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PLUMMETING FROM THE SKY: THE DECLINE OF ALITALIA

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Abstract

This case discusses the decline of the Italian airline Alitalia. It sheds light on Alitalia's financial problems, caused by its cumbersome relationships with the government and labour unions and a continuous lack of strategic positioning following the disruptive entry of new players in the Italian aviation industry. The case covers the most recent developments that have led to Alitalia's bankruptcy in 2017 and ends with a case-study situation in which the reader is challenged to find a new positioning strategy and partner for Alitalia to ensure a profitable future.

Keywords: Alitalia; low-cost carrier; legacy carrier; positioning strategy

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Plummeting from the Sky: The Decline of Alitalia

Alitalia is like lazarus with a double heart bypass. It's dead but won't lie down
- Andrew Charlton, aviation analyst

In May 2017, Alitalia's employees refused to agree with a reorganization plan that would cut 1700 jobs, decrease salaries by eight percent and inject two billion Euro to save the airline in need. The proposal was Alitalia's management last hope to avoid a bankruptcy procedure, which was started shortly after the employees' dismissal. The main shareholders and the Italian government had already stated their unwillingness to provide further structural investments. The result was the appointment of three commissioners who, supported by a 600 million Euro "bridge-credit" from the government, were tasked with finding a way out of the crisis. Starting with a public tender, interested parties could express their plans and submit a non-binding bid until mid-June 2017, where after negotiations were planned to enter a more advanced stage. If these six months did not yield a new owner, Alitalia's assets would be liquidated.

The bankruptcy procedure provided the commissioners with a new episode in the turbulent history of Italy's national pride. A history that had cost the taxpayer more than 10 billion Euro, mostly due to inefficient business models, strong labor unions and a protective government. New entrants on both sides of the spectrum had disrupted the market and had left Alitalia *stuck in the middle*. After years of hardship, a glimmer of hope emerged when Abu Dhabi's Etihad Airways acquired Alitalia and promised to restore profitability within three years by investing in both service levels and routes. Three years later Etihad stopped funding, leaving many surprised about what had gone wrong and if there even was a future for Alitalia. As the commissioners went through the list of bidders two main questions arose: *which strategy would Alitalia have to pursue to finally succeed in the international skies? And which partner would be the most suitable?* Was it time Alitalia would convert into a low-cost carrier or was there still an option of continuing as a legacy carrier operating all over the globe? Perhaps a hybrid strategy would be successful to restore profitability. The commissioners prepared themselves for an extensive analysis.

Alitalia: a national symbol

Alitalia has a long and rich history that started just after the Second World War on September 16th, 1946, when it was founded in Rome by the Italian government and the British airline BEA, later rebranded as British Airways. Aerolinee Italiane Internazionale was the result of a joint investment operation of around one million British pounds with shared ownership. The first operations started in 1947 when a full passenger plane flew from Turin to Rome Ciampino. During the first couple of years the main routes were the ones between Milan and Rome and Turin and Rome. However, Alitalia also operated its first international flight in 1947, when a Savioia Marchetti SM95 successfully landed at Oslo airport with 30 passengers on board (Historic Wings, 2012). One year later in 1948, multiple destinations in the Americas and Europe were added to Alitalia's routes. Due to these impactful developments, Alitalia soon became *Italy's symbol of optimism in the era after the Second World War*. Nevertheless, the company ran losses in its first four years and passenger levels were stuck at around 75.000 (Historic Wings, 2012). In the fifties, Alitalia pioneered the aviation industry in an attempt to become profitable. Its entire post-war fleet was replaced by state of the art airplanes such as the McDonnell Douglas DC-3 and DC-4. With four propellers, a bigger fuselage and a pressurized cabin, airplanes began to take the shape of airplanes we know today. Moreover, the airline introduced female cabin members dressed in designer outfits, and in-flight services such as hot meals. These measures resulted in an improved financial performance in the first half of the fifties, which motivated the management to renew the fleet again by introducing the DC-6, DC-7 and Convair 340. In 1957 the company merged with fellow Italian airline Linee Aeree Italiane and continued to use this name. An implication was that the fleet grew substantially to 40 planes and routes amounted to 10 million kilometers (Historic Wings, 2012). Due to the merger, Alitalia became the 12th largest airline at the time. However, the airline kept on suffering losses in the end of the fifties. In 1959 there had not been a single year in its history in which Alitalia had recorded a profit. The sixties saw a gradual expansion of Alitalia's network in North America, South America and Europe. For the first time the airline passed the one million passengers a year threshold. This increase in passengers coincided with the introduction of jet-engines, which made many overseas destinations less than one day away. Alitalia introduced the McDonnell Douglas DC-8, DC-9 and the Sud Aviation Caravelle in its fleet. The sixties also marked a change in hub (main airport) as operations were moved from Rome Ciampino to the new Rome Fiumicino airport. In 1960, Alitalia gained international recognition as the official carrier of the athletes during the Olympic Games in Rome. Four years later an official agreement with the pope was signed in which Alitalia ensured responsibility for all his flights. That same year, 1964, Alitalia founded daughter carrier Aero Transport Italiani (ATI) that focused on connecting the North and South of Italy. In this decade Alitalia entered the top three of European aviation and more importantly became *fully owned* by the Italian government as the British shareholder was bought-out. Despite the lack of profitability, skies were blue for Alitalia in the seventies and eighties. Alitalia kept its leading role in aviation by adding new entertainment features, designer cutlery, contemporary cabin art and new outfits for its stewardesses. Substantial investments were made in long-haul routes to North America for which the brand-new Boeing 747 jumbo jet and the McDonnell Douglas DC-10 were purchased. Because of this, Alitalia was the first airline not to operate any propeller planes (Mohanty, 2004). The fleet was further updated by the Boeing 727 and Airbus A300 to operate shorter flights more efficiently. In the beginning of the eighties Alitalia founded a second daughter airline named Aermiditerranea, that mostly intended to fly domestic routes. This contributed to passing the 10 million passenger mark for the first time in history in the mid-eighties. At the beginning of the nineties, Alitalia transported almost 25 million passengers to 66 countries around the world (Mohanty, 2004).

Heavy turbulence ahead: stuck in the middle

Problems in the domestic market started to emerge in the second half of the nineties with the entry of the low-cost carriers (LCCs) Ryanair and EasyJet. These airlines were founded in the eighties and nineties, following the deregulation of the global, and thus Italian airspace, formalized in the "*open skies agreement*". Previously regulated by the government, this agreement made it relatively easy and cost-efficient to start an airline and operate in multiple countries. The LCCs' business models revolved around reducing costs to an absolute minimum, by letting customers pay for every extra on board, and by minimizing turnaround times to cover a maximum number of flights per day. The result was a cost advantage of around 50 to 60 percent and thus the possibility to offer much lower fares (Mohanty, 2004). See **EXHIBIT 1 and 2** for an extensive explanation of aviation terms and the low-cost and legacy carrier business model. Alitalia, as a legacy carrier, was still charging premium prices and offered premium services. On some routes Alitalia's prices could exceed Ryanair's fares by factor ten. Alitalia's response was Alitalia Team, a daughter airline that had to compete in both Italy and the rest of Europe with the low-cost rivals. The aircraft and personnel both stemmed from ATI, a former regional subsidiary, and Alitalia itself. However, lower wages of the cabin crew and pilots and more flexible working hours had to reduce costs. The plan was to gradually absorb the parent company's assets and personnel to create a leaner structure, by moving operations to Alitalia Team. This last factor led to tension among the work force and another subsidiary was launched in 1997 under the name Alitalia Express, operating a much smaller fleet suitable for regional flights (Mohanty, 2004). Alitalia soon *found itself stuck in the middle,* see **EXHIBIT 3**. On intercontinental flights, it lost customers to the likes of KLM, Air France, British Airways and Lufthansa, airlines that offered a higher service level and better routes (Mohanty, 2004). In the domestic and European market, Italy's pride lost market share to the low-cost entrants. The fares and cost structure could simply not match those of the rivals, as many employees had old contracts with the parent company. At the turn of the millennium, Alitalia was bleeding money as losses amounted to €170 million in 2000 (Mohanty, 2004). The situation deteriorated even further due to the improvement of Italy's high-speed train connection, which hurt the domestic market substantially. Even worse, the terrorist attacks on 9/11, the Iraq war and concerns about the SARS disease, resulted in a decline in passengers of about 25 percent in the months following 9/11 compared to the year before. Passenger levels on flights to the United States and Canada were almost halved following the turmoil. In the Italian market Alitalia was losing its dominant position as its market share declined from 75 percent in 1996 to 50 percent at the beginning of

2003 (Mohanty, 2004). The government still had a majority stake in the airline that carried 25 million passengers a year. The beginning of the millennium also marked a new strategic partnership as Alitalia joined the *SkyTeam*, an alliance between carriers like Air France, KLM and Delta Air Lines founded to increase their route offer by code sharing their destinations. Other motives were the participants' increase in leverage when negotiating deals with suppliers of fuel, insurances, ground operations and airport slots.

Mayday-Mayday: government, please help!

