

# “How Successful Will The Klm-Air France Partnership Become? Lessons learned from the KLM-Northwest Alliance”

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## How Successful Will the KLM-Air France Partnership Become? Lessons learned from the KLM-Northwest Alliance

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### Abstract

Although expected, the new partnership of KLM and Air France did strike a blow. Pros and cons were expressed in the popular press regarding this fundamental decision. Some wondered about the weak position KLM might have after the merger. Others suggested that the consensus minded KLM might have a positive impact on the state governed Air France. By looking back at KLM's experience in managing their international partnership with Northwest, we may provide some insight in KLM's capacity to deal with their partners. We intend to demonstrate how the alliance between KLM and Northwest turned into a success. Both partners learned to translate their intensive contacts into routines that eventually strengthened their alliance. Even the periods that put the cooperation under tremendous pressure finally led to improved cooperation.

This article is based on a qualitative study interviewing fifteen top managers of KLM-Northwest while using a framework that illustrates the successive stages of alliances. That framework can instruct managers to recognise the stages an alliance goes through which a form of intensive cooperation increases. The framework clarifies the determining variables in each step of an alliance life cycle and may be helpful to understand a likely implementation of the KLM-Air France partnership.

### Introduction

*"In 1989, KLM and Northwest airlines formed the first international alliance in the airline industry. It was a great leap forward. Some ten years later many airlines have followed this strategy. Fifteen years later, KLM will settle an arrangement with a new type of partnership. This time it will be with Air France and so KLM will be again the first one who plays the ball. But whatever the costs would be, we have to do this. Otherwise KLM will no longer exist in five years time."*

KLM's statement about their intention to merge with Air France as published in a Dutch newspaper (NRC Handelsblad, 19 October 2003) highlights two explicit messages. *First*, the Dutch carrier apparently wants to stress its capabilities of being a pioneer in arranging partnerships in the airline industry. This explicit message has, however, not been embraced whole-heartedly by the Dutch public whose pride about their own national carrier – the oldest in the world still carrying its original name. They somehow worried that their Dutch carrier begins to unravel and will be left with only a small share in Air France. *Second*, KLM officials are fully aware that this new joint force will not be without problems. Instead of enthusiasm about the new cooperation, KLM staff responded hesitantly and some were even pessimistic about the new formation. They ask themselves what KLM will be in five years time. Questions are raised about the integration of the cultural differences between the Dutch and French parties. And they wonder how many jobs will be lost?

An interesting study conducted by Bleeke and Ernst (1993) demonstrated that more than two thirds of all alliances encounter serious problems during their first two years of existence. This high mortality rate clarifies the cautious, sometimes openly hostile, opinion about initiatives taken for merger and acquisitions. A cohesive insight into the characteristics and dynamics of strategic alliances and their key success factors is therefore urgently needed. This article will illustrate some of the key features of an alliance relationship by looking back at the longstanding cooperation between KLM and Northwest (Wahyuni, 2003). This research is based on a framework, which identifies different important phases an alliance passes through. We believe that KLM's experience in

that partnership is a valuable asset to detect the role the Dutch carrier can play in its future relationships with the French partner.

This article will not deal with the choice the executive directors of KLM and Air France recently made. A more relevant issue is how both partners are going to put their synergy together. KLM has demonstrated a remarkable capability to deal with alliances and that asset may therefore be relevant in appreciating the chances for a new success in its cooperation with Air France.

This paper consists of three parts. *Firstly*, we will introduce the framework of the relevant features in the development of strategic alliances. Emphasis will be put on the operational phase of an alliance. *Secondly*, we will explore the development of the KLM-Northwest partnership and how the cooperation became established. *Finally*, we will try to link the KLM-Northwest experience to the current partnership of KLM with Air France.

## Theoretical Framework

Literature in strategic alliance development shows that alliances develop over time. They pass through three main phases: formation, operation and evaluation (Wahyuni et al., 2003). Formation refers to the phase during which the future partners conceive an interest in the possibility of forming an alliance, understand each other's goals and settle an agreement about reciprocal contribution. During the operational phase, the alliance is established as a productive venture and people are appointed, systems installed, and operations put in place. During this phase, partners experience cooperation on a daily basis. They begin to recognize differences in culture, organizational structure and behavior. Those involved discover that they have to cope with conflicts that become manifest. During the period of evaluation, the partners try to find out ways that may strengthen the further development of their alliance.

Each of those phases provides the alliance with a specific foothold to continue into the next step of alliance development. Literature indicates that the success of strategic alliances is partially the result of an adequate partner selection and the formulation of clear agreements during the formative phase (Dacin & Hitt, 1997, Child & Faulkner, 1998). However, to be able to reach the evaluation phase, partners have to manage successfully the operational phase of their cooperation. This is what we call the path of any alliance: tensions and conflicts come to the fore and the interaction between the parties becomes more intense. This situation also occurred in the Northwest-KLM alliance. No surprise that many alliances fail in this phase. It is therefore essential to focus on this phase. There are four important variables that have to be considered: partner contribution, control, communication and conflict.

