁹⁵ Randøy, T., Pettersen Strandenes, S., (1997).

⁹⁶ Mats Lönnkvist, Interview (March 5th 2013).

⁹⁷ Mason, K.J., (2000).

Figure 4 - Nordic Market Shares Oct 2011⁹⁸

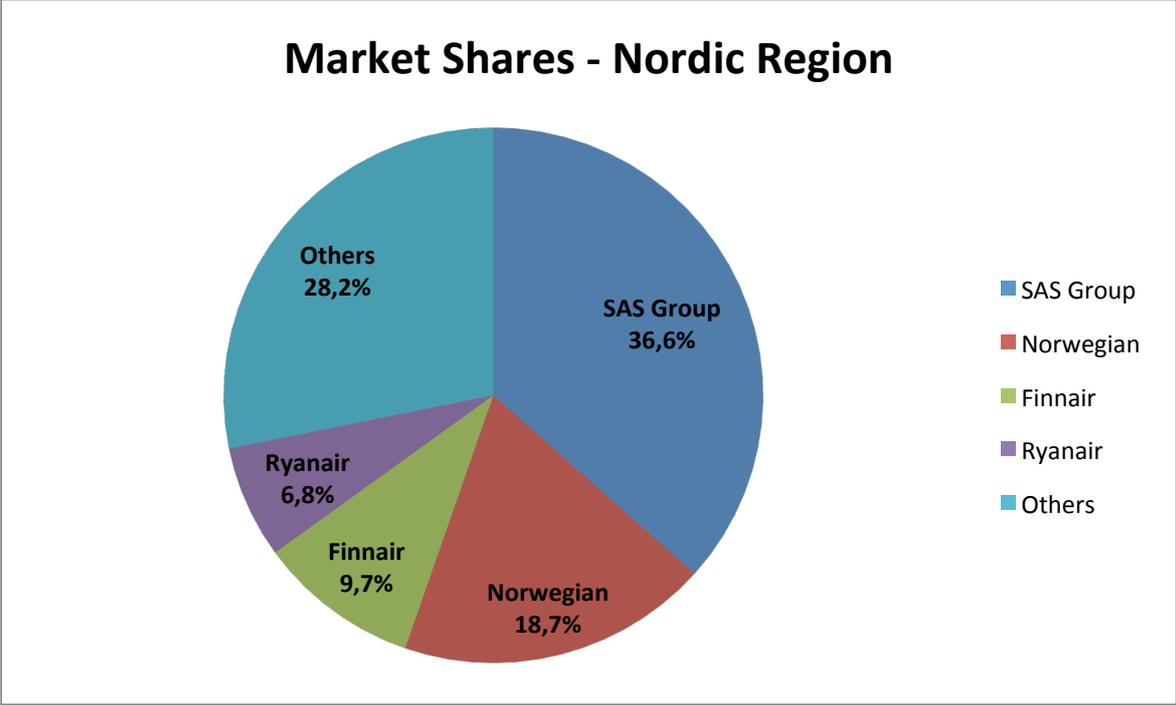


Figure 4 - Nordic Market Shares: The figure shows the market shares of the Nordic region in October 2011.

When comparing SAS present market share, 36,6 %, to ten years ago, 50 %, the increased competition becomes apparent.⁹⁹ Another discouraging fact for SAS is the steady decline in number of passengers carried, which has gone from 38 million in 2005 to 25 million in 2010.^{100,101} The changing and intensifying competition climate has also recently meant the demise of the three Nordic regional airlines Cimber Sterling, Skyways and City Airline.¹⁰²

During the last decade the Nordic regions LCCs have stood for almost all the region's growth. Norwegian growth in particular has stemmed from SAS market share on intra-Nordic and European routes. This becomes apparent when considering that SAS in January 2007 carried 1,5 million more passengers compared to Norwegian, a number that had decreased to 0,745 million in January 2011.¹⁰³

⁹⁸ Airline Leader, (2013).
⁹⁹ CAPA, Center for Aviation, (2013).
¹⁰⁰ SAS Annual Report (2010), p.5.
¹⁰¹ SAS Annual Report (2006), p.5.
¹⁰² CAPA, Center for Aviation, (2013).
¹⁰³ Airline Leader, (2013).

The present customer strategies are increasingly being directed towards the leisure segment. This strategic direction is mainly due to the prediction that 80% of the market growth until 2020 will stem from this segment.¹⁰⁴ In addition the LCCs are expanding by adding both regular business destinations and increasing frequencies, which have also increased competition for the business segment. As the business segment has the best potential for high-yield on the upside it is also a segment traditionally including high costs e.g. private lounges.¹⁰⁵

The fierce competition in the Nordic airline industry is illustrated well by the fact that Norwegian today alone is competing for 60 % of SAS total revenue.¹⁰⁶ Further highlighting the regions' intense competition Norwegian managed, in spite of already applying a low-cost strategy, to lower its average unit costs with 22% during 2008-2011.¹⁰⁷ Between the Nordic regions' three biggest airlines in terms of seat capacity; SAS, Norwegian and Finnair, Norwegian is also the cost leader followed by Finnair with SAS lagging comparatively far behind. However, between all airlines of the region Ryanair is the number one cost leader.¹⁰⁸ Ryanair has two main hubs in Oslo and Skavsta and operates from seven Swedish airports. The airline is currently negotiating with an additional seven airports, mainly in mid/north of Sweden; in order to serve its expansion plans.¹⁰⁹

The Nordic region, characterized by comparatively strong economic foundations, makes it a very attractive market for airlines seeking high yield. A future factor that could change the competitive climate of the Nordic region would be an LCC successfully implementing a long-haul low-cost network model.¹¹⁰ Since Norwegian is already pursuing such plans, it is likely that the changes in the Nordic regions competitive environment are far from over.^{111, 112}

¹⁰⁴ SAS Annual Report (2012), p.18.

¹⁰⁵ Airline Leader, (2013).

¹⁰⁶ CAPA Center for Aviation, (2011).

¹⁰⁷ Airline Leader, (2013).

¹⁰⁸ CAPA, Center for Aviation, (2013).

¹⁰⁹ Kinnander, O., (2011).

¹¹⁰ Wensveen, J.G, & Leick, R., (2009).

¹¹¹ CAPA Center for Aviation, (2012).

¹¹² Airline Leader, (2013).

4.3 Case study: Scandinavian Airlines System

4.3.1 The Scandinavian Airlines System Story (1946 - 1981)

Following the Second World War, SAS was founded as a consortium between the three national Scandinavian airlines (Svensk Interkontinental Lufttrafik AB), Denmark (Det Danske Luftfartselskab, DDL) and Norway (Det Norske Luftfartselskap, DNL). The joint-venture agreement stated that intercontinental flights only were to be made to North- and South America where the three initial operators would fly under the name of Scandinavian Airlines System. On inter-European flights and domestic flights, the three national airlines operated as separate entities although they were still stationed at their respective home airport. Thus they had a different local customer base and low level of competition.¹¹³

In 1948 the interconnecting agreements were extended to include cooperation on all international flights going out from Scandinavia. At this point the consortium consisted of five different organizations operating in parallel: Overseas SAS, European SAS, DDL, DNL and ABA. The major competitor of the time, Braathens, was in 1951 prohibited to fly international flights, which gave the consortium monopoly on all international flights from Scandinavia. A new company was formed and the separate entities ceased to operate under their own brands and SAS was more or less consolidated.¹¹⁴

From the 1950's and onwards, the airline experienced a lot of success. They pioneered the jet-aircraft and developed the concept of intercontinental flights with Stockholm Arlanda as main hub. During this era SAS expanded rapidly, providing routes from Scandinavia to such destinations as New York, Los Angeles, Chicago and Tokyo. This also included the foundation of Thai Airways, which was formed as a joint venture between SAS and the Thai government. The strategic joint venture opened up for big expansion possibilities in Southeast Asia.¹¹⁵ The vast expansion had made SAS one of the biggest and most technologically refined airlines towards the 1970's. At the end of the decade, SAS had experienced extensive growth that had led to an extensive acquisition of aircraft from various manufacturers. However, the capacity was now too big to fit the required volume. At the time SAS had also staff dispersed around the world for long periods at a time, which was costly. These factors

¹¹³ sasgroup.net, (2011).

¹¹⁴ sasgroup.net, (2011).

¹¹⁵ sasgroup.net, (2011).

meant that SAS was ill equipped for the oil crisis and subsequent economic downturn at end of the 1970's.¹¹⁶

4.3.2 From deregulation to competition (1981-1997)

Increased customer focus

After managing to get through the oil crisis, SAS appointed Jan Carlzon as CEO in 1981. At this point, SAS was an avant-garde in terms of technological operations but weaker on the commercial side of operations. Since competition was limited, the marked demand was more or less taken for granted. The board had become acclimatized to decision making made issue by issue, without any comprehensive strategic path. SAS' focus was to a large extent biased towards five-to-ten-year plans, which were merely guidelines for financial management. Jan Carlzon entered with the vision of turning the company around, making it more focused on the market and the customer. Jan Carlzon said; we used to fly airplanes and we did that very well, now we have to learn how to fly people.¹¹⁷ He replaced the entire management group and the new ensemble worked together with formulating a new strategic focus. He realized that this would require extensive investments and restructuring but since he was clear with what he aimed at and what positive business implications this would provide, the board agreed to support this new vision. The firm was at this point integrated to a large extent, having operations ranging from food production to technical services in-house. Jan considered the new focus to be a very fortunate move since talks about deregulating the airline industry commenced as early as in 1985.¹¹⁸

What Jan Carlzon and his management directors did was giving the service units more responsibility and resources and thus putting more focus on the direct link to the customer. This provided a more flexible service organization with a focus on primarily giving business-travelers a convenient flying experience based on their needs and preferences following the strategy of becoming "*The Business Man's Airline*". The flight chart and schedule was designed to accommodate this group in the best possible way, flying early mornings and late afternoons at high frequency on both domestic and medium-ranged flights.¹¹⁹

¹¹⁶ Jan Carlzon, Interview (March 5th 2013).

¹¹⁷ Jan Carlzon, Interview (March 5th 2013).

¹¹⁸ Jan Carlzon, Interview (March 5th 2013).

¹¹⁹ Jan Carlzon, Interview (March 5th 2013).

Jan Carlzon was convinced that in order to increase profitability when focusing on the business segment, SAS needed to increase customer experience. Costs had to be increased in the activities directly linked to these income-bringing operations. In the same manner, he states that it is just as important to cut costs in areas that are not as important in order to uphold the current strategy. Jan Carlzon argues that cutting costs across all activities are not good for your core strategy - the focus must be on supporting your core strategic focus and provide what is necessary to do so. Another important aspect in order to move the organization in this direction was to motivate the employees to change their routines and in some ways also their values.¹²⁰

In its customer strategy, SAS continued their clear focus on the business traveler and providing this segment with a high level of service. One of Jan Carlzon's core aims at the time was to manage the airline as a service provider rather than having the production focus that he considered had characterized the company historically.¹²¹ The great success following the increased customer focus and the turnaround that he successfully had brought to SAS in the end of the 1980's sparked the need for new strategic changes. Jan Carlzon had the vision of packaging the entire travel-experience, providing limousine service to and from the airport, hotels and tax-free. Later on he has concluded that this was not consumer-driven but rather an inside-out focus that was actually contradictory to his former vision. Former public relations manager, Peter Forssman, states that this might have increased SAS' burden in terms of the inherited cost base.¹²² In order to improve the cabin factor in periods of low frequency in business travel, SAS launched summer campaigns with lowered rates targeting leisure travelers.¹²³

The leisure traveler indeed became increasingly important as rumors of deregulation intensified. This for several reasons: the recession and insufficient product differentiation but also the deregulation of the market, which provided the leisure traveler with more alternatives and more attractive fares. The focus on the business traveler however remained strong with clear targeting. SAS experienced a need to further strengthen its product towards the business segment mainly due to increased competition from other legacy carriers operating Scandinavia-Europe flights. At the time, many businesses had implemented clauses in their

¹²⁰ Peter Forssman, Interview (April 26th 2013).

¹²¹ Carlzon, J., (1988).

¹²² Peter Forssman, Interview (April 26th 2013).

¹²³ SAS Annual Report (1992), p. 18.

employee contracts that forbid the use of first class on these flights. This was a challenge for SAS which first class had a very low cabin factor. As a response SAS replaced first class with EuroClass. EuroClass was an upgraded version of economy class including additional services like rebookable tickets.¹²⁴ This turned out well for SAS as EuroClass proved to be very attractive for the business segment with good value for money e.g. in terms of availability and service level. SAS had realized that the customer would only pay for what he/she perceives as important.¹²⁵

Jan Carlzon perceived that deregulation would lead to a consolidation of the market. The predictions included the need to become one of Europe's five largest airlines in terms of capacity together with; Lufthansa, AIR France and British Airways and potentially Iberia. This since the predications also indicated that second tier airlines, including SAS, would struggle as a result of the lack of capacity. As the plans for deregulation were made public SAS took initiative for a strategy called "One of five in 95", also referred to as the Alcazar project. The strategy involved the fusion of the four-second tier airlines: Dutch KLM, Austrian Airlines, Swissair and SAS. The fusion would have created Europe's largest airline and also created cost benefits e.g. sharing one administration, one board etc. These cost rationalizations were predicated as crucial to compete in the deregulated market. In spite of the merger's potential cost and market-based benefits, the fusion would in the end fail. The failure was mainly due to political reasons e.g. different transatlantic partners. The failure can also be partly explained by the upswing of the general economic climate, which lowered the general understanding for the need of consolidation and cost rationalization.¹²⁶

SAS aircraft fleet included a number of large aircraft. This was both costly to maintain and could not be utilized to their full potential on short-haul flights. Jan Carlzon wanted to replace these with two-engine aircraft that were optimized to fly non-stop out of Scandinavia to typical business destinations such as London.¹²⁷ After a long period of negotiations, Jan Carlzon managed to convince the board that new, smaller, two-engine-aircraft were necessary in order to do this. However, at the final hour, Danish authorities opposed the idea of having two-single engines since it would undermine Kastrup as a natural hub - reducing tax-free sales and other airport-related business. Thus SAS remained with a set of different types of

¹²⁴ Peter Forssman, Interview (April 26th 2013).

¹²⁵ SAS Annual Report (1993), p. 16.

¹²⁶ Jan Carlzon, Interview (March 5th 2013).