Alitalia soon found itself in a situation of overcapacity. To respond to the drastic decline in demand, Alitalia decreased its capacity by 20 to 30 percent, mainly by cancelling intercontinental routes. To solve the excessive labour force problem, management came up with a two-year plan in 2001 that proposed to lay off 4000 employees, decrease working hours and wages accordingly (so-called solidarity contracts), cut more routes and decrease quality of services on board (Mohanty, 2004). Labor unions strongly opposed to the proposal and demanded the government to step in. Their wish was a *high-quality restructuring instead of a slimming down operation,* demanding investments in routes, hubs and service level. The government and labor unions agreed on a €1.5 billion injection and favorable fiscal conditions for both company and employees. However, management and labour unions disagreed on the employee conditions. They finally settled on a soft-measured plan that agreed on an extra €370 million injection from the government that would not come at the expense of any job losses (Mohanty, 2004). The new plan led to big trouble as the company's cost structure was highly uncompetitive. High fares, high wages and too many employees added to Alitalia's bills. At the beginning of the decade yearly losses were almost a billion, coming close to a bankruptcy. This led to a similar proposal by the management in 2003, namely 2700 job cuts and 1500 solidarity contracts for the next two years. The response of the labour unions was furious, encouraging strikes and again demanding full competitive restructuring instead of downsizing. The position of the government made the situation worse by backing the labor unions and demanding *routes to and from Italian cities remained untouched*. President Berlusconi deemed the proposal as unacceptable because of its *national importance*. Finally, another soft-measured agreement was reached aimed at cutting an extremely low amount of jobs and re-energizing the company. The new agreement pushed Alitalia even further away from its legacy competitors, also due to the entrance of the high-class Gulf carriers: Emirates, Qatar Airways and Etihad Airways. Airlines with unlimited financial means, ready to fight for market share on routes from Italy to Asia, the Middle-East and Africa. Their strategy was to connect the east and west of the world by building massive hubs in their home countries. Also, because of the open skies agreement, they began serving North America from Italian bases. Due to their aggressive strategy, they quickly became dominant on the eastern international routes from Italy, exorcizing Alitalia on many occasions. Next to that, the LCCs were becoming more and more dominant in Italy as their market shares on many routes surpassed those of Alitalia. Aviation specialists still blamed Alitalia's cost structure, pointing at overstaffing of pilots and cabin crew and an old and inefficient fleet. Allegedly, the cost structure of legacy competitors was about 30 to 40 percent lower, while low-cost competitors had an advantage of almost 60 percent (Mohanty, 2004). Alitalia soon found itself running out of cash reserves. The government, once again, decided to intervene by providing a €400 million loan and by injecting almost €1.5 billion in capital by issuing new bonds in 2005. Direct government support was abolished in 2006 by the European Commission. Subsequently, the government tried to privatize 49.9 percent of its ownership, but on the condition that *no job cuts were made and Alitalia's routes, brand and Italian identity would persist*. Air France-KLM agreed to pay almost €750 million for Alitalia, raise another billion in capital, invest in routes and networks and preserve the Italian identity of the company. The government of Romani Prodi and the board of directors agreed on the French-Dutch offer, but the potential deal had agonized multiple labour unions and they reacted with several counter offers. Air France-KLM was unwilling to adhere to these counter offers and pulled out of the deal. Next to that, incoming president Berlusconi had already indicated that he would veto any "arrogant French-Dutch takeover action" and made it an important issue in his campaign. Meanwhile, Alitalia resorted to another €300 million emergency loan from the government to remain its license for the next year. This loan was investigated by the European Union. Romani Prodi and his successor Silvio Berlusconi made another attempt to save Italy's pride, this time by appointing the Italian bank Intesa Sanpaolo to find a new financial structure for the company. The plan that was proposed in August 2008, stated that Alitalia should file for bankruptcy and should divide the company into two legal parts. The first one would contain the debt plus 46 old aircraft and would be liquidated. The second part would contain Alitalia's main assets such as the landing slots, routes, pilots, top aircraft and ground operations. This part would be merged with fellow troubled Italian airline "Air One" and would be bought and receive an injection of €1 billion from a consortium of 15 companies, among which Intesa itself and state-owned Poste Italiane. Another €625 million in debt was taken over by the government. The new company would shed 3200 employees as the result of a reorganization by the Compagnia Aerea Italiana (CAI) consortium. Moreover, wages would be cut by one fourth and most employees' salaries would be variable, based on productivity. Alitalia filed for bankruptcy at the end of August 2008, entering a new round of negotiation with the labour unions. The labour unions were agonized by the proposed measures and rejected the plans, however they were not backed by the government this time. Berlusconi's government stressed the *symbolic importance of its flag carrier* and ruled out the possibility of a foreign airline performing Alitalia's operations in Italy and abroad. After several withdrawals by both CAI and the labour unions and multiple improved plans to lay off fewer workers, an agreement was reached on September 29th, 2008. In the press statement following the relaunch agreement, President Berlusconi expressed his warm feelings: "*Due to the brave consortium of 15 companies, our national airline will be secured for Italy. In this way, tons of tourists will visit our country. Our airline will take them to our coastal cities. Not to France, not to the castles along the river Loire"*.

The new Alitalia: healthy or still lazarus?

After Air France-KLM had announced to invest a further €325 million to obtain a 25 percent stake, Alitalia's flight operations were resumed on January 13th, 2009. Rome-Fiumicino remained a hub, while the Milan-Malpensa hub was replaced by Milan-Linate. Alitalia Express together with Air One CityLiner, was rebranded into Alitalia CityLiner, which received a completely new fleet of Embraer 175s and 190s. Even though forecasts were optimistic, the new Alitalia went on to record big losses. Passenger levels increased by 11 percent until 2012, the load factor increased to almost 75 percent and punctuality also improved, see **EXHIBIT 4**. Operating costs went down until 2012, but then the market turned against Alitalia (CAPA, 2013). The European aviation market had suffered tremendously from the global economic crisis and subsequent Euro crisis. Next to that, fuel prices reached an all-time record, which had a big influence on the costs. Due to Alitalia's risky position, it paid premiums on fuel prices, aircraft leasing and insurance contracts. Alitalia was fighting a battle at multiple fronts: (1) *In the European and domestic market*, LCCs Ryanair and EasyJet had once more responded by cutting fares and the domestic high-speed train connections had become an even better alternative to air travel. The business market was also affected by improvements in videoconferencing. (2) *On intercontinental routes*, the Gulf carriers offered a very high service level and strong route offer, outcompeting the most respected legacy carriers from Europe by a great margin. The European legacies were trying to fight back by upgrading their services. This snowball effect was not doing Alitalia any good. Even though its cost-base was not uncompetitive compared to other legacy carriers, *the average sector length ("distance-positioning") was too low to spread out these costs,* see **EXHIBIT 5**. This implied Alitalia was positioned in no-man's land: *neither truly a network carrier with a significant long-haul operation, nor truly a short-haul point-to-point carrier with a competitive cost base* (CAPA**,** 2013). Hence, Alitalia was suffering from both a "value-positioning" problem and a "distance-positioning" problem. Its busiest routes were mostly domestic, where competition was fierce from LCCs. The main international routes went to other European airports, where travelers connected through hubs of competing airlines to international destinations, see **EXHIBIT 6.** This last point indicated Alitalia's lack of a competitive international route offer and structural underinvestment (CAPA, 2013). Moreover, *Alitalia's lack of value-positioning meant it had gotten even further stuck in the middle*, see **EXHIBIT 7**. Alitalia's only move to remain competitive, was to write-off €91 million in planes and replace it with 55 new aircraft, which were predominantly leased (CAPA, 2013). See **EXHIBIT 8** for Alitalia's financial performance in the first years after the privatization. Soon finding itself in a liquidity crisis, the troubled airline borrowed €150 million from its shareholders in the beginning of 2013 and completed a stock emission at the end of 2013 that yielded another €300 million. Despite everything, Alitalia was still the largest carrier of Italy and the domestic market, but two-third of its revenue came from international flights (CAPA, 2013). With losses amounting to a billion Euro in 2012-2013 and a nervous consortium, it was obvious Alitalia needed to make a strategic choice regarding its value-positioning and distance-positioning.

Flying high: the Etihad merger

In 2014, Abu Dhabi's carrier Etihad Airways decided to invest €560 million in Europe's 11th biggest airline and pay another €400 million to obtain a 49 percent share, which left the majority stake with the Italian consortium. Roughly an additional billion Euro in capital and debt restructuring had been provided by the consortium and other Italian financial institutions. Etihad mainly completed the deal because Alitalia could provide access to the European market, still dominated by the European legacy carriers. With this deal, Etihad enlarged its routes by offering direct and connecting flights to its existing operations. It was part of a larger expansion plan in which Etihad took equity stakes in other airlines to form a large alliance against the existing competition. Etihad's plans with Alitalia were to reposition them as a *global premium airline, by reinforcing its quintessentially Italian image: the history, culture, food and passion* (Etihad, 2014). The plans were optimistic; 2000 employees were fired to reduce costs. Etihad wanted to invest in the hubs Rome-Fiumicino, Milan-Linate and Milan-Malpensa, *to increase Alitalia's long-haul offer*. Rome-Fiumicino, Alitalia's most important airport, would see investments in new long-haul routes to Santiago, Mexico City, San Francisco, Beijing and Seoul. Frequencies to Abu Dhabi were to be increased to feed Etihad's operations, and more weekly flights to New York, Rio and Chicago were scheduled. Furthermore, new short-haul routes would be added. At Milan-Linate, flight schedules were optimized to have better connectivity with hubs of partners (CAPA, 2014). Moreover, there would be more new routes to Asia and the Gulf from Malpensa, where Alitalia's presence was very limited. Alitalia would also benefit from increased connectivity with Etihad's other partners in the equity alliance and direct flights from Venice, Catania and Bologna to Abu Dhabi were planned. For the first time in history, *some domestic routes were structurally discontinued*. Moreover, some routes to Africa and Asia were discontinued, as they could be served from the Abu Dhabi hub by Etihad. To respond to the changed route offer, *the airline increased its long-haul fleet by a third* and transferred part of its short-haul fleet (and options) to the Etihad alliance. Further cost savings were to be realized through synergies with the equity partners in terms of maintenance, catering, ground operations, training, fuel and IT systems (Etihad, 2014). Alitalia's employees would be trained by Etihad regarding etiquettes and languages (Financial Times, 2017). Finally, Etihad aimed at reinforcing the Italian brand by improving the catering services and the lounges at airports. When presenting the merger in 2014, Etihad CEO James Hogan summarized the business plan and stressed the fact that Alitalia had to be profitable in 2017. It was obvious that the airline had to get rid of its dependency culture.