Figure 1 illustrates the overall framework of alliance development. The basic assumption is that the initial goals and the agreement about partner contribution will have an important impact on its further implementation. Initial goals will determine the form of a partner's capabilities in the alliance, the overall position and the critical mutual requirements. Partner interests will affect the willingness to exchange resources. Therefore, an initial agreement on partner contribution has to be settled. A clear initial agreement will help the alliance members to articulate their reciprocal contribution and ensure that the partners will fulfill the objectives of the partnership.

During the operational phase, the alliance relationship will develop through the exchange of resources or partner contribution, communication, management of control and conflict. The alliance relationship will change over time if the intensity between the discerned variables changes. This model takes into consideration that the form of partner contribution and control may lead to conflict. If a partner fails to provide an expected critical resource, conflict is likely to occur (Hyder, 1988). However, control may also affect the exchange of resources. If a partner has formal control over access to a critical resource, it may refuse to supply that resource to the alliance. Control may also provide access to more resources (Kemp, 1999). An unequal distribution of control and the protection of proprietary assets (spill-over of control) can therefore cause a conflict. The capacity to prevent a conflict significantly depends upon the way communication takes place within the partnership.

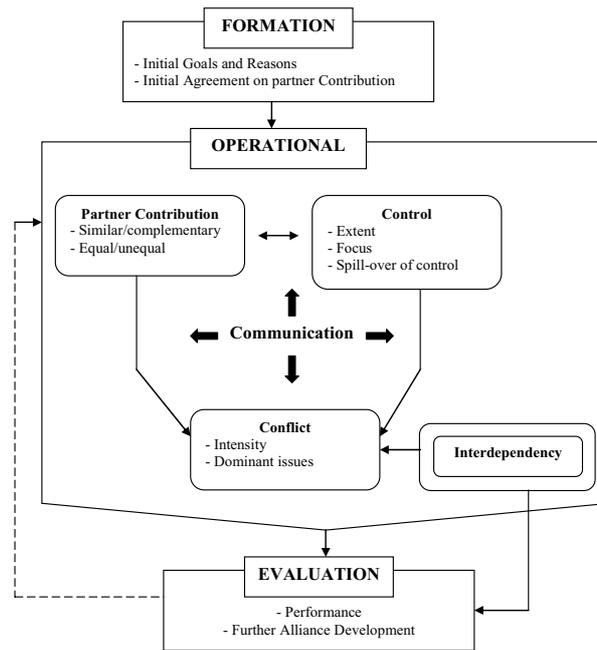


Fig. 1. Key Factors in Each Phase of Alliance Development

Source: Wahyuni (2003).

It is usually assumed that a high frequency of conflict will negatively influence a partner's satisfaction with the alliance. It turns out, however, that this is not always the case. An occasional conflict can be the best evidence of a mutually beneficial collaboration. This has to do with the degree of interdependency in the alliance relationship. The higher the interdependency is, the greater the chance of conflict will be. Interdependency forces partners to complex coordination mechanisms that eventually increase the need for human intervention and intensive contacts. The increasing direct contact increases the likelihood that differences between the interacting members become manifest, thereby increasing the possibility of conflict (Robey & Sales, 1994). On the other hand, however, it cannot be denied that the more partners depend on each other, the more it can provide a synergy for the respective companies to cooperate which in the end may even increase the cohesiveness among the partners. Thus, we may say that a high degree of interdependency will have a positive impact on the continuation of an alliance.

The results of the operational phase will reflect themselves in the evaluation phase. Two important variables in this stage are to be respected: performance and willingness for further development of the alliance. To ensure continuity, an alliance needs to continuously develop and realize synergies. The long-lasting alliance between KLM and Northwest provides an opportunity to assess this variable effectively.

In Figure 1, a dotted line indicates the connection between the evaluation phase and the operational phase. This indicates the life cycle of a strategic alliance. It means that if both partners decide to continue their partnership, this will then reinforce the variables in the operational phase.

## Research Methodology

This study based on an in-depth exploratory research conducted in KLM and Northwest headquarters. Data was collected from face-to-face interview of 15 directors and top managers of both airlines in Amstelveen and Minneapolis, telephone interviews, annual reports, company documents, and from information previously compiled by other researchers. The face-to-face interviews were semi-structured and focused, because we already had particular ideas about four determinant aspects in the operational phase (partner contribution, control, conflict, and communi-

ation). To keep focus, we developed two questionnaires: one for the KLM and one for the Northwest. Questions for Northwest were particularly designed to crosscheck the answers given by the Dutch partner, thereby increasing the reliability of the data. Telephone calls were made to the interviewees immediately after the meetings to clarify any queries or doubts about the interview. All interviews are tape recorded. Most of the interviews took more than one hour and many of them lasted more than two hours.