¹²⁷ Jan Carlzon, Interview (March 5th 2013).

aircraft.¹²⁸ During the same era, a new airport was built in Oslo where the Fornebu airport was replaced with Gardermoen. Jan Carlzon saw this as an opportunity to centralize aircraft maintenance to Kastrup and Arlanda, from the original three locations, and thereby achieve cost savings. However, this opportunity could never be realized, as the idea did not receive support from the Norwegian stakeholders who wanted to keep a Norwegian maintenance unit.¹²⁹

Preparing for deregulation

It is stated in the annual report of 1992 that SAS was now activating its preparation to meet the new competitive market.¹³⁰ This notion was largely based on the deregulation that had taken place in the United States. In the 1980's Jan Carlzon further conceived that the lowering of prices was crucial to meet the new market conditions. Therefore an estimated cost-reduction of 50% was considered a necessity. Jan Carlzon states that he realized that the new entrants had totally different preconditions when entering the market and that it would be much harder for SAS to go from a cost base of 100 to 50 than it would be for newcomers to go from 0 to 50.¹³¹ It is also stated early on that a requirement of a bigger customer base is vital to gain a strong position in the market. A first step towards consolidation was the strategic acquisition of Linjeflyg AB.¹³²

Another opinion that was expressed during the deregulation period was the need to change SAS ownership structure. The fact that all the three Scandinavian states together held a majority stake in SAS was conceived as a limitation for strategic maneuvering due to the differing set of interests implied by this arrangement. There were therefore arguments pointing out that the states should sell their stakes and give place for owners that could take an active role particularly because of the airlines need for extensive cost rationalizations. However, these opinions were not attended to.¹³³

SAS management realized that an even greater plan for reaching more customers was needed. SAS therefore took initiative to increase international airline cooperation, which would enable

¹²⁸ Jan Carlzon, Interview (March 5th 2013).

¹²⁹ Jan Carlzon, Interview (March 5th 2013).

¹³⁰ SAS Annual Report (1992), p. 2.

¹³¹ Jan Carlzon, Interview (March 5th 2013).

¹³² SAS Annual Report (1992), p. 4.

¹³³ Mats Mitsell, Interview (May 6th 2013).

a wider network in order to access a larger customer base.¹³⁴ SAS had therefore co-founded an alliance called "European Quality Alliance" with Finnair, Swissair and Austrian. In addition the company already had an alliance with American Continental Airlines and was part owners of Thai Airways.¹³⁵

The realization of the need for a dramatic cost reduction meant that something had to be done with regards to adjustments of labor conditions that were identified as the major cost burden. The former head of cabin-personnel, Mats Mitsell, recites the intense negotiations with union-representatives regarding the need to increase productivity. However, when strikes burst out, the SAS board and management instructed Mats Mitsell to agree to the requirements of the labor force. He recalls this as a recurring theme. The issues sprung from old organizational habits from the time of regulation, which resulted in further increase in labor costs.¹³⁶ According to Mats Lönnkvist present senior vice president and general counsel, the convenient working conditions have also lead to employees pursuing long careers within SAS. A surprisingly high number of flight attendants, pilots and service personnel have chosen to stay within the company their entire careers. This has created a "demographic bump" compared to its competitors, which was not the initial intent. Management would predict that flight attendants would stay in the business for approximately ten years and then move on to other positions. However, the great working conditions have made many stay with the company. Senior personnel cost more in terms of increased salary and pensions.¹³⁷

During the time of regulation, SAS also built their infrastructure, processes and IT-systems without having the pressure of competition. According to both Mats Lönnkvist and Elisabeth Bylund who at the time had commercial responsibility for SAS intercontinental unit, the lack of incentives to construct effective infrastructure resulted in the company not being as efficient as it could have been from when SAS started to experience competition.^{138, 139}

¹³⁴ SAS Annual Report (1992), p. 2.

¹³⁵ Jan Carlzon, Interview (March 5th 2013).

¹³⁶ Mats Mitsell, Interview (May 6th 2013).

¹³⁷ Mats Lönnkvist, Interview (March 5th 2013).

¹³⁸ Mats Lönnkvist, Interview (March 5th 2013).

¹³⁹ Elisabeth Bylund, Interview (April 14th 2013).

Reaching out to a broader customer base

Towards the mid 1990's, Jan Carlzon's successor, Jan Stenberg, increased the emphasis on widening the customer base. Jan Carlzon had initiated the basis for SAS loyalty program: EuroBonus in 1989. This concept was further developed as it was considered to be an important differentiation factor. In addition to the loyalty program discussions with other airlines concerning the creation of a network alliance were initiated.¹⁴⁰

In 1997, Jan Stenberg introduced the concept of SAS Pleasure, further targeting the leisure traveler. This was a contrast to the previous stance of purely being the "Businessman's Airline". The overall value offer can be view in Appendix 1 - Value offer 1996. 1997 was also the year where the initial cooperation of Star Alliance commenced. The alliance was co-established by SAS and four other airlines: Lufthansa, United Airlines, Air Canada and Thai airways. The ultimate goal of the alliance was to create a superior network enabling the Star Alliance members to connect and provide a network with seamless travel and frequency. Star Alliance also functioned as a tool to ensure appropriate standards for its business and leisure travelers for all its worldwide destinations. The alliance expanded rapidly during the following years extending its route network and providing its members with a larger customer base. Star Alliance' expansion and its importance for SAS as a competitive tool, increased continuously.¹⁴¹ To underline the significance of the increased route network that comes with such an alliance it should be stated that it provides a production element, a distribution element and a marketing element - permeating the entire business, from production to sales and marketing.¹⁴²

4.3.3 Era of crisis - Focus from customer to cost management (1997-2004)

Managing the economic downturn

The future revenue prospects in the airline industry were under serious pressure during the years of 1998-2001. A general economic downturn started to hoop and in combination with increased fuel prices the demand in the business segment deteriorated rapidly.^{143,144}

¹⁴⁰ Peter Forssman, Interview (April 26th 2013).

¹⁴¹ Elisabeth Bylund, Interview (April 14th 2013).

¹⁴² Seristö, H., (1993), p. 143.

¹⁴³ SAS Annual Report (2000), p. 6.

¹⁴⁴ SAS Annual Report (1999), p. 6.

In response to the evident problems, SAS structured an improvement program in 1998, which had the goal of cost improvements with savings of SEK 3 000 million and subsequently strengthen competitiveness throughout the organization.¹⁴⁵

SAS concluded that cost saving strategies could not function alone in a long-run perspective due to the increasingly competitive market where meeting customer needs is of great significance.¹⁴⁶ Stronger focus on the leisure segment became even more important as the recent entrance of LCCs started to intensify competition.¹⁴⁷ The business traveler was also recognized as representing an important part of the company's leisure travel.¹⁴⁸ Also, a renewal program - SAS 2000+ - aimed towards redesigning the SAS service offer was initiated. The e.g. program included: studies on consumer behaviors, implementing more customers related processes and systems, redesigning logos and employee uniforms in order to become more service oriented.¹⁴⁹

The pricing/segment mix at this time was considered the keystone to increase the cabin factor.¹⁵⁰ The new standards in the industry were: higher fares represent better quality and service/flexibility, lower fares represents no frills. With its customer strategy, SAS aimed to target both segments.¹⁵¹ During these years Star Alliance continued to grow and became the cornerstone of SAS' global partner strategy. The most important task was deemed to be the development of a global traffic system with high frequencies and the development of customer-oriented products with high and consistent quality throughout the alliance.¹⁵² It is stated in the annual reports that Star Alliance has helped SAS in achieving considerable competitive advantage since its foundation and that it is crucial that the alliance is withheld and improved.¹⁵³

¹⁴⁵ SAS Annual Report (1998), p. 39.

¹⁴⁶ SAS Annual Report (2001), p. 4.

¹⁴⁷ SAS Annual Report (2001), p. 37.

¹⁴⁸ SAS Annual Report (1998), p. 31.

¹⁴⁹ SAS Annual Report (1998), p. 45.

¹⁵⁰ Mats Lönnkvist, Interview (March 5th 2013).

¹⁵¹ Mats Lönnkvist, Interview (March 5th 2013).

¹⁵² SAS Annual Report (1998), p. 26.

¹⁵³ SAS Annual Report (1999), p. 6.

The wide range of destinations had been a differentiation factor for SAS even before the deregulation. In some ways, the company still experienced the need for being a part of a total communications system, which it had become during the time of regulation.¹⁵⁴

Crisis management

Just as things were looking brighter and charts pointed upwards, the market environment in, the beginning of the 2000s turned out to be very challenging for SAS. The industry was soon affected by a clear economic slowdown in the summer of 2001. Then, the events of 9/11, including the following war in Iraq and its effects of the oil price, re-shaped the whole industry. Economic instability was now fused to political and social agitation as well as reduced confidence in air transport as a safe method of travel. The result was a dramatic fall in demand.¹⁵⁵ During the same period SAS was also involved in the SAS-Maersk corruption scandal where the airlines applied illegal price cooperation on Danish domestic flights.¹⁵⁶ In addition SAS was also banned from applying its EuroBonus program on domestic routes in Norway, one of SAS' most important markets.¹⁵⁷ Due to all these events the SAS Group was forced to quickly adapt capacity to these lower levels. SAS management decided to close a number of destinations, reduce frequencies and to take a total of 21 aircraft out of business.¹⁵⁸

During this period, Jørgen Lindegaard had been appointed as new CEO. As a result of the severe matters depicted above, the main strategic focus at this point was crisis management to ensure the survival of SAS. Consequently, during the first years of the 2000's, the strategic focus was turned inwards rather than towards the market and customers. Earnings improvement through cost savings and renewal of working methods became top priority.¹⁵⁹

4.3.4 Surviving the new conditions in the airline industry (2004-2012)

Organizational unbundling for increased efficiency

When a reasonable cost level was reached and SAS had managed its way through the crisis, there was an urgent need for looking into the future.¹⁶⁰ In order to guarantee SAS' long-term competitiveness and profitability, SAS management implemented the cost saving concept of

¹⁵⁴ Mats Mitsell, Interview (May 6th 2013).

¹⁵⁵ SAS Annual Report (2001), p. 4, 36.

¹⁵⁶ SAS Annual Report (2001), p. 54.

¹⁵⁷ Konkurrensetilsynet, (2002).

¹⁵⁸ SAS Annual Report (2001), p. 4.

¹⁵⁹ SAS Annual Report (2001), p. 4.

¹⁶⁰ SAS Annual Report (2002), p. 9.

"Turnaround 2005". A new SAS group structure was formed with the purpose of simplifying and streamlining the way the various business units' work. Turnaround 2005 prompted personnel within each unit to ask themselves: Are these costs necessary, can we utilize our resources more effectively? A model with a more comprehensive description of this can be viewed in Appendix 2. Going from a centrally controlled model to an organization comprising independent regional/area profit, production and sales units was deemed to create a business with clearer responsibility for earnings and transparency together with shorter lead times. The new structure can be viewed in Appendix 3.¹⁶¹

However, the strategy resulted in marketing and selling offers being parted from production, which vouched for internal competition. Our respondent Elisabeth Bylund, who was responsible for intercontinental flights, says that she had to fight hard to get through to the sales team with her offerings and get recognition. She states that focus on the customer was jeopardized because of the increased internal rivalry. Also, the different Scandinavian countries had different production and sales teams who ran different campaigns, pricing and offerings within their respective regions. According to Elisabeth Bylund, this presented an unclear message to the customer.¹⁶²

The focus on the business traveler was at this point not as clear as before and the spotlight was now set to provide all segments of passengers with the most value for money.¹⁶³ Air-travelers were discovered to grow less interested in comfort and luxury. The new segments were rather interested in getting from A to B as time- and cost efficient as possible. According to all of our respondents, the new preferences within the industry were to a large extent driven by the low-cost carriers, which provided a completely new offer with regards to prices and service. This quickly changed customers view and expectations on air travel.^{164, 165, 166, 167, 168}

¹⁶¹ SAS Annual Report (2003), p. 4.

¹⁶² Elisabeth Bylund, (Interview April 14th 2013).

¹⁶³ SAS Annual Report (2004), p. 11.

¹⁶⁴ Elisabeth Bylund, (Interview April 14th).

¹⁶⁵ Jan Carlzon, Interview (March 5th 2013).

¹⁶⁶ Mats Lönnkvist, Interview (March 5th 2013).

¹⁶⁷ Peter Forssman, Interview (April 26th 2013).

¹⁶⁸ Mats Mitsell, Interview (May 6th 2013).

Snowflake - A failed LCC encounter

One of SAS' most forceful attempts to strengthen competition with LCCs was the foundation of Snowflake in 2003. Formed as a SAS subsidiary the idea was to create a smaller low-cost branch that could compete against the LCCs.¹⁶⁹ However, since Snowflake was operated by SAS employees and processes, it imposed the same costs as the operational standards within the rest of the SAS Group with regards to labor and other operational costs. The concept was for this reason not the success that SAS had hoped for and Snowflake as a separate subsidiary ceased to exist only a little more than a year after the initiation.¹⁷⁰

Reinstating the centralized structure

In 2008, after the takeover of new CEO Mats Jansson, the strategic base changed once more towards a more centralized structure. It was now deemed that in order to create a customer-oriented culture, the business units, which had been turned into separate entities, were again to be integrated into the core company. In the important hubs of Copenhagen, Stockholm and Oslo, SAS started new *base organizations* with responsibility for short- and long haul services, keeping the proximity to the most important markets. A model representing SAS' value chain at this time can be found in appendix 4.¹⁷¹

Core SAS and Strategic shift

The focus towards the customer was at this point to a large extent based on providing a seamless solution for frequent flyers (with no notion of these passengers being business or leisure travelers). The functions of Star Alliance were important parts in insuring this seamless solution enabling customers to benefit from harmonized services and access to a vast and distinguished travel network. In 2009 Jansson launched the new strategic focus of the company, called *Core SAS* which was based on five important pillars: "*Be on time, fly when customers want to fly, minimize travel time, maximize customer perceived value and make it easier to travel*".¹⁷² It was all concluded under the parole "Service and Simplicity" which became the motto for the overall customer strategy. Within this strategic framework it was also pushed for a focus on the Nordic home market. Once again the business traveler focus was augmented together with the frequent leisure traveler. EuroBonus played a big part in this

¹⁶⁹ SAS Annual Report (2004), p. 7.

¹⁷⁰ Mats Lönnkvist, Interview (March 5th 2013).