Flying low: the Etihad merger

When addressing the merger at a press conference in early 2016, Etihad CEO James Hogan admitted that the reorganization and revitalization of Alitalia proved to be a difficult one, but stated that the airline was still "en route" to profitability for the year 2017. One year later, Alitalia was again on the verge of bankruptcy after suffering major money losses. *The upgrade of Alitalia's long-haul routes to the Middle East, Asia and the Americas, the rationalization of the domestic offer, the increased service level, new cost synergies and strong re-branding had not worked.* The expected increase in passenger levels had never materialized and Ryanair had surpassed Alitalia as Italy's biggest airline. See **EXHIBIT 9, 10 and 11** for the development in available seats, routes and passengers. While Alitalia even recorded negative growth, Ryanair had grown by more than 25 percent between 2014 and 2016 in the Italian market. The load factor was only 75 compared to Ryanair's 95 (Wall Street Journal, 2017). Also, the other Gulf carriers, Qatar and Emirates, were exponentially expanding in Italy, making it the second most attractive

European market for the them, see **EXHIBIT 12**. Alitalia's explanation for the appalling results was that the terrorist threat in Europe had a significant influence on the European market. However, there were bigger problems. In the years following the merger, *only six new intercontinental routes had been added*, *while there was still growth in non-profitable European routes* (2%), leaving Alitalia badly positioned on distance as it was before the merger (Wall Street Journal, 2017). *Alitalia was still in a fierce battle as 54% of its flights were domestic, and 70% of the routes it operated were dominated by LCCs*. **EXHIBIT 13** painfully reflects Alitalia's overrepresentation in uncompetitive routes, compared to its main rivals. Etihad's hesitation to invest and the strategic impasse created by former agreements with SkyTeam members made expansion in North America and the rest of the world very difficult, while competition to the east was huge from the other Gulf carriers. Etihad admitted that Alitalia needed a *more rigorous restructuring* since the cost structure was still not competitive. This was partly the result of employee expenses and expensive fuel and lease contracts, as a result of Alitalia's risky situation (Wall Street Journal, 2017). Moreover, due to European regulation, Etihad was only allowed to have a maximum stake of 49 percent. Managing Alitalia from the Middle East showed that Etihad underestimated the country's tangled politics and chronic labour strife (Reuters, 2017). Etihad's strategy of aligning multiple networks of troubled airlines to feed its Abu Dhabi hub turned out to be unsuccessful. In March 2017, Alitalia's board approved a new four-year plan that would have to return the company to profitability in 2019. The CEO stressed the importance of Alitalia's complete network as the *short-haul operations are indispensable to feed Alitalia's profitable long-haul operations*. Therefore, the former had to become more competitive and the latter had to be expanded. *The business model for flights of less than four hours would be adjusted to the low-cost model,* see **EXHIBIT 2**, meaning that customers have to pay for any extras on board such as seat selection, cabin luggage, amenities and food. Next to that, turnaround times would be decreased, more seats would be fitted and fares would be cut to match those of rivals (Alitalia, 2017). However, preferences could be tailored by the introduction of multiple classes in the cabin. The service on long-haul flights would be improved with new entertainment features and interiors. To finally reduce the cost base, Alitalia planned to lay-off 1700 employees and decrease the wages of the remaining workforce by eight percent. Furthermore, contracts regarding aircraft leasing, fuel, ground operations, catering and airport rights would be renegotiated (Alitalia, 2017). The short-haul fleet would be decreased by 20 planes and the long-haul fleet slightly enlarged to serve new and existing profitable routes to the Americas more frequently, made possible by leaving the joint venture with Delta Air Lines and Air France-KLM. All the measures combined should increase revenue by 30 percent and decrease costs by €1 billion in 2019. Shareholders planned to recapitalize the company with €2 billion.

Diverting towards profitability

At the end of April 2017, roughly 70 percent of Alitalia's 12.500 employees voted against the proposed plans. Etihad's willingness to inject new capital depended on the result of the vote. One week later, Alitalia officially entered a stage of special administration, in which three commissioners were appointed to find a way out of the crisis. Their main concern was to ensure a feasible future for Alitalia. The government also provided a €600 million bridge-loan to keep Alitalia in the air until a new owner was found. The commissioners received the first non-binding offers in June and the first binding offers in October 2017. They indicated that they preferred to sell Alitalia "as a whole" to avoid parties skimming the more promising parts of the company (Financial Times, 2017). The situation proved to be a chance to change Alitalia once and for all, because the labour unions were sidelined more than ever. If no new owner was found, Alitalia's assets worth €900 million would be liquidated. The debt amounted to roughly 2 billion Euro. The commissioners were puzzled by the different candidates, and the main questions that arose were the ones that dealt with the strategy and partner for Italy's troubled pride. It was clear that a distinction needed to be made between the short and the long-haul operations, for which each candidate offered a specific ***value-positioning strategy***. *(Low, High)* in this case means the low-cost model for short-haul, and the legacy carrier model for long-haul. Moreover, each interested party also comes with a certain focus on ***distance-positioning***. The assumption is made that Alitalia will remain a separate brand, owned by a partner airline.

(1) The first potential partner, **Ryanair,** embodies the (***low, low) strategy***, ***with the main focus on short-haul***. The Irish airline had disrupted the market in the nineties with its low-cost model and is now the most successful and profitable in Europe, more than double the size of Alitalia. As its operations are limited to the European market, Ryanair would be a good network fit since Alitalia is still strongly represented in Europe, see **EXHIBIT 6 and 13**. Flights between Italy and important European hubs, now mostly served by legacy carriers would provide the LCC with the opportunity to let Alitalia feed the long-haul operations of its strategic partners, a new phenomenon in its business model. This would generate high demand for Alitalia's short-haul. Furthermore, Alitalia would benefit from Ryanair's high market power in Italy, as it is a very important market for the LCC, see **EXHIBIT 14**. Ryanair almost fully rules Milan-Bergamo and offers 69 domestic routes, indicating its interest in the Italian market. Furthermore, the configuration of the fleet with 95 out of 121 aircraft being short-haul, see **EXHIBIT 15**, favors a scenario in which the partner is specialized in short-haul. The cost base, which has been one of Alitalia's biggest problems, could also be improved because the company could bring in the *necessary cultural change*, for which it has become famous by imposing the low-cost model. The question however remains if this is possible, given the history of losses on short-haul routes. The necessary transition will probably also dilute the brand of Alitalia, certainly on long-haul, as it is still associated with its pioneering role in the past and higher quality compared to LCCs. As Alitalia is only sold "as a whole", Ryanair also has to deal with the long-haul operations and 26 aircraft, with which it has no experience. These routes are the most profitable routes, but the network will deteriorate as the connections provided by Etihad's network will disappear. The *LCC lacks scale when it comes to long-haul* and large investments are needed, which could also include building up a partner network. Its ability to do so remains questionable, given the current semi-premium value proposition of Alitalia's long-haul offer. The upside is that the LCC can feed Alitalia's long-haul flights with its impressive network, generating more demand.

(2) The second potential partner is **Etihad Airways**, the former equity partner (49 percent) of Alitalia and this represents the hybrid (***low, high) strategy, with the main focus on long-haul***.

As CEO James Hogan indicated, both short and long-haul operations are indispensable for Alitalia and this requires rigorous investments. With the labour unions more or less sidelined, Etihad could provide this capital and restructuring with its unique financial position, like no other airline. The measures taken in the last years clearly point at the increased importance of high-service long-haul operations, such as the fleet development, service transformation and route offer. The question is whether these upgrades would be good enough to compete with other legacy carriers. Alitalia's cost structure is most suited for long-haul and a strong network is critical with regards to this, see **EXHIBIT 5**. Despite the limited increase in long-haul operations until 2017, Etihad could from 2018 onwards dramatically increase the route offer as Alitalia's Joint Venture on the North Atlantic was abandoned. The plans *to sober up short-haul* as listed above, are promising to restore competitive balance in the European and domestic market by adopting a low-cost attitude. Also, the *knowledge that the Gulf carrier obtained about Alitalia* speaks its favour, as well as the willingness to keep Alitalia's legacy alive on long-haul. However, there would be several drawbacks to this scenario, as Etihad proved to be unable to bring the necessary cultural change in the past. The fact that Etihad can only obtain a 49 percent stake, and therefore needs European partners, makes it only harder to end the dependency culture. Next to that, trust issues with the workforce are likely to arise as 70 percent of the employees recently rejected the Gulf carrier's plans. The Gulf carrier has its own problems in the equity alliance, as daughter airline Air Berlin faces bankruptcy problems and many European legacy carriers are coming after the airline supported by high profits following low oil prices.

(3) The third potential scenario is the (***high, high) strategy with a balanced focus***, that could be implemented with **IAG**, a consortium under the leadership of British Airways that consists of Spanish legacy carrier Iberia, Aer Lingus and LCC Vueling. IAG is one of the three big players in the European market. Iberia was saved by the consortium in 2011 and successfully restructured to return to profitability three years later. The Iberia case shows a striking resemblance with Alitalia, as the main problems are similar: an uncompetitive cost structure due to overstaffing in combination with strong labour unions, a deterioration of strategic positioning, uncompetitive routes, a weak network and below average service levels. The IAG group managed to improve Iberia's brand value by improving all the aspects mentioned, both short and long-haul, reinforcing its historical differentiated strategy. Hence, the consortium showed to be able to deal with labour unions, restructuring operations, routes restoration and repositioning. Due to these similarities, IAG is an interesting candidate. However, since the Spanish market is less competitive than the Italian market, would a premium experience work on short-haul? Alitalia and Etihad had previously shown that the Italian customer was not convinced by this approach. For a legacy positioning on long-haul operations, drastic investments are needed to restore profitability, risking substantial amounts of money while still being outperformed. Nevertheless, with Iberia, IAG had shown that this was possible. However, there is another option within the IAG consortium, which is called the ***(high, low) strategy with a balanced focus***. IAG had responded to market disruptions in the long-haul market by launching LCC *LEVEL*. The business model of *LEVEL* is similar to short-haul LCCs and is mainly a response to LCC Norwegian.com that gained market share on touristic transatlantic flights due to extremely low prices. *LEVEL* operates from Barcelona, while Alitalia's modern en efficient long-haul fleet is well suited to perform similar transatlantic operations from an Italian base. The consortium could ensure that the base is fed adequately and Alitalia could make use of the strong network. It remains questionable whether a *differentiated* strategy for short-haul and *focused low-cost* strategy for long-haul would do the brand any good. At the same time, the long-haul low-cost carriers are disrupting the market fundamentally. In some years' time, choosing for premium on long-haul could seriously backfire, like Alitalia experienced before in the domestic and European market. Maybe the time is just right to implement this strategy.

The commissioners were puzzled by the multiple options that had presented themselves. They had to act fast as Alitalia was exhausting the bridge-credit that was provided by the government. Therefore, they quickly had to decide on the right partner to ensure a bright and profitable future for Alitalia. But which partner can provide a future with blue skies and no turbulence?

Teaching Note “Plummeting from the Sky: The Decline of Alitalia”

Case synopsis

The case begins by informing the student about Alitalia’s bankruptcy in 2017. It gives the student the perspective of the bankruptcy commissioners that are tasked with finding a way out of the crisis. The case then goes back in time by describing Alitalia’s national importance, which is critical in understanding later decision making. Alitalia’s first financial and positioning problems in the late nineties are spelled out, and they are analyzed with a special focus on the entry of LCCs in the domestic and European market. The case continues by describing the vicious triangle between Alitalia, the labour unions and the government, which made restructuring almost impossible in the first decade of the century. At the same time, the impactful entry of the Gulf Carriers in the Italian market is discussed. The case goes on by describing Alitalia’s bankruptcy in 2008 and its performance after its relaunch in 2009. The focus is then transferred to Alitalia’s merger with Etihad Airways in 2014. Subsequently, Alitalia’s recurring problems are analyzed, together with the most recent developments that have led to the special administration in which Alitalia is situated. Finally, the case informs the student to consider the short and long-haul strategy separately and goes on by outlining the plans of the three main bidders in the process: Ryanair, Etihad Airways and International Airline Group (IAG).