¹⁷¹ SAS Annual Report (2008), p.12.

¹⁷² SAS Annual Report (2008), p. 8.

as a result of its ability to attract both leisure and business travelers. The model representing core SAS can be viewed in appendix 5.¹⁷³

During Mats Jansson's period as CEO, SAS was involved in several merger rumors. The most prominent was the one with Star Alliance partner Lufthansa. A merger would have created Europe's largest airline. The negotiations were presumably far-gone but then the financial crisis struck and the Germans chose to withdraw their interest.¹⁷⁴ Another merger rumor of this period was SAS/Finnair. The logic of this rumor being that the two airlines are both in the Nordic market exposed to the same consumption patterns. However, in spite of positive comments e.g. from SAS chairman, neither this merger took place.¹⁷⁵

In 2010 incumbent CEO Richard Gustafsson took over the stewardship of SAS. During this year the cabin factor was improved and even so was the customer satisfaction. The SAS Core strategy remained the base for strategic focus since it had proven to help reaching the goal of keeping a streamlined service for customers.¹⁷⁶ The focus increased yet again on the business traveler, which sparked the necessity of eliminating several flight legs and a reduction of capacity on underperforming routes.¹⁷⁷ Some charter-routes and typical leisure legs, e.g. Canary Islands, were reduced in capacity and the resources were instead put into providing more routes and flights towards typical business destinations, for instance London and New York.¹⁷⁸ A program focusing on giving benefits and creating loyalty liaisons with business clients had been developed earlier on under the name: SAS Credits-Programme. The relationship with some of the major business clients were deepened and resulted in 20 000 new SAS Credits members.¹⁷⁹ By 2011 SAS managed to reach the best customer satisfaction rating in eleven years and the airline was also the most punctual in Europe, which it now had been for three years in a row.¹⁸⁰ The last few years, Gustafsson and his team have once more increased the focus on the business traveler and are putting a lot of effort into further strengthening the relationship with business clients in line with the Core SAS Strategy.¹⁸¹

¹⁷³ SAS Annual Report (2008), p. 8.

¹⁷⁴ IceNews, (2008).

¹⁷⁵ E24, SVD Näringsliv, (2009).

¹⁷⁶ SAS Annual Report (2010), p. 10.

¹⁷⁷ SAS Annual Report (2010), p. 10.

¹⁷⁸ Björnelid, R., (2011).

¹⁷⁹ SAS Annual Report (2010), p. 34.

¹⁸⁰ SAS Annual Report (2011), p. 2.

¹⁸¹ SAS Annual Report (2011), p. 8.

Also, more effort is put into providing supplementary services, which is deemed to provide more revenues besides the ticket sales.

4.3.5 SAS present customer strategy– 4Excellence (2012-2013)

In September 2011 SAS launched its "4Excellence" strategy, 4XNG. The goal with the 4Excellence strategy is to achieve excellence in four main areas: commercial excellence, sales excellence, operational excellence and people excellence. It particularly includes the centralization of administration to Sweden because of structural gaining's and since Sweden, compared to Denmark and Norway, has a lower general employment rate. The strategy is expected to add approximately 1,8 billion SEK to SAS income statement for the period of January-October 2012.¹⁸² With the strategy SAS seeks to become the first legacy carrier in Europe to have a unit cost that enables the company to compete with the LCCs. Reducing the unit costs is heavily prioritized since customers in general are not willing to pay a higher fare because of SAS comparatively high cost structure. Another important goal is to increase aircraft utilization which is low compared to the LCCs. An overview of the main characteristics of the 4XNG strategy can be viewed in appendix 6.¹⁸³

One of the main reasons for SAS applying the 4Excellence strategy is the aim to reduce its unit costs that are clearly above its competitors as can be seen in the below presented chart. Of particular interest is the fact that SAS unit cost (12), same as "Cost of Available Seat-Kilometer" (CASK), is close to twice as high as Norwegians and Easy Jets (6), who are both established LCCs. The chart is also very illustrating as it points out SAS average flight length in kilometers being relatively short when compared to the other airlines applying the legacy model. SAS on average therefore competes on short-haul routes with a higher CASK than the other low cost carriers.¹⁸⁴

¹⁸² SAS Annual Report (2012), p. 6.

¹⁸³ SAS Annual Report (2012), p. 13.

¹⁸⁴ CAPA Center For Aviation, (2012).

Figure 5 - SAS CASK position in comparison to competitors¹⁸⁵

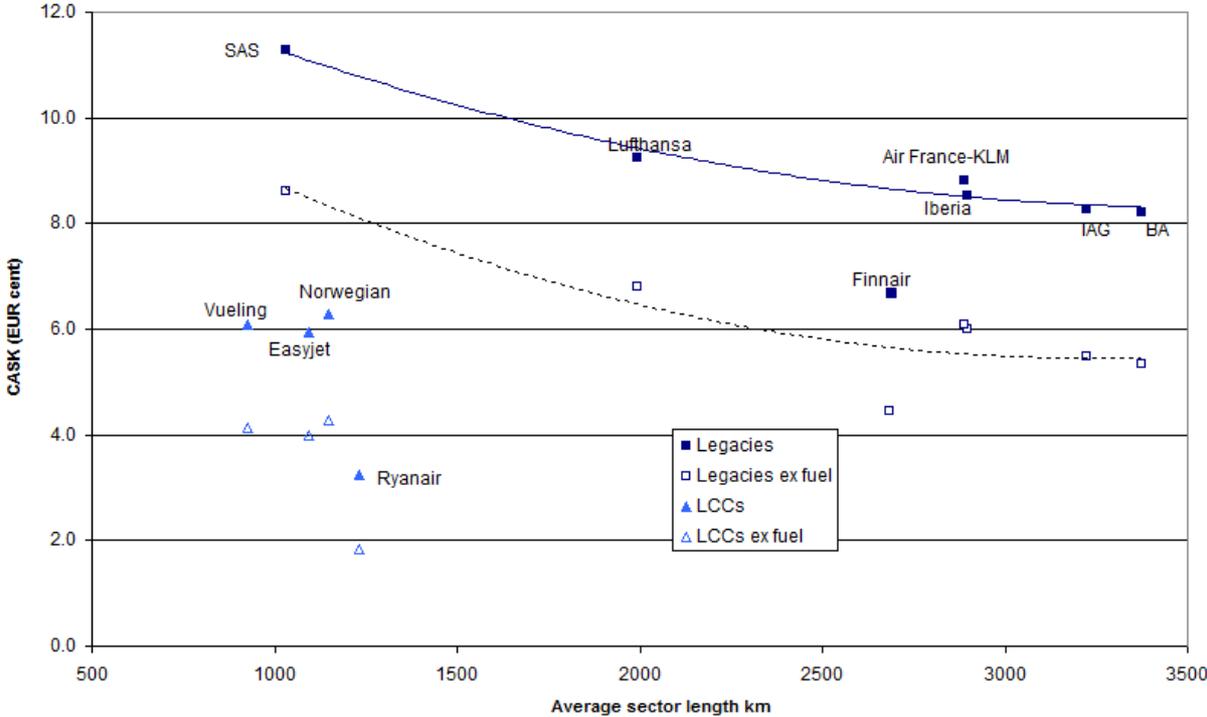


Figure 5 - The figure shows SAS' relative cost position in comparison to other airlines - both legacy carriers and LCCs. Y-axis shows costs in EUR. The X-axis shows Average sector length km.

Segmentation

With the 4Excellence strategy SAS aims to continue its historic focus on the business traveler segment as it today stands for 50 % of SAS total revenue. SAS has got a strong position in this segment in spite of competition both from other legacy carriers and also from LCCs beginning to approach the segment.¹⁸⁶ The fundamental for SAS route network is composed by destinations which are important to the Scandinavian businesses e.g. intra-Scandinavia and London. SAS continues to further stress the importance of aligning its products according to the travel patterns and preferences of the business traveler.¹⁸⁷ Therefore the frequency is kept high on important business routes like Stockholm-Copenhagen and Oslo-Bergen. Business travelers also continue to rely on punctuality, an area that SAS are strong being one of Europe's most punctual airlines and work to continue to improve.¹⁸⁸ To further serve this segment SAS has introduced "Fast track" and "Smart pass" which prioritizes business

¹⁸⁵ CAPA Center For Aviation (2012).
¹⁸⁶ SAS Annual Report (2012), p. 14.
¹⁸⁷ Mats Lönnkvist, Interview (March 5th 2013).
¹⁸⁸ SAS Annual Report (2012), p. 4.

travelers when passing through security, resulting in potential time savings.¹⁸⁹ SAS has also to a large extent succeeded in its effort to innovate within the area of customer self-service options. This particularly after SAS, in 2013, were rewarded as the first airline achieving IATA's (International Air Transport Association) fast travel Award platinum status.¹⁹⁰

The need to reduce the unit costs also stems from a particular strategic aspect described by SAS general counsel and senior vice president Mats Lönnkvist. This strategic aspect is mainly composed by SAS ambition to adjust to IATA's prediction that the leisure segment will stand for approximately 80 % of the airline industry's growth until 2020. However, Mats Lönnkvist does not believe it is possible to only focus on the business segment.¹⁹¹ Therefore SAS strives further to adapt to the traveling preferences of the leisure segment, in addition to the business segment. It also includes more focus on lowering fares, as the leisure segment, compared to the business segment, is not ready to pay for a higher cost structure and at the same time gives a lower average yield per seat sold. Therefore lowering fares also requires a lower cost structure to create profit. Serving the travel pattern of this segment also addresses the need to adapt to seasonal patterns associated with this segment.¹⁹² Therefore popular leisure destinations e.g. Cagliari, have been evaluated individually according to which periods the destinations are attractive.¹⁹³

During 2012 approximately 26 million customers traveled with SAS.¹⁹⁴ This was a decrease from 27.2 million in 2011.¹⁹⁵ Mats Lönnkvist describes the double segmentation focus as something that is applicable and necessary. He further states that it does not mean that you have to operate "two different companies". Instead they are, according to Mats Lönnkvist, regarded as possible to combine and still function on the two different markets.¹⁹⁶

SAS network strategy - Star Alliance

With 136 routes in 2012 excluding the scheduled introduction of the 45 new routes in 2013 and with 1111 departures per day SAS remains the largest Nordic operator. In addition to the

¹⁸⁹ SAS Annual Report (2012), p. 14.

¹⁹⁰ IATA, (2013).

¹⁹¹ Mats Lönnkvist, Interview (March 5th 2013).

¹⁹² Airline Leader, (2013).

¹⁹³ Copenhagen Airports, CPH.dk.

¹⁹⁴ SAS Annual Report (2012), p. 4.

¹⁹⁵ SAS Annual Report (2011), p. 2.

¹⁹⁶ Mats Lönnkvist, Interview (March 5th 2013).

introduction of new routes, SAS plans to increase the frequency on several important routes during 2013.¹⁹⁷

SAS' membership in Star Alliance, according to Mats Lönnkvist, continues to play an important strategic role.¹⁹⁸ It allows SAS to connect its customers, primarily originating from the Scandinavian region, with the other 26 members route networks including United Airlines, Lufthansa and Singapore Airlines. This provides the customer with a comprehensive global network to a total of 1329 destinations in 194 countries. The customer is also, because of the membership, guaranteed a certain service level and the opportunity to check in luggage directly to destinations in spite of using different airlines. For business travelers in particular, the membership grants access to lounges of other Star Alliance members.¹⁹⁹

In 2012 SAS continued to further develop its strategic cooperation. In particular SAS entered a joint venture agreement with Singapore Airlines further connecting Scandinavia and Singapore. The agreements ambition is to increase capacity and improve the customer offerings when traveling to and from Northern Europe to Southeast Asia, Australia and New Zealand.²⁰⁰

As has been stated there are several advantages with SAS membership including the ability to provide a global full service commodity. In addition, according to Mats Lönnkvist, it provides SAS with feeding routes e.g. Stockholm-Chicago where approximately 80 % of the passengers continue their journey and only 20 % stay in Chicago.²⁰¹ However, there are also disadvantages with the membership, primarily as a cost driver. There are certain costs linked to the maintenance of the network such as IT, negotiations and also routes where SAS is obliged to operate routes of none primary interest in order to serve other alliance members.²⁰²

EuroBonus

Mats Lönnkvist describes how SAS continues to put heavy emphasis on enhancing and rewarding customer loyalty with its EuroBonus system, which is regarded as a highly

¹⁹⁷ SAS Annual Report (2012), p. 16.

¹⁹⁸ Mats Lönnkvist, Interview (March 5th 2013).

¹⁹⁹ SAS Annual Report (2012), p. 16.

²⁰⁰ SAS Annual Report (2012), p. 16.

²⁰¹ Mats Lönnkvist, Interview (March 5th 2013).

²⁰² Mats Lönnkvist, Interview (March 5th 2013).

important tool for competition, marketing and observing.²⁰³ EuroBonus continues to reward customers for traveling with SAS and also with members of Star Alliance. Depending on the price paid and destination the customer receives a number of points that can be exchanged for new tickets or hotel nights regardless of personal travel pattern. Today 41 % of SAS total revenues come from EuroBonus customers. SAS internal goal is to raise this figure to 50 % by the year of 2015. SAS has also emphasized the "SAS credits" concept, which is a unique loyalty program for small and midsize companies. In addition SAS continues to be very strong on the corporate contracts section stemming mainly from the Scandinavian export industry.²⁰⁴

On the negative side, Mats Lönnkvist points to the fact that the EuroBonus system causes administrative costs for maintaining and developing its IT platforms. The platforms are important and have got complex structures, this also requires full integration with the other Star Alliance members' IT platforms. There are also legal difficulties in Norway for applying the EuroBonus system. In Norway SAS is forbidden to apply the system on domestic routes based on a decision from the Norwegian state.²⁰⁵ This decision has caused decreased competitiveness.²⁰⁶ In particular it has been difficult for SAS to explain the ban to its customers. At present time however, SAS is once again challenging the ban decision by implementing domestic EuroBonus on the business segment claiming support from EU regulation. Recently there has also been, from SAS perspective, positive signals suggesting a cease of the ban.²⁰⁷ Mats Lönnkvist conceives that the ban of EuroBonus clearly limits SAS ability to differentiate its commodity in the domestic Norwegian market and therefore the legal outcome is central for future competitiveness.²⁰⁸

In spite of the cost structure and local legal difficulties SAS continues to regard the EuroBonus advantages as bigger than the setbacks. EuroBonus is regarded as a useful tool to differentiate.^{209, 210, 211}

²⁰³ Mats Lönnkvist, Interview (March 5th 2013).