Case objectives

This case can be used in an intermediate level course in strategic management in both Bachelor and Master programs, to highlight issues faced when it comes to *strategic positioning of large international enterprises* such as airlines. For Nova SBE, this implies the courses “Advanced Strategy” and “Corporate Strategy” in the MSc program. The case also aims to equip students with the *fundamental knowledge to understand the forces that are at stake in the aviation industry*. As the industry is expected to double in size in the next 20 years, it becomes at some point inevitable to offer students the possibility to follow a course in aviation management. This course could be a newly designed course at Nova SBE, taking position as an elective in the curriculum. Lastly, the case also tries to shed light on the *stakeholder view of strategy*, in particular how the interference of external parties, such as labour unions and the government, can interfere with strategic decision making, which resulted in Alitalia's dependency culture, high costs and lack of strategic leadership.

Supplementary readings

- **Budd, Lucy, and Stephen Ison**. 2014. *Low-cost Carriers: Emergence, Expansion and Evolution*. Abingdon: Taylor Francis Ltd.
- **Dostaler, Isabelle, and Triant Flouris**. 2006. "Stuck in the Middle Revisited: The Case of the Airline Industry." *Journal of Aviation/Aerospace*, 15 (1): 33-45
- **Mohanty, Dakshi**. 2004. *Alitalia: The Airline in Trouble*. IBSCDC No. 304-381-1. Cranfield: The Case Centre
- **Shaw, Stephen**. 2011. "Airline Business and Marketing Strategies" in *Airline Marketing and Management*, 85-162. Farnham: Ashgate Publishing Limited

Case discussion and analysis

The questions for class discussion presented below are interlinked and follow a logical sequence. Question 1 challenges the student to get a comprehensive overview of the case and is in line with the objective to get the student acquainted with the fundamental knowledge of this industry. Question 2 and 3 form the problem-solution backbone of the case and are linked to the objective to inform the student about problems regarding strategic positioning. Question 4 is optional and deals with the stakeholder view of strategy, which widens the scope of question 3.

1. Over the past 20 years, the Italian aviation industry underwent some fundamental changes, of which Alitalia was the main victim. Analyze the industry attractiveness of the Italian market in the given period, taking these changes into consideration.

- First of all, the student has to mention the fundamental changes in the Italian aviation industry, namely the disruptive entry of LCCs at the low end and the Gulf carriers at the high end of the spectrum. To understand the impact of these developments he has to look at the changed market shares in the Italian market; the decline of Alitalia and the rise of the LCCs and Gulf-carriers.

- *To gain a holistic understanding, Porter's five forces framework,* see **EXHIBIT A***, should be introduced to shed light on all factors that are at stake*. **New entrant threat**: the deregulation of the European, and thus Italian, airspace in the 80s and 90s, made it much easier for new-found LCCs to enter the industry. They were often overlooked by many legacy carriers (Alitalia in

Italy) and quickly gained market share. Examples in the Italian market are Ryanair and EasyJet. A decade later, the Italian market was targeted by the Gulf carriers. The capital-intensive nature of the industry formed no problem for them, since they had unprecedented financial means at their disposal to target, among others, the Italian market *(HIGH)*. **Substitute threat**: as mentioned in the case, the improvement of Italy's high-speed train connections became a valid alternative for air travel, lowering demand between the main cities on the mainland. Briefly mentioned, improvements in telecommunications may have had an influence on the business traveler segment, as videoconferencing became a cheap alternative *(MEDIUM)*. **Buyer bargaining power**: this has increased with the entry of LCCs in Italian market. With little differentiation power, ticket price and timeliness became the main modes to compete. To respond to the increased domestic demand following the entry of the LCCs, legacy airlines had to react by cutting their fares at least to some extent on shorter flights. To illustrate the striking difference, the student should refer to the massive price gaps between Alitalia and LCCs at the end of the millennium. The substantial improvements in service-level offered by the Gulf carriers also changed the industry, by setting new industry standards on long-haul flights, which most other airlines needed to adopt to satisfy customers *(HIGH)*. **Supplier bargaining power**: The main LCCs operating in the Italian market benefited from discounts they received when ordering a large number of planes at once, as mentioned in **EXHIBIT 2**. Newly formed alliances at the turn of the millennium such as Alitalia's SkyTeam and later Etihad's equity alliance improved airlines' bargaining position vis-à-vis its suppliers. However, as discussed in the case, many airlines, among which Alitalia, still paid too much on their leasing, insurance, operations and fuel contracts, indicating significant power on the side of the suppliers *(MEDIUM)*. **Industry competition**: industry competition has increased with the entry of Ryanair, EasyJet and the Gulf carriers in the Italian market. The development in market share, see **EXHIBIT 9 and 10**, proves the changed and more competitive Italian aviation landscape. Also, the fact that the relatively uncompetitive Alitalia lost most of its market share, despite several instances of government support, is a strong indicator of a more competitive and diverse Italian aviation landscape.

- Overall, the industry attractiveness of the Italian market seemed to have decreased over the given period. Most of this can be attributed to the emergence of new players on the battle field that changed the competitive dynamics.

2. Alitalia's financial problems over the years were partly due to a continuous lack of strategic positioning in the industry. What were these positioning problems and what could have been done to improve this?

- First of all, it should be mentioned that Alitalia has historically been positioned as a legacy carrier, following a differentiation strategy. *To obtain a more conceptual insight, Porter's generic strategies model should be introduced*, see **EXHIBIT B**. Then, referring back to question 1, the student has to start by addressing the first issues that arose in the end of the nineties with the entry of Ryanair and EasyJet, airlines that followed a cost leadership strategy. On the one hand, there was Alitalia's inability and unwillingness to cut cost. On the other hand, there was structural underinvestment in routes and service, which meant that Alitalia was losing track of its legacy competitors. (1) Value-wise Alitalia was stuck in the middle, as depicted in **EXHIBIT 3**: neither following a cost-leadership strategy nor a differentiation strategy. Alitalia's main mistake in this early stage was to completely underestimate the impact of the LCCs. Despite the impasse created by the government and labour unions, a stronger strategic direction, either up or down should have been chosen. Then the student has to mention that due to this impasse and wrong positioning, Alitalia saw the aviation market fragment even further, see **EXHIBIT 7**. The case discusses that Alitalia was pushed even further into the "stuck in the middle positioning" due to the increase in differentiation by the Gulf carriers and the undercutting of LCCs.
- Next to that, it is absolute pivotal that the student mentions another problem, namely (2) Alitalia's inability to either position themselves either as a short-haul carrier or a true long-haul network carrier. It is important that the student notices that the two problems are interlinked, as explained by **EXHIBIT 5 and 6**. In 2012, Alitalia was stuck in no-man's land and its cost base was not competitive for its *"distance-positioning"*. However, it was competitive for a long-haul positioning. Alitalia was lacking long-haul scale and most of its operations were limited to the competitive Italian and European market. Etihad, after acquiring Alitalia in 2014 should have chosen for a clearer strategy that integrated both positioning problems in a coherent manner.

- The situation described in the years following the Etihad merger, highlights the problematic interplay perfectly. The student has to mention that Etihad attempted to choose for a (1) *differentiation strategy (value) on both short and long-haul*, and (2) *to move-up on "distance-positioning" towards long-haul*. The measures that were allegedly taken: more long-haul routes, fewer short-haul routes, more long-haul planes, better service levels and re-branding had not worked to solve any of the two different positioning problems. (1) Travelers were not convinced by Alitalia's new services and passenger numbers even showed a slight decrease, indicating that Alitalia was unable to cross the gap to the main legacy competitors. On short-haul routes, LCCs remained more popular. Next to that, not enough was done to move up on the (2) "distance-positioning". Alitalia was still overrepresented in the non-profitable home and European market, with only a share of 16 percent in intercontinental operations. This was much too low, as compared to the main European legacy rivals, see **EXHIBIT 13**. Although Etihad had a constructive plan, many circumstances prevented Alitalia from obtaining a clear positioning.

3. Analyzing Alitalia's situation in 2017, which strategy does Alitalia need to pursue to become profitable? Which partner would be most suitable to implement this strategy? Do not forget to make a distinction between short-haul and long-haul as mentioned in the case.

- This question is the natural follow-up of the previous one. The student has to mention the main problems of Alitalia's strategy/positioning, discussed in the last part of question two. We should also note that the current situation is rather static, and dramatic change can only be obtained in the medium-long run. The most logical approach is to start formulating the best strategy for both short and long-haul, where after the pros and cons of the candidates are listed. **EXHIBIT B** can be used again to clarify the possible positioning opportunities.

- For the short-haul operations, which we define here as the Italian and European market, it seems very unlikely that a differentiation strategy (high) can return Alitalia to profitability. As mentioned, on 70 percent of Alitalia's routes competition is dominated by a LCC, which symbolizes the traveler's unwillingness to pay for a premium experience. With its differentiation strategy, Alitalia has been loss-making on these routes in the past and even Etihad, after 3 years of experience, concluded that this strategy on short-haul did not work out. Moreover, as Alitalia's operations are still 85 percent short-haul, the result of following this strategy could again prove to be disastrous. Italy's domestic market is also the most competitive in Europe. The negative aspect of following a cost-leadership strategy is that it clashes with Alitalia's historical legacy positioning and potential misalignment with a more premium strategy on long-haul. This can be solved by introducing different classes in the cabin on short-haul, as proposed by Etihad.

– For the long-haul operations, the positioning decision is a bit more ambiguous. As mentioned, Alitalia is actually making a profit on most intercontinental routes and the cost-base is already competitive, which also indicates that the relative lack of quality is not the main issue. The lack of scale is the main problem. The long-haul market is still less affected by low-cost airlines, despite the new long-haul low-cost model that is gaining popularity. On long-haul, service levels and routes are the main modes of competition. Rationalizing this service by imposing the low-cost model, see **EXHIBIT 2**, also on long-haul and offering no connections by flying point-to-point is likely to deter many travelers. It would also not align with Alitalia's historical positioning. However, the long-haul low-cost model, as indicated, is not to be underestimated. It would ensure uniformity in the value proposition. On top of that, making the same mistake as Alitalia did in the past in the short-haul market, could seriously backlash. Hence, both types of positioning could be defended by the student.