²⁰⁴ SAS Annual Report (2012), p. 15.

²⁰⁵ FOR 2007-06-20 nr 684.

²⁰⁶ Trumpy, J., (2012).

²⁰⁷ Nyhetsbyrån Six, Di.se, (2013).

²⁰⁸ Mats Lönnkvist, Interview (March 5th 2013).

²⁰⁹ Mats Lönnkvist, Interview (March 5th 2013).

²¹⁰ Mats Mitsell, Interview (May 6th 2013).

²¹¹ Elisabeth Bylund, Interview (April 14th 2013).

5 Analysis

In this section we analyze SAS based on the thesis' theoretical framework. In chronological order the framework components are analyzed as follows: Porter's Diamond, Path Dependency, SWOT analysis and Porter's Generic Strategies. The chapter is concluded with a brief summary of our findings.

5.1 Analysis of the competitive environment - Porter's Diamond

5.1.1 Pre and during deregulation period, 1985-1997

5.1.1.1 Interrelated components

Factor Conditions

The access to labor, capital and infrastructure in the Nordic region was during this period solid. Labor was a key factor as airlines competed primarily with a service offering that emphasized on the customer's experienced service. We conceive that in order to ensure the performance of their staff many airlines agreed to high salaries and pensions in order to avoid costly strikes resulting in reduced customer confidence. The lucrative offerings given to employees during this period have without any doubt contributed to the stressed financial situation of many second-tier airlines. The access to capital varied during this period and the national carriers with state ownership in general still enjoyed support. However, our notion is that airlines in general to a larger extent perceived that the upgrade of the European Union antitrust-rules, which would change the possibility for state subsidies in case of financial difficulties. In terms of infrastructure Europe was already well established where each national carrier enjoyed superiority in their home country together with bilateral international flight agreements.

Demand Conditions

The demand conditions during this period were highly beneficial for the national carriers. The Nordic countries with strong export industries meant that the airlines had access to business travelers with a high willingness to pay for extra value. The strong demand from the business segment had created a sense that travelling was an experience combined with getting to the desired destination. The airlines innovation was therefore related to increasing the customer's experience e.g. adding luxury with connected hotels and limousine service. We conclude that

in practice airlines with high unit costs could compensate by increasing their prices without experiencing significant decreases in demand since customers in the regulated Nordic market did not have a choice.

Related and supporting industries

During this period the national monopolists enjoyed a position that did not force them to rationalize their costs compared to the same degree as in today's market. Therefore airlines produced several of their products and services in-house e.g. IT-systems and aircraft maintenance. One of the most important supporting industries was naturally the aircraft industry. This industry played an important role particularly in terms of reducing fuel usage. Other industries that were applied during this period, even though they are not related to the core business, were the hotel and ground transportation business.

Firm strategy, structure and rivalry

The strategies and structures of the national carriers during this period were established on a monopolist basis. They could therefore operate decentralized organization structures with multiple functions at different locations, which reduced general productivity. Instead the primary focus was aimed at which service innovations could be added in order to extract maximum output from their customers. Therefore the competition that did exist was generally between the national carriers for the business travelers for intra-European flights or with smaller domestic airlines for leisure travelers. We regard the rivalry during this period to change slightly from being very low to a point where national carriers started to feel the deregulation effects. The adjustment strategies for a deregulated market were hard to implement for two main reasons. Either potential entrants in a deregulated market were not taken seriously or strategic cost rationalizations could not be implemented as neither owners nor unions found them motivated. During the deregulation period there were examples of airlines that conceived that the market would need to be consolidated as airlines had to grow to reach a profitable capacity. There were efforts to merge national carriers e.g. SAS, KLM, Austrian airlines and Swissair. However, these efforts proved difficult primarily because of political reasons. The importance of alliance strategies did also spark during this period and such cooperation's became increasingly important for competitiveness. As competition was further introduced airlines also felt an increased need to enhance customer loyalty. Therefore numerous loyalty/bonus programs were introduced. From this section we find it important to

further emphasize the fact that the low level of rivalry did not enhance the competitiveness of the Nordic region, particularly in terms of cost innovation.

5.1.1.2 Exogenous parameters

Government

The government parameter is important for this period, as it did not only play the role as regulator but also as owner. As we have mentioned the market for domestic flights were regulated and the market for international flights was run by bilateral agreements between states. These facts did contribute to a limited scope for competition and undermined the importance of innovation for the national carriers. During this period the European Union, inspired by the deregulation in the United States, decided that deregulation would take place. This meant that steps towards increased competitiveness were taken and at the same time the opportunity for state subsidies was supposed to decrease. In the Nordic market, the Swedish government in particular was very eager in this process but at the same time in our opinion aggravated SAS cost rationalization strategies, e.g. undermining SAS' goal to centralize maintenance. Summing up the government parameter it, in our opinion, played a mixed role both as regulator and as owner, a role that is not advantageous for any part.

Chance

Chance is very important in order to understand why strategies for cost rationalizations during this period were, in our opinion, ineffective. After the deregulation had been initiated in 1992 the Nordic economy had slowly begun to pick up. This meant that flying increased along with profits. Since the airlines in general did well and enjoyed profitability, our general perception is that it was hard to convince state owners and unions about the necessity of cost reductions. We believe that if the economic environment had been more challenging during this period the cost rationalization strategies would have received more understanding, particularly from unions.

5.1.2 Post deregulation, 1998-present

5.1.2.1 Interrelated components

Factor Conditions

Despite now operating in a deregulated market, salaries and pensions of former flag carriers of the second tier segment had not been fully adjusted. Past lucrative offerings to employees and unions which both meant high costs and lower productivity in terms of working hours have been sources of uncompetitiveness. In terms of access to capital the state owners have on multiple occasions contributed with capital e.g. to SAS in 2009, in order to solve its financial difficulties despite having publicly expressed a general unwillingness to make such acts.²¹² Infrastructure wise the Nordic airline industry has gone through changes where the former primary airports are experiencing competition from secondary airports.

Demand Conditions

The demand component is the factor that we have found to vary the most compared to the former period. With the introduction of LCCs we claim that the demand character of the airline industry has changed significantly. With the entering of LCCs the general attitude for flying has gone from being perceived as a luxurious experience into being regarded as a method for travelling between two points. People are increasingly selecting the airline offering the lowest price between two points instead of looking at service level. This change in attitude is also being reflected in the business travel segment. Today businesses are becoming increasingly reluctant to pay high fees for having their employees flying in an upgraded class. Instead many chose to fly economy. In spite of this trend we note that the economical strength of the Nordic region has held the demand for business travel on a fairly high level, as the demand for fast track and lounges is still attractive.

Related and supporting industries

The airline industry's general approach to supplier has changed and shifted towards the LCC model where only core activities are included. Hence, many former flag carriers have increasingly outsourced and sold off non-core related business functions e.g. hotels. Instead the non-core operated by external companies specializing in the areas. The aircraft industry is

²¹² SAS rapport 2009

for natural reasons still an important supporting industry and its importance has increased especially in terms of fuel efficiency as these prices have soared. Some of the airlines of the LCC group have increasingly introduced new groups of supporting industries. One such example supplying their flight crews with personnel from staffing firms, which they can add during periods of economic growth and then reduce during economic downturns.

Firm strategy, structure and rivalry

The entrance of LCCs has reshaped the whole industry both strategically and structurally. The LCC strategy in terms of segmentation is pointed towards all segments interested in flying at the lowest possible fare including both business and leisure. We have noticed that the LCC segmentation together with the decreasing demand for luxury flying implied in the demand conditions section has also shifted the legacy segmentation increasingly towards the leisure segment. The rivalry of the European airline industry is today generally divided into three airline categories where the category of airlines not applying the LCC strategy to a full extent and not reaching required capacity e.g. second-tier carriers continue to struggle. Organization wise administration has become increasingly centralized to achieve cost savings. As the rivalry has intensified for the Nordic market from the LCCs the need for consolidation and cooperation has been emphasized between the legacy carriers striving for capacity. Cooperation wise the application of strategic alliances, including integrated loyalty programmes, has also increased during this period among the legacy carriers in an effort to strengthen competitiveness. The Nordic market is very attractive with its comparatively strong economies and dispersed geography. Therefore the battle for market shares is immense and we therefore think that it is, from a consumer perspective, a healthy competitive environment in terms of innovation and productivity. In our opinion, the LCCs enjoy a solid competitive advantage.

5.1.2.2 Exogenous parameters

Government

Our opinion of the government role of the Nordic airline industry is that the deregulation has had a very positive effect on competition. The intense competition witnessed today has improved the availability of cheap fares and also intensified the need for constant innovation and cost rationalizations. The governments of the Nordic region have also taken an active role in enforcing anti-trust regulation where mutual airline agreements limiting competition e.g.

SAS-Maersk have been penalized. On the other hand we have an example where we think the government role has been over elaborated. This involves the decision of the Norwegian state to forbid SAS EuroBonus on domestic flights. In our opinion, in the battle for market shares particularly between SAS and LCC competitor Norwegian which does not rely as heavily on such system, SAS EuroBonus is a tool for gaining competitive advantage. Hence the ban of EuroBonus undermines competition and we therefore find this decision unfortunate. Another unfortunate contribution to the competitive environment of the Nordic airline industry is the state ownership in SAS. We find the role as both owner and regulator to be undermining the competitive environment, particularly for the competitiveness of the airline. Our judgment is that the airline would benefit from an owner structure that does not involve the experienced bureaucracy and complexity following its present structure.

Chance

When discussing the Chance parameter it is inevitable not to include the events of 9/11. The fact that aircraft were used as tools to complete the terrorist attacks put tremendous pressure on the airline industry. Following the events the increased costs in terms of e.g. security laid a heavy burden also on airlines operating not just in the Nordic market but also globally. We are convinced that if the events had not involved the airline industry the required cost rationalization speed would not have been as intense. Legacy airlines would not have suffered financially to the same extent. However, the tougher competition climate also forced an increased innovation rate that was beneficial for the customers as well as the airlines able to keep up with it e.g. LCCs. For this period we also highlight the effects of the financial crisis starting in October 2008. The crisis had tremendous effect on the competitive environment of the Nordic airline industry and forced further cost rationalizations e.g. as flying declined. However, it is not the effects of the crisis in general that we want to emphasize. Instead it is the timing. Just prior to the crisis coming into effect SAS and Lufthansa went through serious negotiations of a merger that would create Europe's largest airline in terms of capacity. Following the crisis however it did not go through. We consider that this potential merger would have had a huge impact on the competitive environment of the Nordic market. The merger would, in our opinion, have created a legacy airline with the ability to compete with the LCCs for Nordic market shares.

5.2 Path Dependency

5.2.1 Labor cost lock-in

When SAS was acting in a regulated market, personnel, workers and their union representatives could fairly easy negotiate on higher wages and improved benefits. Higher pricing of tickets could cover the subsequent increases in costs. This was made possible much due to the lack of competition. The increase in prices would not hurt the business of SAS significantly since the willingness to pay was still high amongst the core segment of business travelers. This has resulted in SAS having some of the most generous working conditions in the industry when entering the deregulated market in the Nordic region and subsequently the highest labor costs. When talks of a possible deregulation started, as mentioned, the management deemed that a cost reduction of 50% was deemed necessary in order to remain competitive. The cost base has been hard to manage since strong unions and organized employees have responded with strikes when managers have attempted to reduce salaries and benefits. Additionally, the demographic bump that has come with the lucrative labor conditions is imposing a larger cost mass. We argue that the experience of senior personnel might also have improved their legitimacy in negotiations on working conditions, increasing the difficulty for managers to reach new agreements. This has implicated forcing effects on decision-making, pressuring managers to keep a high standard with regards to labor conditions.

Lately, however, SAS strategies relating to the 4XNG rationalization program has managed to reach an agreement on less lucrative labor conditions. It is hard to deem whether it is enough. We argue nevertheless that the path dependency will continue the difficulty in reaching further agreements on cost reductions. We argue that this is a great example of what path-dependency theory describes as a lock-in effect, incarcerating the company in a difficult position with regards to the cost structure.

5.2.2 Organizational inefficiency

Another result of the increased convenience with regards to the conditions within the company is that the organization had grown more complex with lower productivity. The different business units were at the point of deregulation badly interconnected and personnel had little incentive of improving efficiency and interrelating activities. The complexity made it difficult to highlight the cost structure and draw conclusion on where to cut and where to

improve. An attempt at getting rid of this problem was to unbundle the different business units in line with the "Turnaround 2005" program. However, the disintegration of business units leads to internal rivalry and miscommunication. We have found that the quarrel between the different entities turned the focus from the customers and inwards, undermining the service focus towards customers and their needs. Since this separation quite quickly turned out to be a bad strategy for the customer focus, the new management led by Mats Jansson restored the former organizational structure.

These procedures have acted as attempts to reduce SAS' heavy cost burden and lack of competitiveness that is sprung from years of being a monopolist. Bearing this in mind, we can crystallize a path-dependency: due to the heritage of being in a regulated market, SAS was forced to make cost-reducing decision that all-in-all may not have been for the benefit of the company's competitiveness and certainly not for the customer focus. Moreover, the project of unbundling and then reinstating the former organizational structure imposed a lot of additional administration, restructuring and also confusion within the company. We argue that this has kept the wheel of path dependency running. It has also hampered SAS strategic formulation space, within the company and also with regards to the outside image. We highlight that this is a chain of events that also has its origins within the cost base, formed before deregulation.

5.2.3 Heterogeneous procurement

During the years of regulation, SAS would purchase aircraft that fit their immediate needs, had the best contemporary technology or provided best value for money. This has resulted in the aircraft fleet being very heterogeneous. The basic ideas of purchasing different types of aircraft were mostly done during the years of regulation. At this point in time there was not as much incentive to be efficient on the ground compared to the highly competitive environment experienced today. Different aircraft types calls for different technical support and service knowledge. This has shown to be a contributing factor to the lack of efficiency and increasing the time that planes stay on the ground. As mentioned, a plane is only profitable in the air, carrying passengers. Increased time spent on ground service means increased costs. We argue that this is a path dependent issue that also has affected SAS' decision-making and strategic focus.

5.2.4 State ownership

SAS has also been exposed to the interest of the individual states, which has affected the company's operations. One example of this is SAS intention to purchase only effective short-to-medium-range aircraft. Such purchase would have meant that fewer connecting flights would be necessary to fill the planes, particularly at Kastrup, the Copenhagen based hub. Fewer connecting flights would mean that less local personnel for maintenance and airport sales would be required. With the fear of losing local jobs this strategy was heavily protested against and abolished, thereby undermining SAS' ability to formulate strategies. We regard this as a path dependency depicting organizational efficiency related to the heritage of having a government ownership stake.

5.3 SWOT Analysis

The SWOT analysis constitutes explains SAS strategic competitiveness of today. Particularly the analysis emphasizes SAS strategic position in relation to the LCCs.

5.3.1 Strengths

- SAS is the largest carrier in the Nordic region and is market leader in the domestic market.
- SAS is Europe's second most punctual airline (2012).
- Through its strong network, including Star Alliance, SAS can offer destinations in all continents.
- Has recently enforced an extensive savings package.
- Operates the largest number of routes and has the highest frequency on popular routes among its Nordic competitors.
- SAS has a history and is still strong in terms of innovation e.g. recently receiving IATA's fast travel Award platinum status.
- Its popular loyalty programme "EuroBonus" used by approximately 41 % of their customers.

5.3.2 Weaknesses

- Compared to its main competitors, particularly the LCCs, SAS has high and inflexible unit costs.
- Comparatively high passenger fares as a result of the high unit costs.
- Recent focus on both the business and leisure segment risks indistinct brand identification.
- SAS has a dispersed aircraft fleet from various manufacturers with varying age, which requires a wider range of expertise, this costs more compared to the, who operate an aircraft fleet from a single manufacturer.
- SAS aircraft utilization is comparatively low.
- SAS passenger wise, relatively limited home market makes it challenging to support a large long-haul network.
- The ownership structure with the Scandinavian states together holding a majority of the votes makes SAS strategic decision process complicated. In addition SAS also has to get the approval of several nationally based unions.

5.3.3 Opportunities

- Outsource and sell ownership stakes in unprofitable and non-core related businesses e.g. maintenance to more effective partners.
- With a change in ownership structure were the national stakes are sold a new owner has got the potential of rationalizing SAS strategic decision making process
- The ability to expand travelling access for their customers via their extensive route network.
- Opportunity to lower its dependency on the uncertain demand from business travelers by increasingly focusing on the leisure segment predicted to stand for the majority of the growth in the airline industry until 2020.
- Ability to increase its competitiveness thanks to the recently applied savings package.

5.3.4 Threats

- Macroeconomic development including the high exposure to increased fuel prices
- Market impact as SAS is active in several markets and could be affected by several negative market cycles at the same time.
- SAS has got a history of fierce labor and union relations risking expensive strikes

- The Nordic market that SAS operates in is characterized by fierce competition both from LCCs and legacy carriers.
- Capacity development, with the largest market share of the Nordic region SAS is exposed to shifts in demand causing both over and under capacity.

5.4 Generic Strategies:

5.4.1 SAS' competitive position - pre-deregulation

SAS CEO Jan Carlzon had understood that the deregulation of the European market was imminent as early as in 1985 following the events taken place in the United States. The company and its management had during a number of years developed a form of differentiation strategy, without even experiencing much competition. Focusing on the business traveler and providing enhanced service was the core idea when positioning the company. Jan Carlzon's vision of providing augmented service permeated the entire organization, which allowed for increases in costs, but also provided for great brand recognition and customer satisfaction.

With regards to SAS' focus on being the businessman's airline our perception of SAS differentiation strategy is that it was focused and ultimately aimed at differentiating in a narrow market scope. We support this statement with our empirical findings, particularly our interview with Jan Carlzon. He stated that SAS specific focus and ambition was to differentiate their product in order to further serve the interest of the business traveler segment. This strategy was operational for the first couple of years in the deregulated market because of the stable conjuncture as depicted previously in Porter's Diamond. For example SAS laid heavy emphasis on providing high frequency departures to business destinations and therefore flew smaller aircraft. SAS thereby differentiated their product from airlines focusing on a general segment including both business and leisure, with lower frequency but larger aircraft.

An extension of Carlzon's differentiation strategy was the investments in hotels and limousine services. This was believed to extend the service offerings, making SAS into a complete travel agency. We argue that the strategy was enabled due to the strong position that the company had attained in the regulated market. Nevertheless, the strategy turned focus from

the core business of air travel that would arguably have deterring effects later on, implying high costs.

Even though SAS' monopolistic situation has provided a broader market, the strategy per se was focused, aiming towards excellence within a limited market range. SAS had at the time, every business unit integrated in the company, everything from food and beverages to baggage handling which was important in order to provide the enhanced customer experience. The personnel were informed to keep the focus on the customer front and center. People working in the service organization were given more and more responsibility to handle every client issue in the best suitable way without having to ask a superior boss for permission.

Figure 6 - SAS position Pre-regulation

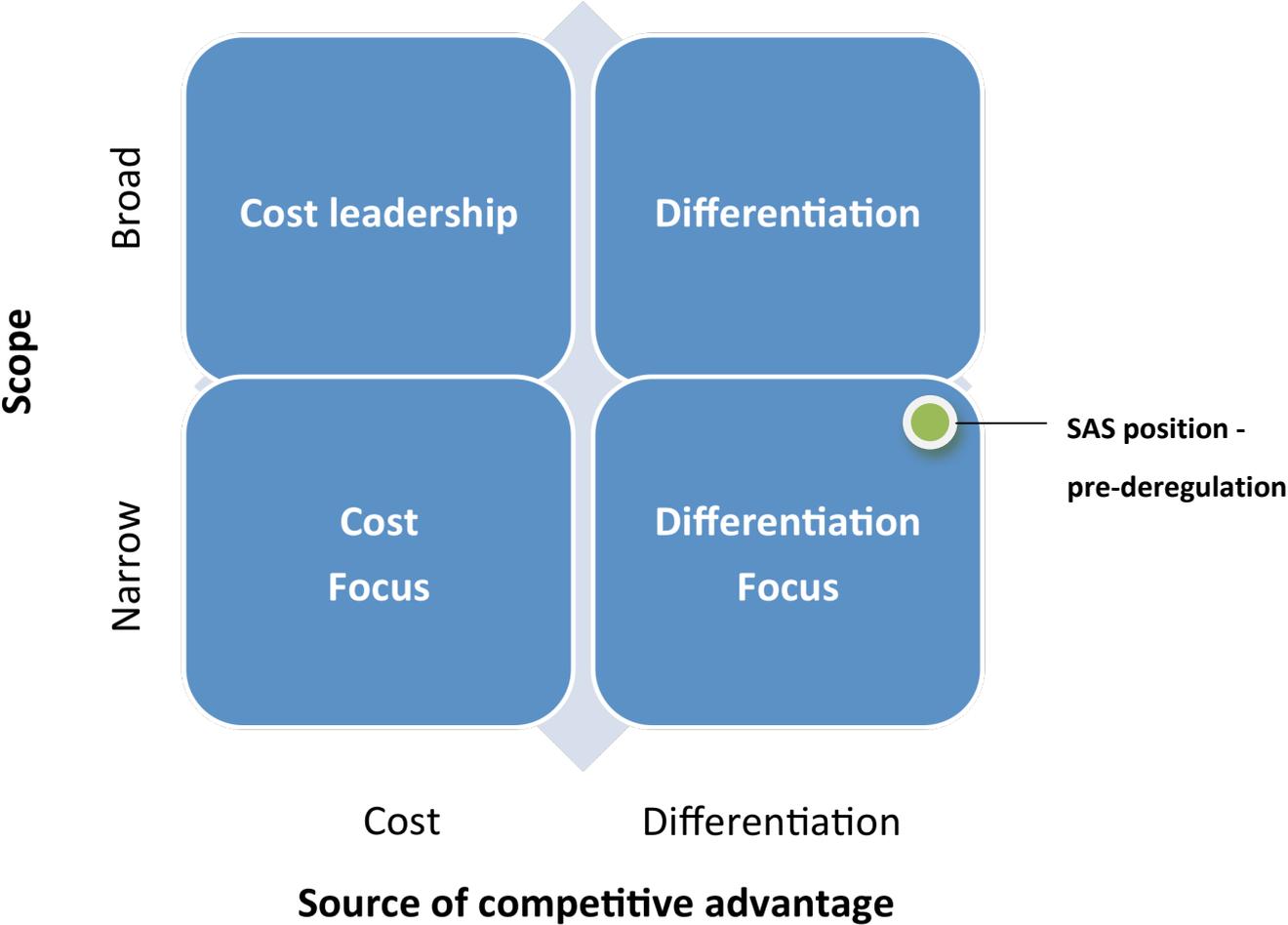


Figure 6 - The figure shows SAS' position within the Generic Strategies matrix before the market was deregulated based on our analysis of empirical findings and applied theory.

5.4.2 SAS' competitive position - post-deregulation

New standards brought by LCCs

As described in the empirical section, SAS has had a rough time managing the overwhelming entrance of LCCs into the market and their subsequent reshaping of the foundations of the industry. According to Porter’s description of cost leadership, we argue that the description of the LCCs as presented in the theoretical section of this thesis fits very well into this depiction. We find that all the key elements are there; namely economies of scale, some of the new entrants started to operate on remote airports; some put a lot of focus on purchasing a homogenous aircraft fleet. Last but not least, a major change that came with the LCCs was

that they presented a new business model with dramatically reduced operational costs as a result of the decrease in service offerings. More and more responsibility was put on the customer and self-service in terms of booking, check-in and several other travel-related services. The in-flight experience was minimized, turning the cabin into more of a bus for public transportation in comparison with the historic legacy standards. The new standards paved the way for dramatically reduced fares, which attracted a big portion of the market. In all of our interviews, our respondents have been very clear on the fact that this business model has changed the way we look at air travel and subsequently reshaped the preferences of the regular traveler. The new model started to force SAS to take new strategic directions.

Differentiation and segmentation

When applying the Generic Strategies to the development of SAS, we find that they have made strong attempts at gaining competitiveness through differentiation. SAS has had the mindset of being the primary airline for the business traveler more or less the entire time. Differentiation has been made through segmentation, mainly done by providing different classes within the cabin - such as Business Class, EuroClass, Economy, Economy extra etc. Another important corner stone in the differentiation process has been the provision of loyalty program, EuroBonus. This has provided SAS with a big and loyal customer base, mainly targeted at business travelers who in turn would like to make use of their benefits in their private travel. Lastly, we have identified strategic alliances and mainly Star Alliance to be a strong differentiation factor. The alliance has provided SAS with a vast network of destinations that no low cost carrier would be able to provide. Star Alliance also makes interlining possible which means that you can travel from e.g. Stockholm to New York with connection in Frankfurt, all on one boarding card and only having to check in your luggage once. That represents a clear advantage against LCCs point-to-point model.

Attempts at low-price challenges

SAS has also made attempts to conform to the strategies of LCCs in order to keep up with competition in the price-sensitive segment. Most notably this was done through the foundation of SAS Snowflake. The purpose of Snowflake was to offer a low cost alternative by founding a separate brand and concept. However, due to the cost base continuing to stay high, it was an impossible task to make the low-cost approaches profitable in the long run since labor conditions and wages stayed the same. Other strategies have been initiated in order

to attract the entire spectrum of travelers, e.g. removing the concept of business class, providing a single-class cabin and reducing arrival service. The path dependent lock-in effects in labor conditions and inefficiency have clearly made it very difficult to reduce costs sufficiently to present an attractive, competitive and profitable low cost alternative.

The restraining effects on the ability to formulate successful, competitive strategies, caused by their path-dependency of having acted in a regulated market, have made it almost impossible to meet the new standards in the industry, brought about by the LCCs. We emphasize once more that it is much more difficult to reduce a cost level from 100 to 50 than to build a cost structure from the ground up that is 50, representing the market standard, which LCCs have taken advantage of.

Double segmentation strategy

SAS' attempts to appeal to both price-sensitive and more "experience-seeking" customers have, in our opinion, placed them somewhere in the middle of the Generic Strategies matrix. Throughout the years, their strategies have pended between these two strategic focuses. Sometimes they have even had both differentiation and cost leadership in focus. A good example is once more the introduction of Snowflake. The aim was to attract some of the low cost segment by providing attractive fares while at the same time providing the more service-oriented offer that SAS have had throughout the years - still running the EuroBonus program as well as being a Star Alliance member. Strategically this was arguably not very well structured since running a low-cost airline with a legacy-carrier cost structure is not reasonable. We also argue that this presents an unclear message of what the company wants to achieve, both with regards to the customer and internally. We base this conclusion mainly on the answers from our respondent Elisabeth Bylund who has stated that that the focus of the company during this time was unclear to the personnel as well the customer. In contrast, the strategic focus of LCCs has been very clear, attracting the wider market scope with a standard offer that has been a successful strategy.

We argue that it might have been confusing and not very trustworthy in terms of the view of the customer, for a legacy carrier all of a sudden wanting to be a low cost alternative. What is apparent still is that SAS was ultimately forced to take these actions as a direct result of the new standards brought about by the LCCs. What we want to emphasize here is that we argue

that the path dependency of being a monopolist operator has clearly undermined the ability of having one clear strategic focus. By this we mean that the lock-in effects in labor costs, the heterogeneous aircraft fleet, the high operational costs and the less effective organization (costly organizational restructuring) that are all a heritage of being a monopolist, have made it almost impossible to become a low cost alternative.

SAS strength in attracting the business segment and their benefits of being a founder and member of Star Alliance and EuroBonus has made the company hold on to this core strategy which we believe has been crucial for its survival. On the other hand, it seems that the business segment arguably is growing less profitable as a result of the changes in customer preferences. Evidently LCCs are reshaping the industry to the extent that the business traveler, in the sense that we formerly have known them, is slowly changing to a more simplified form. People in the segment seem to be less and less interested in additional service and paying the premium that it requires. Hence, if this development continues and SAS clings on to their differentiation strategy- becoming e.g. a comparatively luxurious alternative, their costs would increase to a level of which only a small business segment would be reachable which would result in shrinking volume.