- Coming to the partner choice, the student should immediately observe that option (3) IAG is not likely to suit Alitalia's optimal strategies discussed above. Despite the experience and advantages of IAG, a differentiation strategy on short-haul is not likely to be successful, so the success of the ***(high, high)*** and ***(high, low)*** strategies is questionable. Moreover, a balanced focus between short-haul and long-haul is also not likely to solve the "distance-positioning" problem. However, the options should still be discussed in class as there are many interesting features to these strategies. This leaves us with option (1) Ryanair and (2) Etihad Airways. The student has to sum up the pros and cons as explained in the case, after which a class discussion should follow.

- Ryanair ***(low, low)*** **and main focus on short-haul**, as indicated, would be a very strong fit mainly due to its strong position on short-haul flights in the Italian and European market and Alitalia's fleet configuration. The main focus on short-haul also provides a strong direction.

Alitalia would very much benefit from Ryanair's high market power. Next to that, and not to be underestimated, Ryanair could end the dependency culture that was greatly responsible for many financial issues. Alitalia's legacy image would suffer from this scenario, but uniformity is ensured with the (low, low) strategy. The main friction lies in the long-haul operations. Ryanair has zero experience when it comes to this, lacks the network and partners, and its "no-fringe" model could end up as a success or a disaster. This choice is defendable, but comes with high uncertainty.

- Etihad Airways ***(low, high)*** **and main focus on long-haul,** would also be a strong fit. It understands that a cost-leadership strategy on short-haul is needed and, as mentioned, came up with a strong plan to implement this. It would also be the only partner that is willing to increase both quantity and quality of the profitable long-haul operations, solving the "distance-positioning" issue. On top of that, it is more capable than Ryanair on long-haul with a very strong network and has great financial means. It also has three years of experience in managing Alitalia. However, it proved to be unable to change Alitalia's positioning before and trust issues with employees are likely to arise. Moreover, the maximum stake of 49 percent and the carrier's own problems with the equity alliance are factors that do not speak in its favour. Content-wise Etihad would probably be the best option, but the mediocre conditions discussed here could cause significant problems.

4. Alitalia's case highlights the importance of the stakeholder view of strategy. Identify the main stakeholders, their salience and potential influence in the commissioners' choice by mapping their position for each option.

- This question widens the scope of the previous question by introducing the various stakeholders in the process. It gives the instructor the possibility to increase the difficulty of the case by incorporating the stakeholder view of strategy theory.

Recommended reading:

- **Mitchell, Ronald K., Bradley R. Agle and Donna J. Wood.** 1997. "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts." *The Academy of Management Review,* 22 (1): 853-886

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- **CAPA - Centre for Aviation**. 2013. "Alitalia battles for survival in 2013, despite operational improvements." Accessed September 21, 2017. https://centreforaviation.com/insights/analysis/alitalia-battles-for-survival-in-2013-again-despite-operational-improvements-99946
- **CAPA - Centre for Aviation**. 2015. "Alitalia's new strategy realigns it to feed Etihad, but needs to change loss-making mindset." Accessed September 22, 2017. https://centreforaviation.com /insights/analysis/alitalias-new-strategy-realigns-it-to-feed-etihad-but-needs-to-change-lossmaking-mindset-206345
- **CAPA - Centre for Aviation**. 2014. "Etihad & Alitalia agree and affirm their partnership vision. Protectionist voices will become louder." Accessed September 21, 2017. https://centreforaviation .com/insights/analysis/etihad--alitalia-agree-and-affirm-their-partnership-vision-protectionist-voices-will-become-louder-181662
- **CAPA - Centre for Aviation**. 2016. "Alitalia's network benefits from Etihad partnership. Now time to shed dependency culture." Retrieved September 22, 2017. https://centreforaviation.com/insights /analysis/alitalias-network-benefits-from-etihad-partnership-time-now-to-shed-the-dependency-culture-278771
- **CAPA - Centre for Aviation**. 2017. "Alitalia: defying gravity again – another loss, another turnaround plan, maybe another last chance." Accessed September 30, 2017. https://centreforaviation.com /insights/analysis/alitalia-defying-gravity-again-another-loss-another-turnaround-plan-maybe-another-last-chance-334681
- **CAPA - Centre for Aviation**. 2013. "Alitalia buys time with its new four-part 2013-2016 industrial plan, part 1." Accessed September 15, 2017. https://centreforaviation.com/insights/analysis/alitalia-buying-time-with-its-new-four-part-2013-2016-industrial-plan-part-1-118038
- **Etihad Airways**. 2014. "Alitalia and Etihad finalise €1758 million investment deal." Accessed September 22, 2017. http://www.etihad.com/en-gb/about-us/etihad-news/archive/2014/alitalia-and-etihad-airways-finalise-1758-million-investment-deal/
- **Historic wings**. 2012. "Italian wings: Alitalia." Accessed August 2, 2017. http://fly.historicwings.com /2012/09/italian-wings/
- **Holloway, Stephen**. 2008. *Straight and Level: Practical Airline Economics.* Abingdon: Taylor Francis Ltd.
- **Mohanty, Dakshi**. 2004. *Alitalia: The Airline in Trouble*. IBSCDC No. 304-381-1. Cranfield: The Case Centre
- **Politi, James, and Tanya Powley**. 2017. "Alitalia to favour bids for whole company." *The Economist*, August 1. https://www.ft.com/content/8143cdf8-76c9-11e7-a3e8-60495fe6ca71
- **Reuters**. 2017. "New Etihad boss to rethink strategy after Alitalia dream fails." Accessed September 30, 2017. https://www.reuters.com/article/us-etihad-strategy-analysis/new-etihad-boss-to-rethink-strat egy-after-alitalia-dream-fails-idUSKBN1872F3
- **Shaw, Stephen**. 2011. *Airline Marketing and Management*. Farnham: Ashgate Publishing Limited
- **The Wall Street Journal**. 2017. "Alitalia's Turnaround Strategy is a Flop." Accessed September 30, 2017. https://www.wsj.com/articles/alitalias-turnaround-strategy-is-a-flop-1489240801

Appendix “Plummeting from the Sky: The Decline of Alitalia”

Exhibit 1: Definition of the aviation terms used throughout the case

Code sharing	A practice commonly observed in airline alliances. Multiple airlines sell tickets for the same flight, which is operated by only one of the partners
Cost per passenger	One of the most popular measures of operating efficiency in the aviation industry. Sometimes the term CASK is used as cost indicator. CASK = operating costs / available seat miles (flight distance * airplane seat capacity)
Distance-positioning	The positioning either as a short-haul carrier or network carrier (short and long-haul). The average flight length in kilometers can be used to classify airlines in this regard
Ground operations	Is a collective term that includes activities such as catering, passenger services, cargo and airplane handling
Hub	Main airport in an airline’s network to transfer passengers to other airports in its network. “Connecting through a hub” means that the traveler changes airplanes at the hub on the way to his final destination
Legacy carrier	See **EXHIBIT 2**
Load factor	A measure of efficiency that quantifies the aircraft utilization. Defined as the percentage of seats filled
Long-haul	Generally conceived as flights longer than 4000 kilometers. In the case of Alitalia this mainly relates to intercontinental flights with the exception of Northern Africa and the near East
Low-cost carrier (LCC)	See **EXHIBIT 2**
Pax	Number of passengers
Point-to-point	The notion of directly flying to a destination, without the need to connect through a hub. It is the opposite of the network model and is often used by low-cost carriers so save costs on luggage handling and schedule optimization
Short-haul	Used in the case to indicate flights shorter than 4000 kilometers. Sometimes the term “medium-haul” is used to classify the sub-range of flights between 1500 kilometers and 4000 kilometers. In Alitalia’s situation, short-haul refers to domestic and European flights, including Northern Africa and the near East
Slot	Designated time frame purchased by an airline, which allows for take-off or landing at a certain airport
Turnaround time	The time the aircraft spends on the ground in between two flights. This is affected by catering, cleaning, luggage handling, boarding and disembarking
Value-positioning	The positioning either as a low-cost carrier or a legacy carrier. The inability to do so results in a “stuck in the middle” positioning

Source: Own work

Exhibit 2: The low-cost versus legacy carrier business model

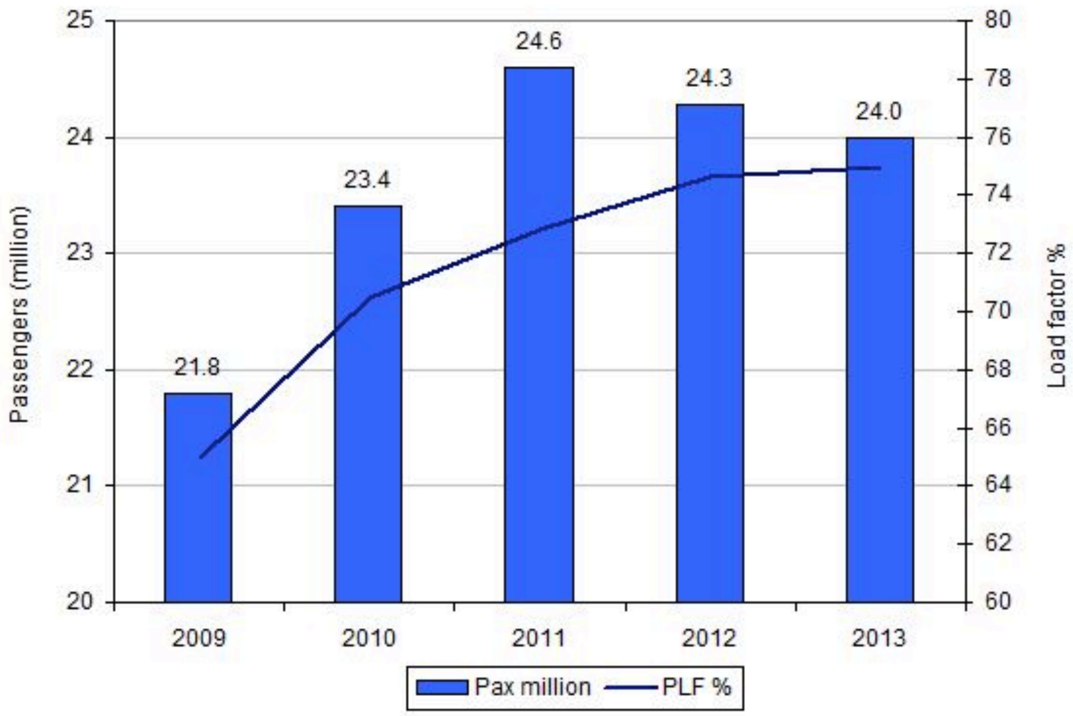
Low-cost business model *Ryanair, EasyJet, Vueling*	**Legacy carrier business model** *KLM, Air France, British Airways, Lufthansa*
• Focus on single flights within Europe, without offering connecting flights (point-to-point) to reduce operational costs and save time • Maximization of daily flights by quick turnaround times • Mainly flying to secondary airports to reduce landing and take-off fees. Some airports might even pay LCCs to land and depart since they bring traffic • Second-tier slots schedule • Only one type of aircraft in the entire fleet to reduce maintenance costs • Placing large airplane orders to receive substantial discounts • Limited leg room to increase passenger levels and no adjustable seats to minimize defects • No hospitality included, food and drinks can be purchased on board together with perfumery and lottery tickets • Booking and check-in done online to limit commission to travel agencies • Additional fees for luggage check-in • Cabin crew cleans the cabin in between flights to limit turnaround times • Limited number of seats for business travelers with no special services • Lower salaries and more flexible contracts for employees • No compensation for employees' hotel expenses • Cost-oriented: advantage between 40%-65% vis-a-vis legacy carriers	• Focus on both European and intercontinental flights, offering connections (with partners) to cover entire routes • Alliances with other legacy carriers • Slower turnaround times and special cleaning teams to increase perceived service level • Flying to primary airports during the most popular slots • Operating multiple types of aircraft in the fleet • Relatively spacious leg room and baggage allowance more lenient • Hospitality included and source of differentiation • Focus on business travelers i.e. multiple classes in the cabin • Loyalty programs and business lounges for frequent flyers and business travelers • More overhead costs and more bureaucracy in headquarters • Employees' hotel expenses are often covered • Involved in cargo transportation and owner of multiple ground operations • Service-oriented

Source: "Straight and Level: Practical Airline Economics". Stephen Holloway. 2008.

Exhibit 3: Perceptual map of the European aviation industry at the turn of the millennium

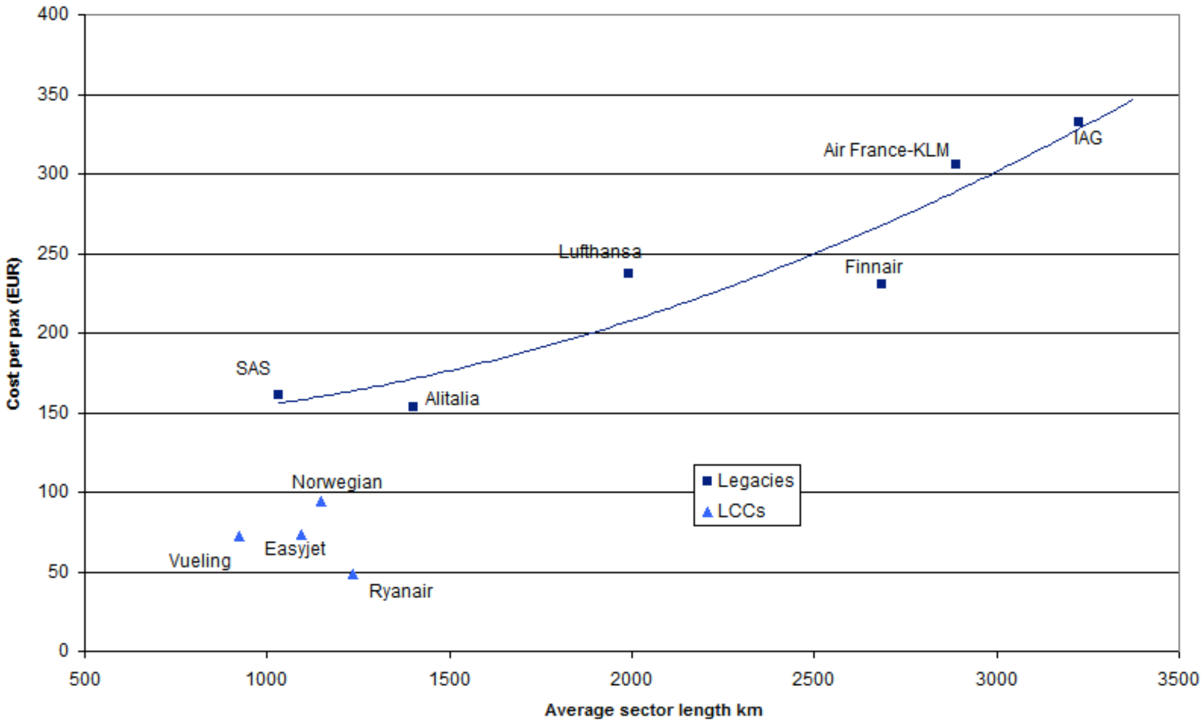
Source: Own work

Exhibit 4: Alitalia's passenger numbers and load factor between 2009 and 2013



Source: CAPA – Centre for Aviation, Alitalia. 2015.

Exhibit 5: Cost per passenger versus average sector length in 2012

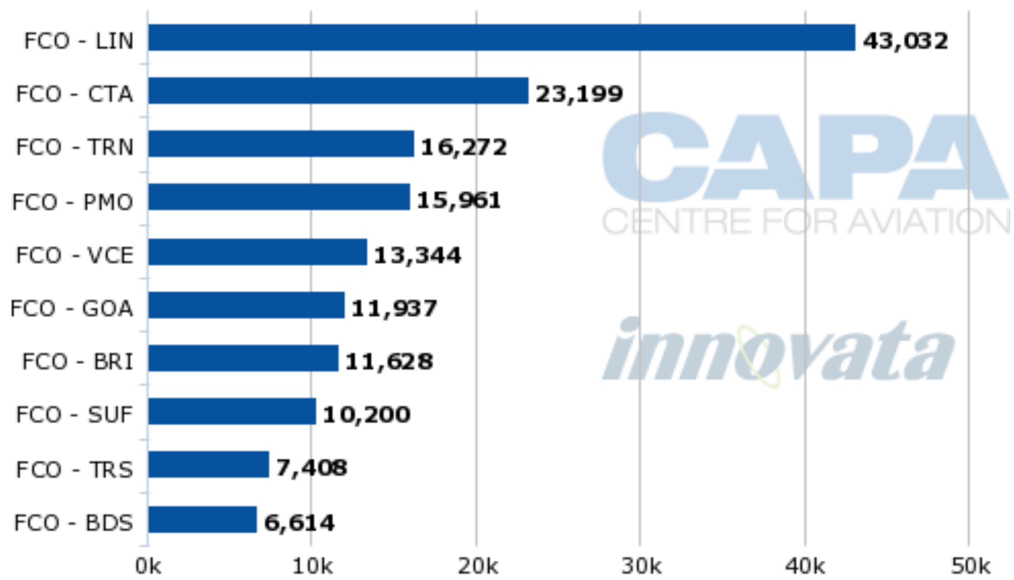


** This exhibit portrays Alitalia's average sector length and cost per passenger versus its main European competitors. Its cost base is quite competitive vis-à-vis its main legacy competitors, as can be seen from its positioning on the map below the plotted cost-line for legacy carriers. However, its average sector length is more similar to that of low-cost carriers, who have a much lower cost per passenger. This indicates Alitalia's positioning-problem: it is neither truly a network carrier with significant long-haul operations, nor truly a short-haul point-to-point carrier with a competitive cost base (CAPA, 2013).*

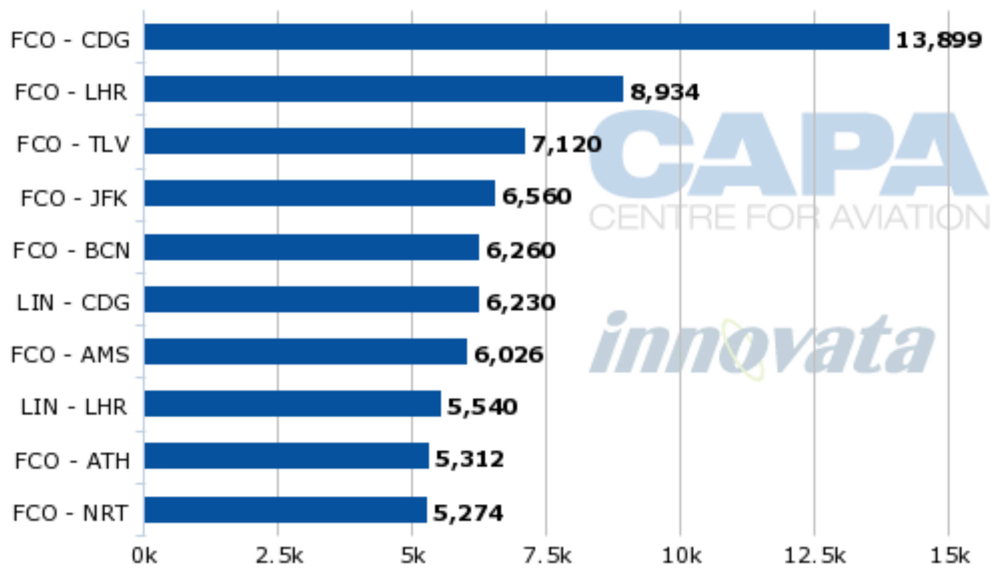
Source: CAPA-analysis of company accounts and traffic data. 2013.