We argue that SAS is to some extent stuck in the middle - but not entirely in the sense that is depicted in Porter's theory. This since SAS can still compete in the traditional sense for the business segment. They are still forceful in this segment where they also have a strong market share and recognition. An example of a strength that SAS is currently leveraging is reducing the time that travelers spend at the airport in line with the 4XNG Strategy. According to our respondents, this is the most crucial factor when appealing to business travelers. SAS' offerings of business products are well appreciated. This is very clear through the vast expansion of their loyalty program, EuroBonus and the fact that the majority of SAS' turnover comes directly or indirectly from the business segment. If SAS can identify and attract a larger customer segment that still has a demand for augmented service in line with the contemporary needs of the business traveler, one may argue that there is a small chance for SAS to improve competitiveness since they historically have been very strong in the field. On the other hand this would require a lot of restructuring and a clear focus towards only this specific segment. In order to do this, they would probably also have to slim down the organization to a large extent, giving up the race of the most price sensitive consumers. This restructuring would naturally imply a lot of layoffs and other sufferings. Most likely, the state

ownerships and union representatives would not favor such a restructuring, which is why the chances of it being successful in practice remain small.

SAS position in today's market is challenging and we argue that it is at this time crucial for the company to formulate one strategic focus. The present 4XNG strategy is an attempt at reducing costs dramatically in order to secure survival. The strategy is also making an attempt at appealing to the core, classic segment of business travelers. Thus, it still has a little bit of both with regards to strategic focus. The question then remains - will SAS ever regain profitability or is their path dependency paving the way to failure? According to our analysis with the basis of Porter's Generic Strategies, SAS is in a weak position for increasing competitiveness.

Figure 7 - SAS position post regulation - in comparison with position of LCCs

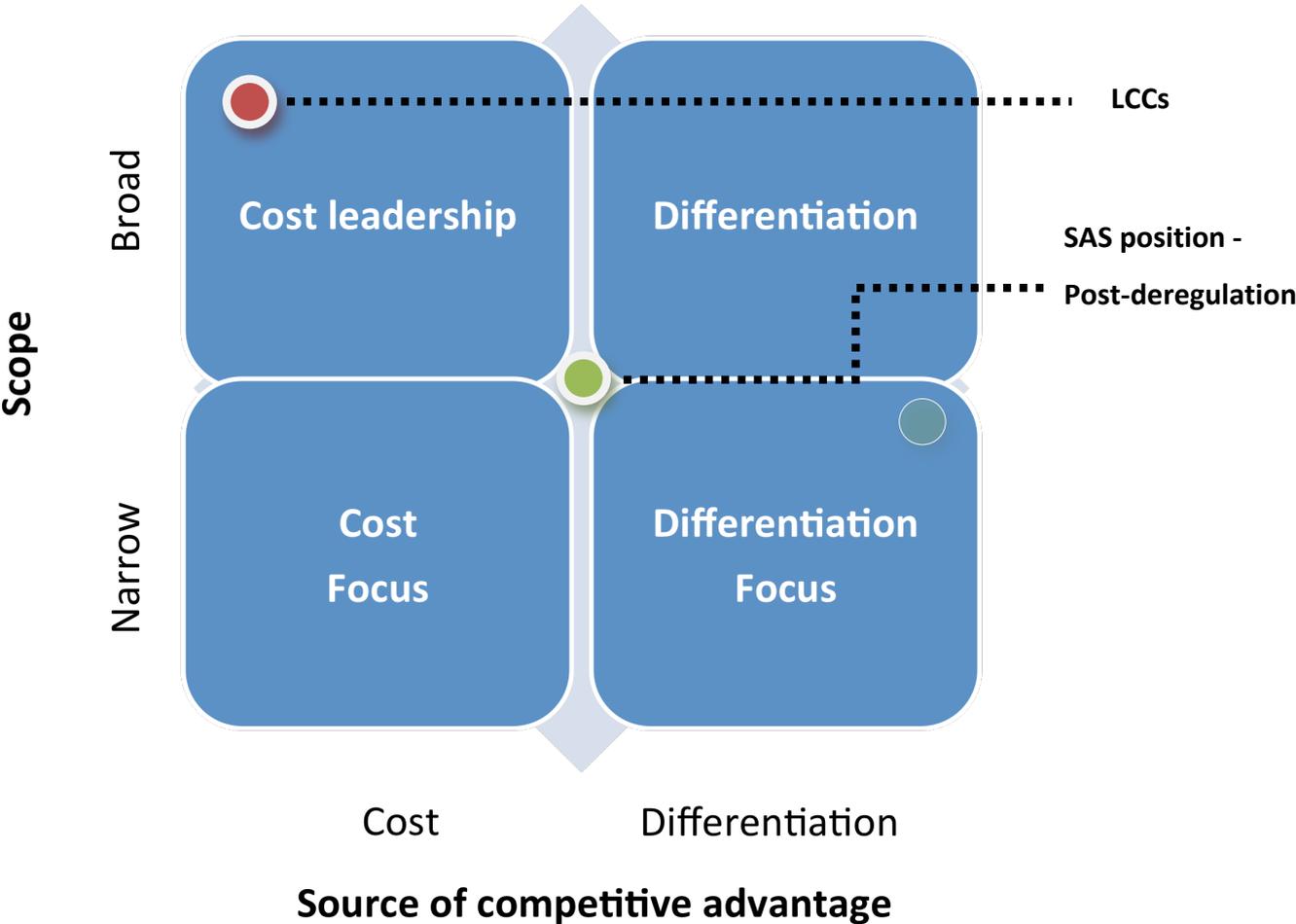


Figure 7 - The figure shows SAS' position within the Generic Strategies matrix post deregulation based on our analysis. The LCCs position is in the top left corner.

5.5 Summary

Summarizing our case study based on our theoretical framework this section indicates several important aspects of SAS strategic development as a former monopolist. Our most important finding is that SAS customer strategy cannot be understood without addressing its cost structure. SAS cost structure has continuously limited the airline's strategic maneuvering space in spite of several cost packages being initiated. This limit has had a negative impact on SAS relative competitiveness particularly since keeping costs low is the heart of the successful LCC model. The main reason for this is that SAS has been unable to minimize its costs in order to compete in a regulated market. This has largely been due to its complex decision process including dominant unions keeping employee related costs high.

SAS has struggled with adopting its customer strategy according to the changes in demand towards leisure travelling following deregulation and entrance of the LCCs. An example of this is SAS periodical operations of supporting businesses e.g. hotels and limousine services. These businesses, which do not relate to SAS core business, have in general not been successful in a deregulated market; they have merely increased the cost base and made it more inflexible. One reason for the slow transformation, as is indicated in our analysis, is that SAS has not understood how to approach the growing importance of the leisure segment e.g. its unsuccessful Snowflake strategy. SAS today still claims to be increasingly addressing the leisure segment but the foundation of its network system does not, even though having undergone slight changes, differ significantly from the one applied during deregulation.

SAS has continued to apply the legacy model and an important part of its strategic development has been to expand its cooperation with other legacy carriers. This is illustrated by the development expansion of Star Alliance. SAS has also had strategic belief based on the consolidation of the market; it has therefore continuously searched for a partner but so far without success. Another important part of the legacy model that has been elaborated upon during the period is SAS EuroBonus that is today representing an important source of competitiveness.

6 Conclusions and implications for future research

This chapter will be initiated with brief conclusion of the findings of our analysis. We will then present a critical angle of the theoretical models included in our theoretical framework. The chapter continues by stating the generalizations that primarily serve as recommendations to managers and regulators participating in future deregulations. We will then provide a concluding discussion of the generalizability of our findings. Ultimately implications for future research are presented.

6.1 Conclusions of findings and discussion

Our thesis indicates that companies with a history as a state monopolist are, when their respective markets are deregulated, facing challenges on a strategic level based on their path dependency. In terms of customer strategy, a monopolist in a deregulated market bears a heritage that implies different prerequisites for competition compared to post deregulation entrants. We argue that our findings show that a deregulated market puts pressure on a former monopolist, particularly on its cost structure as you cannot longer respond to increased costs by increasing your prices since customers will then select a competitor offering a lower price. Furthermore our view is that competitors entering a market post deregulation construct their cost base from 0 and build it to 50, this while the monopolist starts from 100 and have to adapt to 50.

6.1.1 Conclusions of theoretical concepts

Developed initially in order to analyze a *nation's* competitiveness Porter's Diamond was used in our thesis to analyze empirical findings of the characteristics of the Nordic *region*. The fact that we do not use it as an analysis tool specifically in line with its original purpose might imply a problem. This since a region implies a larger set of characteristics, which might imply more complexity than the model is constructed to handle. However, we argue that the Nordic countries share characteristics relevant for this thesis, such as consumption patterns, preferences and social structure. Hence, we have found the model to be useful - specifically when looking at exogenous parameters and describing the role of government and chance within the selected region.

Regarding the use of path dependency theory we recognize that it historically has been used to analyze and describe technologies and their self-reinforcing lock-in effects. In this thesis we have used path dependency in a broader sense. We recognize that criticism towards this might be that we have taken liberty in interpreting the term in order to fit with the purpose of our research. In spite of this we have deemed that it can also be applied to business models in a strategic context since the term path dependent is very broad and have a wide span of interpretation. Also, we consider that it is of importance to note that we have used path dependency primarily to describe a negative causal chain of events and subsequent decision-making. We stress that we do recognize that the theory is also used to describe lock-in effects that are of positive nature for a company's competitiveness. This is often portrayed through companies that have managed to set a technological standard in an industry, which may imply a competitive advantage. Furthermore, to enforce our discussion on the above statements regarding the usefulness of the theory, we argue that all companies are in some form subject to path dependency. Companies are arguably always affected by decision-making -caused by chance or specific events- that are irrevocable. Decisions that often are made by bounded rationality and habits. We conclude that it is therefore a useful tool for our purpose; a key to looking at historical events, strategic decisions and their subsequent effects on the competitiveness of former monopolists.

Our analysis made through the scope of Porter's Generic Strategies resulted in a conclusion that our monopolist is to some degree stuck in the middle. We want to underline, as indicated in the theoretical section, that there supposedly are studies on companies that have managed to gain competitiveness through a more hybrid strategy in relation to Porter's framework. This may imply that being stuck in the middle does not necessarily mean being prone to failure. The monopolist may thus stand a chance at gaining competitiveness by running a hybrid strategy.

6.1.2 Methodological insights

The predominantly applied qualitative research method has served us well when investigating the matters of our research problem since we have had good access to qualitative empirical data. However, we recognize that a similar study also could benefit from a more quantitative approach. Our thesis does not to a large extent focus on measurable data in terms of statistics, financial statements etc. We consider that such approach could be useful to put in relation to our study in order to show in larger detail how the financial state of the former monopolist has

been affected by the industrial and internal development. It should be noted that we realize that a more quantitative approach would also require a more quantitative data-collecting method with more respondents and an interview design built upon measurable answers.

6.2 Generalizations

6.2.1 Implications for managers

The results of the analysis of our empirical findings have led us to conclusions regarding actions that we find recommendable for managers of monopolies when subjected to deregulation. The most important being:

- We conceive that it is important to be serious in preparations of lowering the cost base. Most likely, competition will introduce a lower price level since this is something that new entrants probably can leverage. We therefore suggest that all possible measures should be taken in order to construct a competitive cost structure. Some of the most important components of the cost structure are labor- and productivity conditions. Employees and their unions are unlikely to accept reduced e.g. compensation levels and increased productivity demands only because of general managerial based predictions of deregulation impacts. This is likely to result in opposition in terms of strikes and reduced employee satisfaction reflecting on customer experience. In order to avoid a situation where management loses the capacity of improving the company's cost structure or vice versa where employees and unions do accept these suggested improvements we want to emphasize the need for dialog. Management must be able to fundamentally explain and motivate the specific efforts needed to improve the cost structure to its employees and respective unions. This also includes describing the industrial impact of deregulation. By doing so management will increase their chances of receive understanding from its employees and thereby uniting forces, which we consider together with the company's customers, to be its most important assets. Such understanding has got the potential of enhancing the company's competitive situation and in the long run creates mutual beneficiaries.
- For the former monopolist we argue that it is important to understand that the business model applied in a regulated market might have to be adjusted or even totally

remodeled in case of deregulation. New entrants in a deregulated market are able to apply a new business model and in turn reshape the conditions for competition. Our findings have shown that this may lead to new consumption patterns and consumer behavior. Once the market is deregulated, we argue that the former monopolist cannot expect that this structure is still applicable. Instead the increased capacity for changes in demand is important. We recognize the difficulty for former monopolists to do this, in particular if the economy at the time of deregulation is strong. However, we emphasize that it is important to take competition seriously and not ignore threats and cling on to old habits and patterns too fiercely. A useful tool for gaining understanding of the aftermath of deregulation is to look at other countries where deregulation has already taken place.

- We conceive that an additional effect of market deregulation, which is implied in our findings, is the potential need for market consolidation. We argue that this also may be a tool for an improved cost base. Consolidation may be expressed by different events where the most evident from our case study is the potential benefits from merging with competitors. However, our research has shown a successful merger can be difficult to accomplish. A suggestion for preparations in order to facilitate this is to slim the organization to core operations -selling supporting subsidiary operations. This in order to aid the organizational fit between the merging partners. We believe that a company created through a merger enjoys benefits in terms of scale based cost advantages e.g. two administrations are transformed into one, only one IT system requiring maintenance etc. These effects may not be achieved by increased strategic cooperation even though there are advantages in terms of a broader market scope and a differentiation factor.

6.2.2 Implications for regulators

Our study implies that both authorities and government play a vital role in the event of deregulation. With the ambition of creating a market characterized by fair competition emphasizing the speed of innovation, a determined approach is arguably of great importance. When deregulating a market we believe it is vital to understand the sources of competitive advantage. These sources may vary depending on which business model is applied as there, unlike in a regulated market, can be different models used for competition. Based on our

empirical findings we have also drawn some conclusions that we argue may be of advice to regulators in order to make the market conditions work in accordance with the above:

- We believe that it might not be favorable to be an actor or owner while at the same time being a regulator/deregulator. This may send complex signals to market actors and consumers regarding special interests. In terms of ownership, the competitiveness of a market does not benefit from having an actor with state ownership. Conversely, neither does the competitiveness of the state owned company. State subsidies will in general only provide short-term aid and result in the company not being forced to get to the bottom of its problems. They may also distort the competitive environment of the market.
- Also, we argue that it is of importance to have a clear competition framework in place that ensures legal action against anti-competitive behavior in order to secure equal conditions for all actors within the industry.
- Lastly, our belief is that a regulator should ensure that the legal framework of the industry does not disfavor specific actors because of their strategies.

6.2.3 Concluding discussion

From a customer strategy perspective your strategy in a deregulated market, in addition to structural constraints, we conclude that it is challenging to adapt to new conditions also in terms of segmentation. Our research indicates that the most profitable segments in a deregulated market are also those that are most difficult to keep hold of in a deregulated market since all companies, including ex monopolists and new entrants, will seek to obtain to improve their margins.

Lastly, during our research for this thesis, we have reacted to implications that Swedish companies and their managements historically seem to have been strong in financial management and organizational restructuring. We argue that this might be a heritage from Sweden's solid industrial development where focus has primarily been put towards financial architecture and production. However, it is our understanding that this have vouched for less focus on product offerings and providing service desirable to the contemporary consumer. Therefore, strategies that are applied by new entrants that are changing preferences within an

industry make it hard for management to keep up with new standards. This since complex, inflexible but solid company structures has made it hard to perform swift strategic changes.

6.3 Implications for future research

Our theoretical framework was constructed, as a tool deemed useful when analyzing former monopolists being subject to competition through deregulation. We consider that its general nature, comprising a generic theory selection, makes it useful when studying other industries subjected to the same circumstances. We find it particularly useful for highlighting a chain of internal causations that are affected by external implications, e.g. state deregulation and how they in turn have shaped the monopolist's ability to be competitive. For future researchers, it would be useful to include more macro-economical factors affecting the industry in order to explain the in-depth, economical consequences of an industrial deregulation.

The problematization of this thesis has mainly been focused on market operations and three customer strategies - and subsequently the cost base related to these. In order to reach more in-depth conclusions regarding the state of the monopolist and its competitiveness it might be interesting to study more parameters and operations of the business within the cost- and organizational structure.

Lastly, it could be of interest to study the strategies and operations of new entrants in a more specific fashion. Including more concrete examples of how the most significant new entrants have gained competitiveness this would highlight their management of e.g. cost leadership and put it in a clearer contrast to the strategic patterns of the monopolist.

In spite of the monopolist's challenges related to path dependency we are convinced that these can be overcome. In the end, what it all comes down to is the managerial willingness to accept that business will never be the same after deregulation and that adjustments of the internal structure will be necessary. Those failing to do so will likely end up in the amiss of history while those succeeding stand a good chance of laying the foundation for solid future competitiveness.

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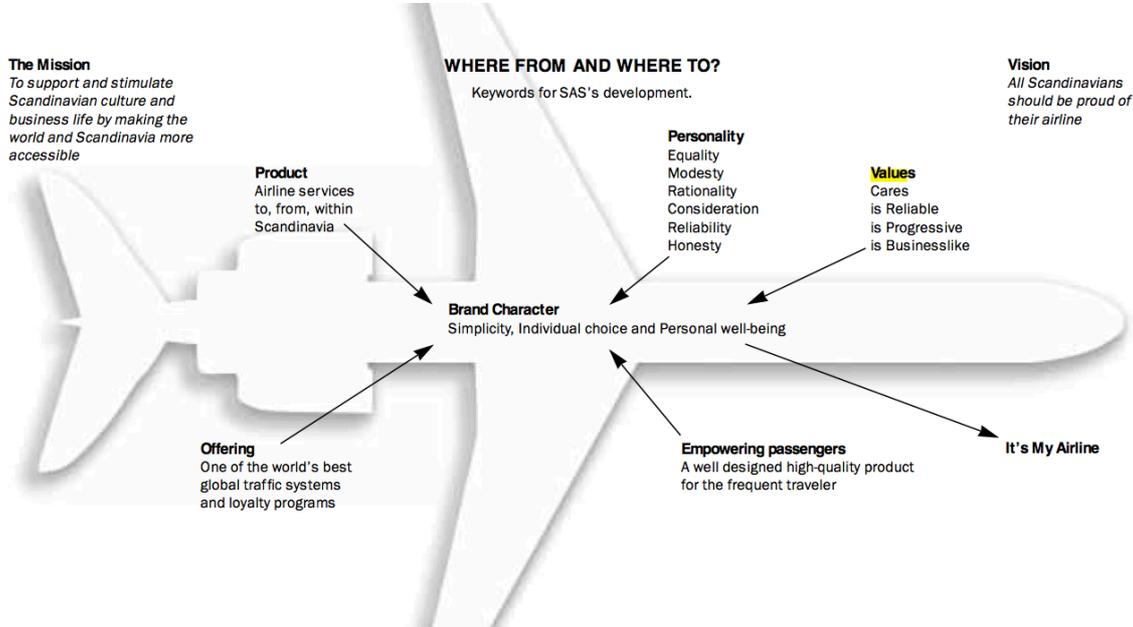
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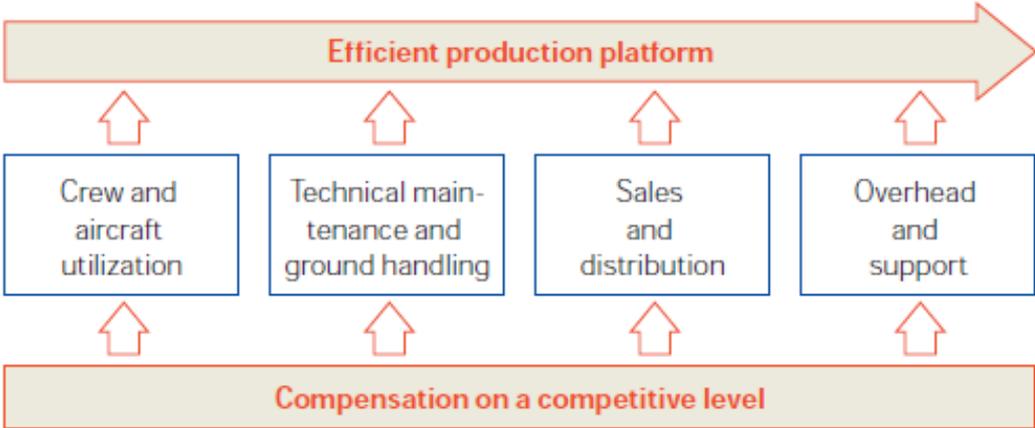
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8 Appendices

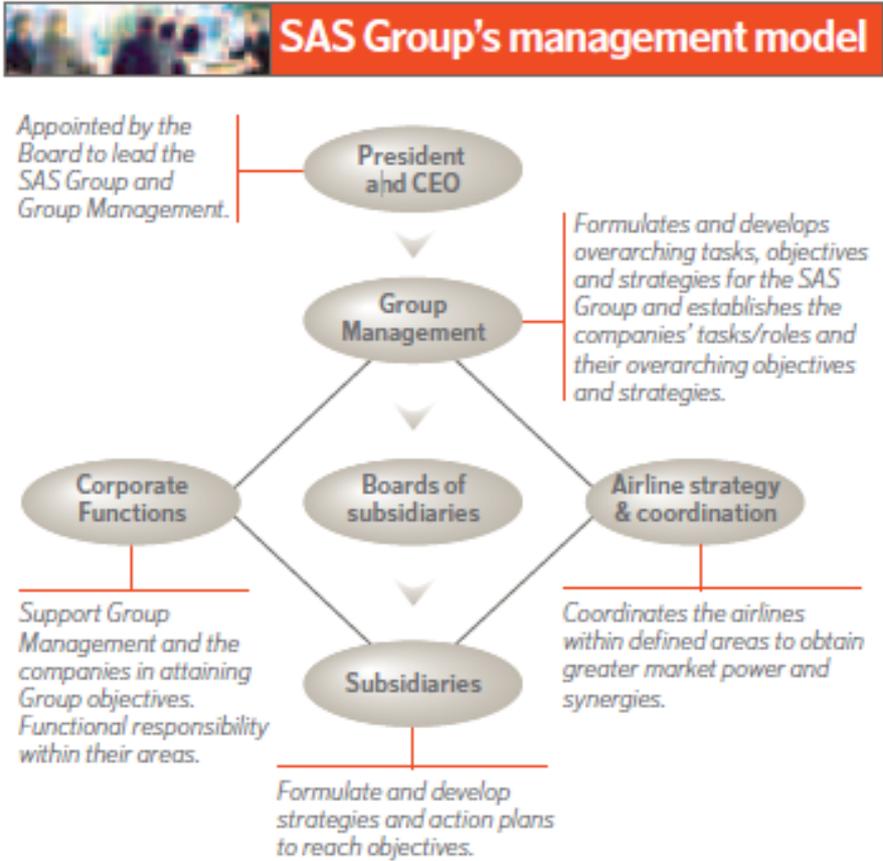
Appendix 1 - Value offer 1996



Appendix 2 - Turnaround 2005



Appendix 3 - SAS Group Management 2004



Appendix 4 - SAS Value Chain 2007

The SAS Group's commercial initiative focuses on the entire travel chain



Before the journey

At the airport

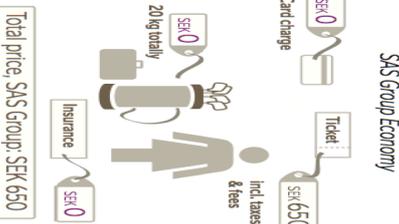
In the air

Upon arrival

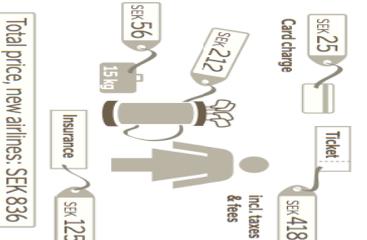
After the journey

Efficiency throughout the travel chain is crucial. Everything from convenient booking to expedited security control, efficient check-in and being treated well on board are decisive factors for choosing an airline.

What does a trip from Stockholm to Paris cost?



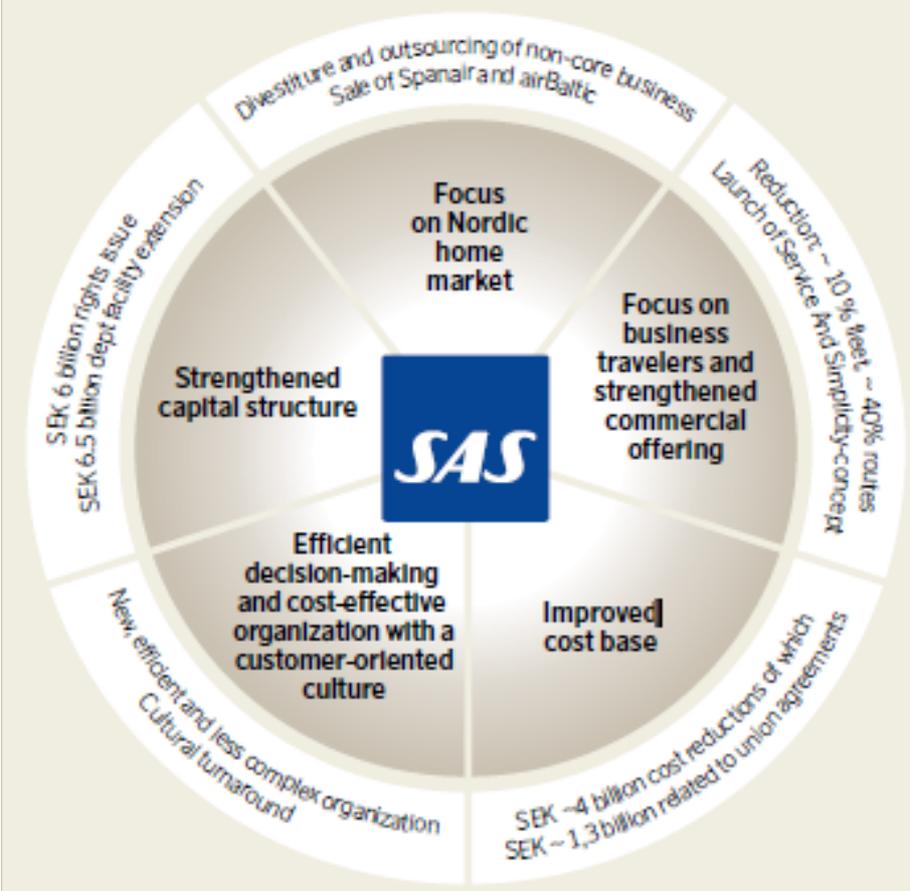
Example of a new carrier



With the new carriers it is often the case that in addition to the fare, passengers have to pay payment card charges, baggage charges etc. Flights from secondary airports often result in longer total travel times.

The price example is based on information on airline websites on March 12, 2007.

Appendix 5 - SAS Core



Appendix 6 - 4XNG

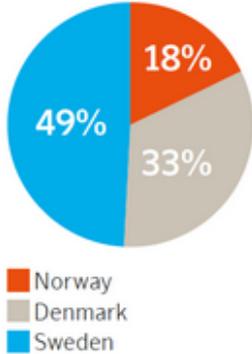
4Excellence has delivered results...

In September 2011, the 4Excellence strategy was launched with the goal of achieving excellence in four core areas by 2015 – Commercial Excellence, Sales Excellence, Operational Excellence and People Excellence. In total, about half of the measures have been implemented with a resulting earnings effect for the January–October period of about SEK 1.8 billion before nonrecurring items.