Exhibit 6: Alitalia's weekly available seats on the main domestic and international routes in 2013

Domestic routes



International routes



FCO = Rome Fiumicino
LIN = Milan Linate
CTA = Catania Airport
PMO = Palermo Airport
VCE = Venice Marco Polo Airport
GOA = Genoa-Cristoforo Colombo

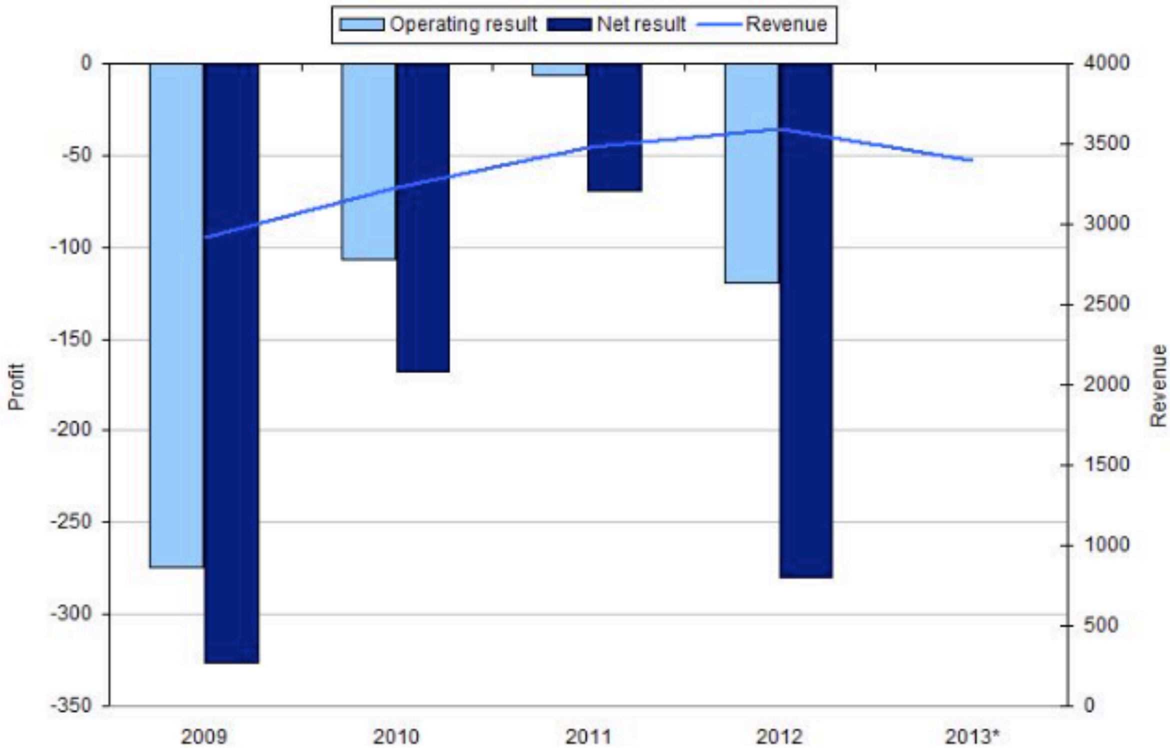
CDG = Paris Charles de Gaulle
LHR = London Heathrow
TLV = Tel-Aviv Airport
JFK = John F. Kennedy New York
BCN = Barcelona El-Prat
AMS = Amsterdam Schiphol Airport

Source: CAPA – Centre for Aviation & Innovata. 2014.

Exhibit 7: Perceptual map of the aviation industry in 2012

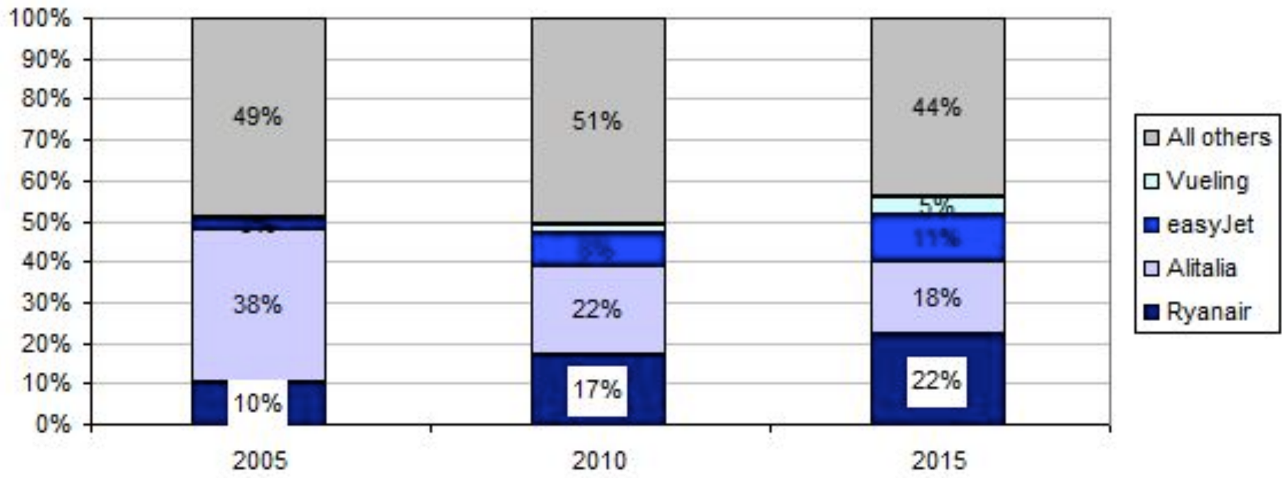
Source: Own work

Exhibit 8: Alitalia's financial performance in the years following its relaunch (2009-2013)



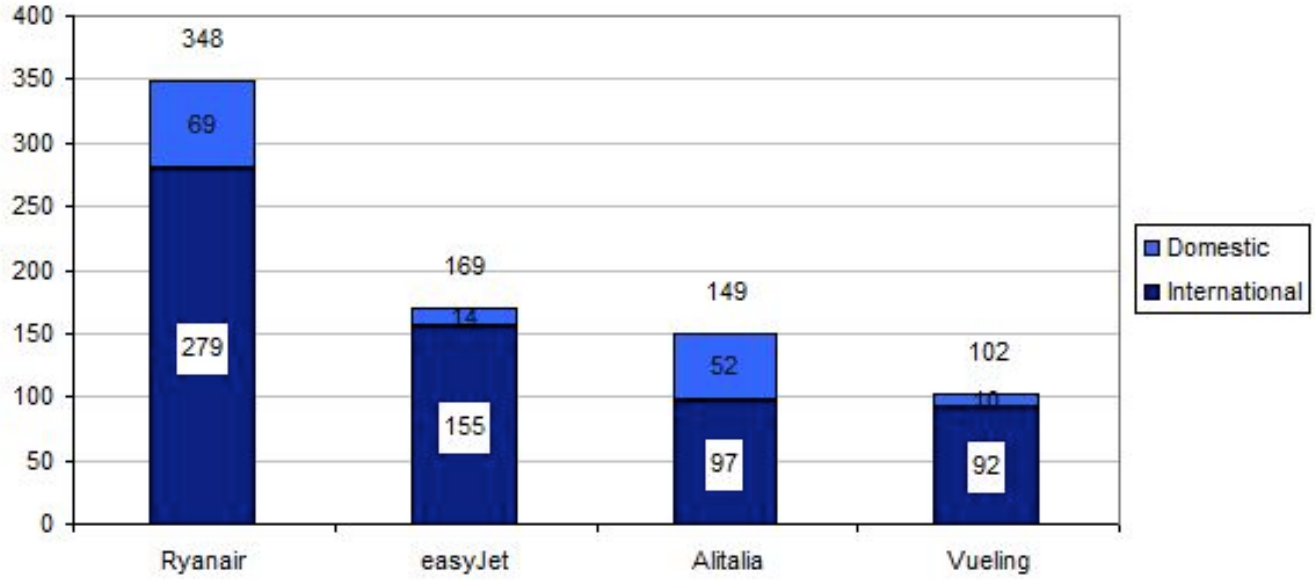
Source: CAPA – Centre for Aviation, Alitalia. 2013.

Exhibit 9: Distribution of total available seats on the Italian market in 2005, 2010 and 2015



Source: CAPA – Centre for Aviation and OAG Schedules Analyser. 2015.

Exhibit 10: Number of routes offered from Italian airports in 2016 – Ryanair leader

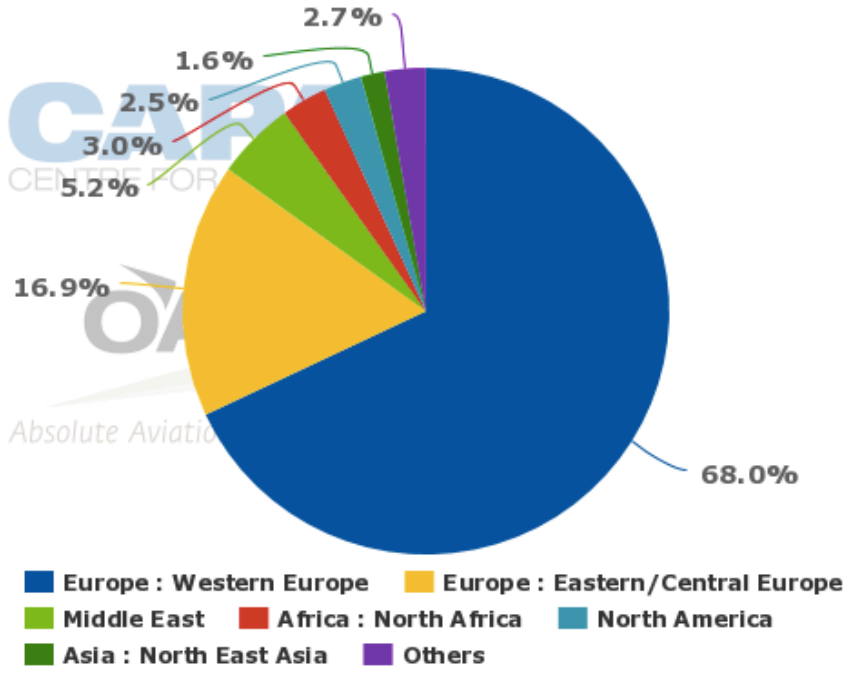


Source: CAPA – Centre for Aviation and OAG Schedules Analyser. 2017.

Exhibit 11: Passenger levels of Alitalia between 2008 and 2015

Source: CAPA – Centre for Aviation and AEA. 2015.

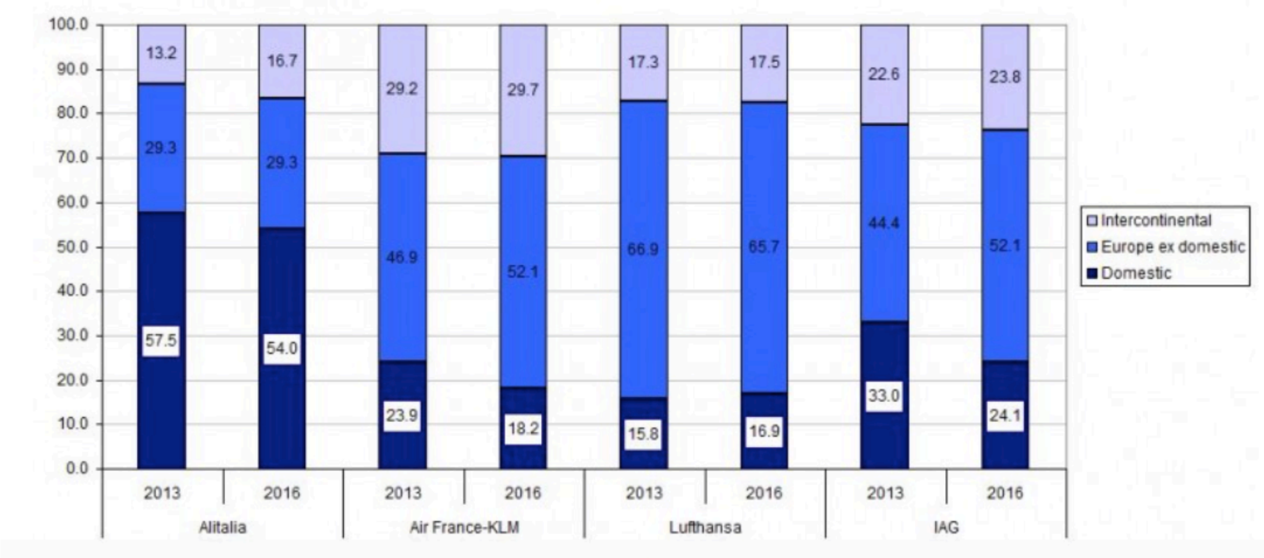
Exhibit 12: Italy's international seat capacity in 2016



**Routes from Italy to the Middle-East and Asia were largely dominated by Etihad's competitors: Qatar Airways and Emirates, while the European routes were prone to the LCCs. Expansion in North America was very difficult as a result of agreements with Alitalia's SkyTeam partners.*

Source: CAPA – Centre for Aviation and OAG. 2016.

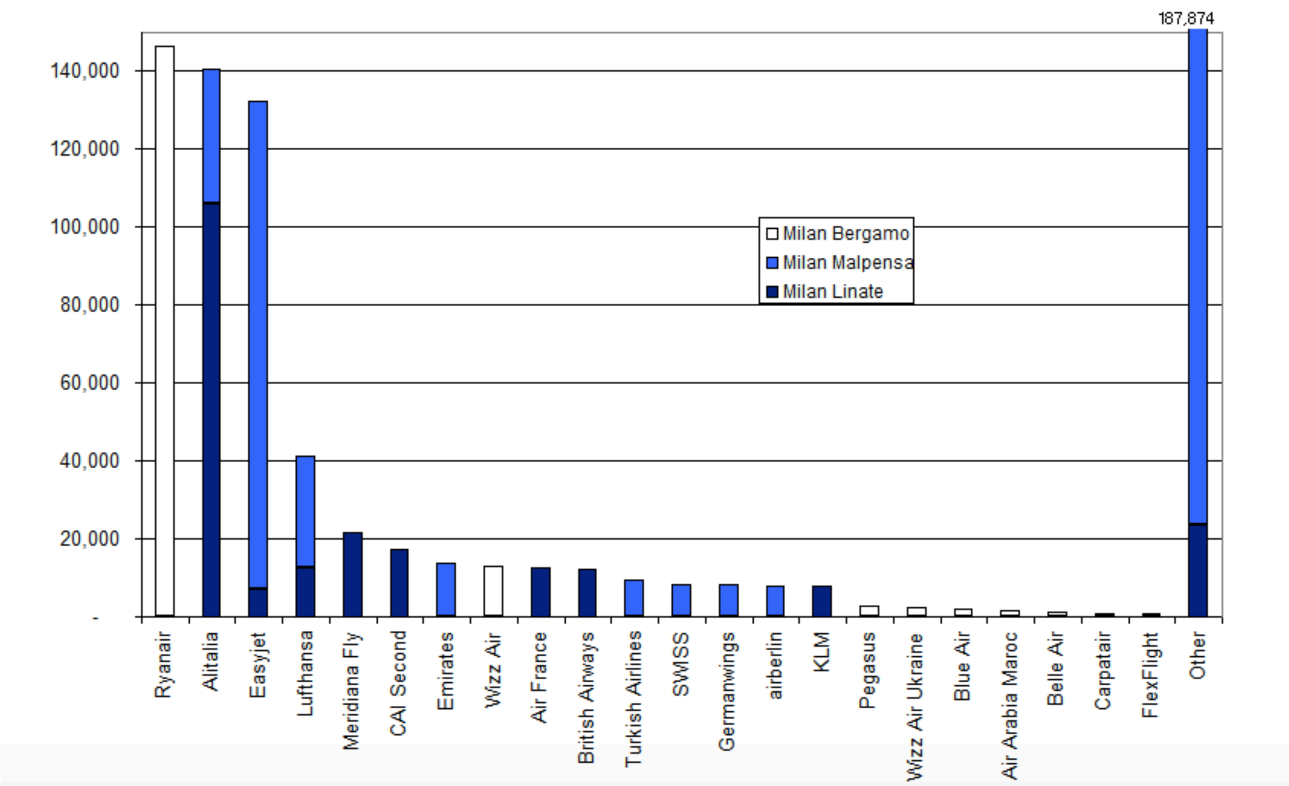
Exhibit 13: Breakdown of available seats per destination in 2013 and 2016 for the main European legacy carriers



**Note Alitalia's slight change towards long-haul operations. It should be observed that Lufthansa has similar "intercontinental" levels, but is around four times bigger than Alitalia.*

Source: CAPA – Centre for Aviation and OAG. 2016.

Exhibit 14: Weekly capacity at Milanese airports by airline in March 2013



Source: CAPA – Centre for Aviation & Innovata. 2013.

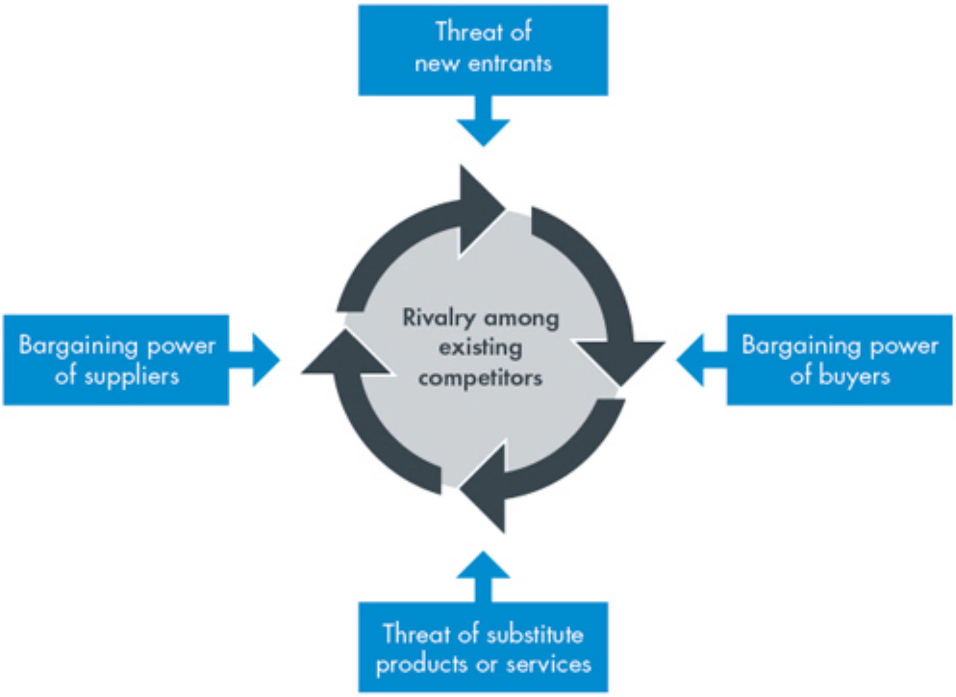
Exhibit 15: Alitalia's fleet in 2017, including Alitalia CityLiner

Aircraft type	Number in use	Remarks
Embraer 175	15	Operated by Alitalia CityLiner to serve low-demand short-haul routes. Capacity around 85 seats
Embraer 190	5	Operated by Alitalia CityLiner to serve low-demand short-haul routes. Capacity around 100 seats
Airbus A319	22	Short-haul aircraft. Smallest member of Alitalia's Airbus fleet. Capacity around 140 seats
Airbus A320	41	Short-haul aircraft. Capacity around 175 seats
Airbus A321	12	Short-haul aircraft. The extended version of the Airbus A320 with a seat capacity of around 200
Airbus A330	14	Long-haul aircraft capable of serving intercontinental routes. Capacity around 260 seats
Boeing 777	12	Long-haul aircraft capable of serving intercontinental routes. Capacity around 300 seats

Source: Alitalia – corporate. 2017.

Appendix Teaching Note "Plummeting from the Sky: The Decline of Alitalia"

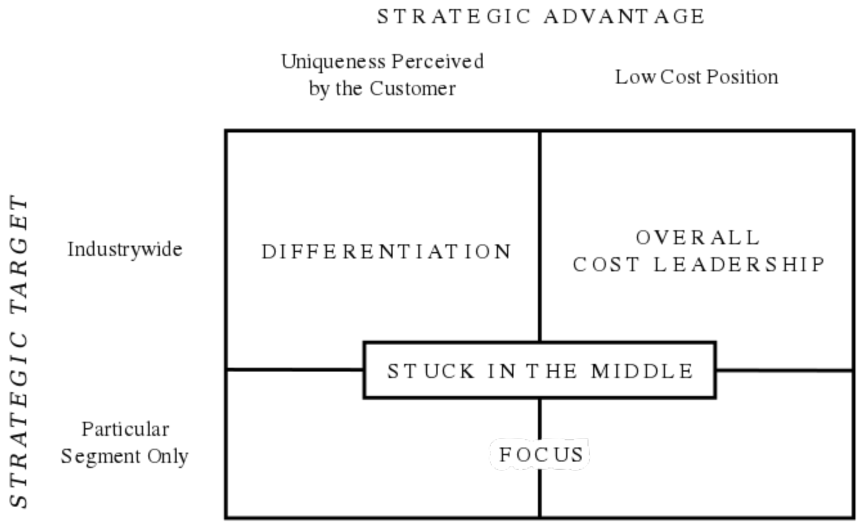
Exhibit A: Porter's five forces model determining industry attractiveness/profitability



**Porter's five forces model is a tool that can help to estimate the attractiveness and thus profitability of a certain industry. The tool is used in question 1 to understand the impact of some fundamental changes in the Italian aviation industry. The five forces are depicted in the exhibit above and are classified in the case as low, medium or high. The stronger (higher) the forces, the less attractive the industry becomes.*

Source: "Contemporary Strategy Analysis". Robert M. Grant. 2012.

Exhibit B: Porter's generic strategies, including the "stuck in the middle" positioning



**Porter's generic strategies framework deals with firms' strategic choice given their competitive scope. This framework is used in question 2 and 3 to obtain a more conceptual understanding. Legacy carriers can be seen as following a differentiation strategy, while the cost-leadership concept can be linked to low-cost carriers. Some new long-haul low-cost players qualify as following a cost-focus strategy, given their limited scope. The inability to position the firm in one of the quadrants yields a "stuck in the middle" classification.*

Source: "Airline Marketing and Management". Stephen Shaw. 2011.