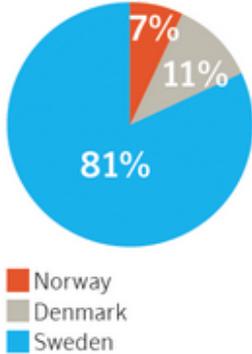


Commercial Excellence	Operational Excellence	Sales Excellence	People Excellence
Targets 2015 <ul style="list-style-type: none"> Be the first choice of Nordic business travelers Capture a significant position in leisure travel Customer satisfaction – No. 1 in Scandinavia 	Targets 2015 <ul style="list-style-type: none"> Decrease unit cost by 3–5% per year Total emissions to be reduced by 20% 	Targets 2015 <ul style="list-style-type: none"> Robust growth in contract volumes Proportion of revenue from EuroBonus members ~50% 	Targets 2015 <ul style="list-style-type: none"> Job satisfaction at SAS should be in the top 5 for the entire Nordic transportation sector
Outcome January–October 2012 <ul style="list-style-type: none"> Passenger revenue up 5.6% Customer satisfaction index 72 38 new destinations New clear SAS profile implemented on the ground Fast Track at an increasing number of airports Increased capacity in Copenhagen Smart Pass implemented throughout Scandinavia More options, for example, lounge access 	Outcome January–October 2012 <ul style="list-style-type: none"> Unit cost down 4% Multiple LEAN activities implemented Increased productivity New IT-based distribution platform Blue1 integrated into Scandinavian Airlines Increased fuel efficiency 	Outcome January–October 2012 <ul style="list-style-type: none"> New EuroBonus partners New Star Alliance partners SAS Credits now has 30,000 members A more customer-oriented and cost-efficient sales organization Investment in digital channels 	Outcome January–October 2012 <ul style="list-style-type: none"> Job satisfaction index 63 – benchmark 68 Leadership index 69 – benchmark 66 Roll-out of performance management

Geographic allocation of administrative posts, 2012



4XNG target, 2015



The future SAS organization

	2012	On completion of 4XNG
Administrative units	3 units	1 unit in Stockholm
Divestments and consolidation	Widerøe, Blue1, SAS	SAS
Distribution of employees in Scandinavia	Sweden 30% Norway 34% Denmark 36%	38% 31% 31%

Appendix 7 - Intervjumall Jan Carlzon

- Vad var din roll inom SAS och hur länge arbetade du inom bolaget?
- Hur ser du idag på arbetsfördelningen mellan styrelse, ägare och dig, under din tid som koncernchef?
- Hur upplevde du de statliga ägarnas roll och inflytande?
- Ser du en konflikt mellan det kunddrivna och kostnadsbesparingar (om man skär i kostnader så betyder det oftast att man ger kunden mindre)?
- Anser du att man måste ha ett tydligt strategiskt fokus eller kan man tillämpa flera olika strategiska fokus?
- Vad utmärker SAS strategi som monopolföretag jämfört med om SAS från början hade agerat på en fri marknad.
- Finns det något du anser i efterhand att man borde ha gjort annorlunda när ni insåg att avregleringen skulle genomföras?
- Vad gäller kundsegmenteringen var ni väldigt fokuserade på business-segmentet och att bli business man's airline. Hur kom det sig?
- Hur är din syn på de strategiska allianser SAS har ingått?

Appendix 8 - Intervjumall Mats Lönnkvist

- Vad är din roll inom bolaget och hur länge har du arbetat inom SAS?
- Hur ser du på fördelningen och inflytande mellan styrelse, ägare och ledning?
- Upplever ni ofta att ni får med styrelsen på det ni vill göra?
- Hur märks det statliga ägandet av?
- Hur har SAS övergripande strategier präglats av det faktum att man en gång var i monopolsituation?
- Hur tror du att SAS strategiska fokus hade sett ut om man SAS varit utsatt för konkurrens redan från början?
- Med facit i hand - finns det strategiska aspekter som man borde ha genomfört annorlunda?
- Hur har skiftet från fokus på affärsresenärer till privatresenärer påverkat utgångsläget? Vilket segment bör man fokusera mer på?
- Tror du att man kan ha en bredare strategi, dvs. bedriva både lågkostnads och affärsfokuserad samtidigt?
- Vad skulle du säga är SAS konkurrensfördelar gentemot lågkostnadsbolagen och tvärt om?

Appendix 9 - Intervjumall Elisabeth Bylund

- Vad var din roll inom bolaget och hur länge arbetade du inom SAS?
- Det finns dem som hävdar att bolagiseringen som genomfördes i början av 2000-talet har varit en avgörande faktor för utvecklingen inom SAS. Hur ser du på det?
- Finns det några exempel på strategiskt beslutsfattande som direkt har påverkats av SAS ställning som monopolaktör, efter det att marknaden avreglerades?
- Finns det exempel på sådant man inte har kunnat göra?
- Hur har arbetssätt och processer påverkats av att man en gång varit monopolaktör?
- Bör man under 1980-talet ha tagit tydligare tag i kostnader då man insåg att avregleringen skulle äga rum?
- Förändrades kundsegmenteringen under din tid på SAS och i så fall hur?
- Hur skall SAS fortsättningsvis möta konkurrensen från lågkostnadsbolagen?
- Hur har lågkostnadsbolagen ändrat preferenserna för flygresor?
- Är människor fortfarande beredda att betala lite mer för bättre service inom flyget?
- Hur viktigt har Star Alliance varit för att klara konkurrensen?
- Hur viktigt har EuroBonus varit som kundstrategi betraktat?
- Hur anser du att SAS bör positionera sig för framtiden?

Appendix 10 - Intervjumall Peter Forssman

- Vad var din roll inom SAS och hur länge arbetade du inom bolaget?
- Vad anser du har utmärkt SAS övergripande strategi utifrån det faktum att man - innan avregleringen - hade en monopolposition. Hur anser du att dessa strategier hade sett ut om man endast agerat på en öppen marknad?
 - Exempel på strategiska beslut.
 - Vilka specifika, bakomliggande faktorer låg till grund för dessa beslut?
 - Med facit i hand, vad anser du att man kunde ha gjort annorlunda för att gynna SAS?
- Från ett kundstrategiskt perspektiv, hur har SAS arbetat under din period som anställd?
 - Hur har bolaget segmenterat mellan olika kundgrupper och hur har denna segmentering förändrats? Varför?
 - Hur har SAS strategi för medlemskap i- och utformning av strategiska allianser sett ut? Varför valde man den typen av alliansstrategi?
 - Hur har man inom SAS arbetat med lojalitetsprogram och vilken funktion fyllde de?
 - Hur upplevde du att SAS utvecklade sina kunderbjudanden i form av kringtjänster inom respektive segment under din period?
 - Vilket område bör SAS - ur en strategisk synpunkt - fokusera på för att stärka sin position? Vilka kunder, vilken marknad etc?
- Upplevde du under din tid på SAS att bolaget präglades en allmän uppfattning att man hade ett ansvar som tillhandahållare av hög tillgänglighet vilket inverkar på bolagets val av destinations/nätverksstrategi?

Appendix 11 - Intervjumall Mats Mitsell

- Vad var din roll inom SAS och hur länge arbetade du inom bolaget?
- Hur har det statliga inflytandet påverkat SAS förmåga att skapa konkurrenskraftiga strategier efter avregleringen?
- Vad anser du har utmärkt SAS övergripande strategi utifrån det faktum att man - innan avregleringen - hade en monopolposition. Hur anser du att dessa strategier hade sett ut om man endast agerat på en öppen marknad?
 - Exempel på strategiska beslut.
 - Vilka specifika, bakomliggande faktorer låg till grund för dessa beslut?
 - Med facit i hand, vad anser du att man kunde ha gjort annorlunda för att gynna SAS?
- Från ett kundstrategiskt perspektiv, hur arbetade SAS arbetat under din period som anställd?
 - Hur har bolaget segmenterat mellan olika kundgrupper och hur har denna segmentering förändrats? Varför?
 - Hur har SAS strategi för medlemskap i- och utformning av strategiska allianser sett ut? Varför valde man den typen av alliansstrategi?
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- Upplevde du under din tid på SAS att bolaget präglades en allmän uppfattning att man hade ett ansvar som tillhandahållare av hög tillgänglighet vilket inverkar på bolagets val av destinations/nätverksstrategi?

SAS - monopolistens dilemma

Delar av samhällsdebatten de senaste åren har präglats av förhållandevis negativa ordalag kring de tidigare Svenska monopolföretagens roll i Sveriges marknadsekonomiska system. Man har närmast dagligen kunnat läsa om SJs stillastående tåg och Telias korruptionsskandaler. Den mest allvarliga situationen förefaller dock råda inom SAS där konkurshot varvas med nya sparpaket och nedskärningar för att hålla bolaget i luften. SAS historia och bolagets tidigare ställning som monopolist har onekligen ett finger med i spelet kring den problematik som råder.

SAS etablerades som ett konsortium mellan de Skandinaviska staterna Danmark, Norge och Sverige under efterkrigstiden och kom under följande årtionden att utvecklas till ett mycket tekniskt framstående flygbolag. Bolaget var pionjärer på interkontinental trafik och var tidiga med att utnyttja jettflygplanens kapacitetsfördelar. Styrkan i att producera en stark reseapparat i kombination med utebliven konkurrens på den reglerade flygmarknaden hade dock lett till ett förminskat kundfokus och serviceerbjudande in slutet av 1970-talet.

I början av 80-talet rekryterades därför Jan Carlzon till VD-stolen. Jan Carlzon blev känd för sitt citat "vi brukade flyga flygplan och det gjorde vi väldigt bra och nu måste vi lära oss att flyga människor". SAS gick igenom en omorganisation som i huvudsak innebar att mer ansvar gavs till serviceleden. Tanken var att fokus, resurser och ansvar skulle läggas på den personal som var i direkt kontakt med kunden. Jan Carlzon ansåg att det var just mötet med kunden som var själva reseerbjudandet och kärnan i verksamheten. Det viktigaste kundsegmentet under denna period ansågs vara affärsresenären varför företagets erbjudande främst riktades mot dessa. SAS var nu mer ett servicebolag än ett produktionsbolag vilket var en lyckosam strategi som ökade bolagets popularitet och banade väg för enorma framgångar under de kommande åren.

I slutet av 1980-talet insåg man dock inom ledningen att den Svenska flygmarknaden var på väg att avregleras. Flygexperten Niklas Sandberg kommenterar händelseförloppet: "- Man hade sett det ske i USA och man visste att den Europeiska Unionen hade diskuterat en eventuell avreglering av den Europeiska flygmarknaden. SAS ledning insåg att detta skulle ändra förutsättningarna och att följderna skulle bli en konsolidering av marknaden."

Under flera årtionden hade SAS byggt upp en stor och komplex organisation som belastades av allt högre personalkostnader och förminskad effektivitet. Dessa allt trögare strukturer hade fått goda förutsättningar att växa sig starka tack vare den bristande konkurrensen och starka förhandlingsstyrkan hos de olika Skandinaviska fackorganisationerna. Man stod uppenbart dåligt rustade för att möta den konkurrens som en avreglering skulle innebära.

Ledningen hade blickat mot händelseutvecklingen i USA och kunde identifiera att det stora hotet för de gamla monopolbolagen hade kommit att bli de så kallade lågkostnadsbolagen (Low Cost Carriers – LCC). Sandberg förklarar: "-Ledningen insåg vidare att SAS skulle vara tvunget att genomföra mycket stora kostnadsrationaliseringar i det fall lågkostnadsbolagen skulle etablera sig på den Nordiska marknaden. Man förutspådde att man skulle behöva reducera sin kostnads massa med upp till 50 % för att kunna bli konkurrenskraftig"

En snabb titt på flygmarknaden idag ger en tydlig bild av att farhågorna besannats. Marknaden har konsoliderats och gruppen som representerar lågkostnadsbolag med bland

annat Ryanair och Norwegian i spetsen, har med sin låga prissättning penetrerat marknaden och satt ett enormt tryck på SAS traditionella affärsmodell. SAS arv från att tidigare ha varit en monopolaktör har satt tydliga spår i organisationen och försvårat anpassningen till de nya marknadsstandarderna. Som svar på detta har SAS kontinuerligt sökt möjliga fusionspartners men utan framgång. Istället har man utvidgat det operationella samarbetet med andra aktörer genom en strategisk allians, Star Alliance i vilken man även integrerat bolagets lojalitetsprogram, EuroBonus.

"Lågkostnadsbolagen har på ett framgångsrikt sätt lyckats ändra preferenserna inom flygnäringen. Resenärer har inte längre lika höga krav på service eller bekväma flygstolar. Det viktigaste är att komma från A till B så billigt som möjligt." berättar Henrik Karlsson, ledande expert och författare inom lågkostnadsflyg.

Den nya affärsmodellens intåg i kombination med den snabba förändringstakten har pressat SAS att genomföra förändringar i både organisation och kunderbjudande. En stor del av dessa förändringar har varit mycket svåra eller till och med omöjliga att genomföra mycket på grund av den kostnadsstyngda och ineffektiva organisationen. Ett tydligt exempel är SAS försök att upprätta ett lågkostnadskoncept, Snowflake. Genom att skapa ett nytt varumärke och sälja resor till konkurrenskraftiga priser försökte man utmana lågkostnadsbolagen. Eftersom Snowflake belastades av samma kostnadsstruktur som övriga SAS uppdagades det relativt omgående att modellen inte var lönsam varför konceptet lades ned efter drygt ett år.

På detta sätt har SAS fortsatt att påverkas av sitt arv från att ha varit monopolist. Bolagets nuvarande strategi bygger mycket på att tag i de förmånliga arbetsvillkoren och förbättra effektiviteten. Det återstår emellertid en stor mängd åtgärder för att skapa konkurrenskraft. Detta samtidigt som lågkostnadsbolagen får allt starkare fäste i den Nordiska marknaden och fortsätter att skapa nya preferenser på marknaden.

SAS representerar svårigheten för en tidigare monopolist att anpassa sig till nya marknadsförutsättningar vilka aktualiseras vid en avreglering. Generellt ligger svårigheten för monopolisten att anpassa sin kostnadsstruktur till en marknad med fri konkurrens. Grupper av aktörer vilka äntrar marknaden efter avregleringen har vitt skilda förutsättningar att optimera sin kostnadsstruktur från 0 till 50 samtidigt som monopolisten ska göra resan från 100 till 50. Det viktiga för ledarna för dessa bolag är att vara öppna för förändringar i efterfrågans karaktär då nya aktörers affärsmodeller kan komma att påverka denna. Även lagstiftarens roll är central då denne ansvarar för att upprätthålla innovationsfrämjande konkurrens samtidigt som måste undvika att enskilda aktörer bestraffas på grund av faktorer i deras affärsmodeller. Dessutom finns en uppenbar problematik i att vara lagstiftare samtidigt som man är majoritetsägare i en enskild aktör. En sådan struktur gynnar varken förtroendet som lagstiftare eller aktörens strategiska manövreringsutrymme.

Att som monopolist övergå till en avreglerad marknad kan visa sig svårt precis som i SAS fall. Trots detta är det långt ifrån omöjligt att lyckas. Nyckeln till att lyckas ligger i att som företagsledare var införstådd med att en sådan övergång villkorlös kommer att förändra den forna monopolistens förmåga att konkurrera. Således måste man vara öppen för förändring och våga ta beslut som bidrar till att anpassa organisationen till de nya förutsättningarna. Monopolister vilka misslyckas med detta kommer med stor sannolikhet försvinna från marknaden antingen genom att de köps upp eller genom konkurs. Alternativet är monopolisten som är öppen för förändringar och därmed tillvaratar sin egen potential att bli en konkurrenskraftig aktör även på en avreglerad marknad.

2013-05-22

Nikrik Karlberg