## **KLM and Northwest Alliance**

Recorded in history as the first airline alliance in the world, KLM and Northwest started their relationship in 1989 when KLM acquired 19.3% of Northwest's stocks. The partnership gradually developed from a joint code sharing to the formation of a trans-Atlantic joint venture (JV)<sup>1</sup>. It was amazing that during 1991-1997 both airlines did not set up any formal agreement. After having some problems in the year 1995-1997, they signed an evergreen agreement for a ten-year minimum term of partnership. In principle this alliance can be terminated based on a notice that should be handed out three years before the dissolution.

### ***Formation Phase***

#### *KLM's Initial Goal for Co-operation*

In Europe, governments have heavily regulated the airline industry by determining the flight frequencies, seat capacity and routes to fly. In 1986, the European Court of Justice inaugurated free competition amongst the European airlines. Although competition became stiffer, the airline companies however, still had to follow strict regulations if they flew to other countries. At that time, KLM was only allowed to fly to six cities in the United States, although there was an increasing demand for other American cities. Pieter Bouw (the CEO of KLM at that time) with other managers from KLM (including Leo van Wijk) and McKinsey consultants came to the conclusion that deregulation and market liberalization stipulate KLM to become more cost effective and develop a stronger position in the intercontinental market. It was decided that co-operation with other airlines was needed to build a sustainable competitive position and integrate the networks between America, Europe, and South East Asia.

KLM management evaluated all potential American partners and decided that Northwest Airlines would be the best partner. Three reasons underlined this decision:

*First, as far as the scope of the business was concerned, Northwest had a strong combination of passengers and cargo, which was also the core business of KLM. Second, in view of the market potential of the Pacific, it was very important for KLM to combine the market in the United States, Europe and the Pacific. Third, at that time Northwest Airlines was the most international American carrier that had sufficient international experience compared to other American airlines such as Delta and United Airlines.*

(Pieter Bouw, 30 October 2001)

#### *Northwest's Initial Goal for Cooperation*

Northwest airlines were an American medium-size airline that operated a large network within the United States and to Asia, but had a relatively small network to Europe. To become more competitive in the world market, Northwest needed to extend its operations to Europe. Both Northwest and KLM looked for expansion to realize their goal. By joining forces, Northwest wanted to reinforce their position in Europe. The current Northwest Vice President of Alliances was convinced that no specific partner selection took place at that time. The partnership with the Dutch carrier simply started due to KLM's stock ownership of Northwest.

*This equity position was the initial impetus that started the alliance process moving forward. Besides, our experience in connecting hubs foresaw a strategic position of Amsterdam as a growing international hub. In America, connecting hubs together was a technique that had been highly developed for maximizing traffic flows. Northwest believed*

<sup>1</sup> This partnership could be categorized as a unique JV because of the absence of a new legal entity. The airline regulation did not encourage them to establish a real JV (a new legal entity) due to the issue of nationality of the airline company.

*that we could take the construct we apply to domestic scheduling and use it for developing an international network. Northwest was convinced that KLM would be a compatible partner with whom that network could be constructed.*

(Northwest Vice President of Alliances, 14 May 2002)

### ***The Alliance's Initial Agreement***

Although the American way of doing business is based on the inclination to arrange settlement by contract, this alliance – which started in 1991 – did not have a formal contractual agreement until 1997. While managing the partnership, both companies developed “a series of protocols”<sup>1</sup> that defined how to organize their alliance. As the Northwest Senior Vice President of Alliances explained:

*Since, no one had formed such an integrated alliance in the airline business before, we did not know exactly how to proceed. We agreed on the concept and as long as you trust each other, and keep working out the details defining how to implement the alliance and people keep refining protocols, then it ultimately is accomplished. It was not a defined legal process...but it worked.*

Although both airlines trusted each other and intended to make this alliance work right from the beginning, an Alliance Steering Committee was introduced to manage and coordinate activities of this alliance. Two senior executives from both companies were selected as committee chairmen. This Steering Committee also included the co-chairs of various working groups from passenger business, networks, finance, operations and cargo. The committee holds regular meetings every three months alternately in Amsterdam or Minneapolis. Some issues that have not yet been settled in the contract will be discussed first in the alliance-working group, which may subsequently refer to the steering committee if they cannot reach an agreement. Both airlines underline the importance of reaching a common understanding (consensus) in case of a conflicting issue. If consensus can not be reached, they initially take the subject back into their respective companies and thereafter reintroduce it to the committee. The most typical characteristic of this JV is the fact that there are two co-chairmen who have an equal power in the decision-making process. No decision can therefore be taken without the consensus of both parties.

### ***Operational Phase***

#### ***Partner Contribution***

In the beginning of the alliance, both parties agreed that KLM would operate 60% and Northwest 40% of the capacity. In practice it turned out to be difficult to reach a proper balance. There were differences of contribution due to:

1. The imbalance between capacity contribution, which shifted over the years depending on the market situation, and the variety of schedules and flights.
2. The changing value of the dollar and Euro.
3. Difference in the quality of destinations in combination with the choice of which partner flies which routes. The partner who often flies to profitable destinations will contribute more to the alliance.

The passenger business unit and the financial management division kept track of the settlement between the two airlines. They calculated all the benefits and deducted the costs of the production capacity provided by KLM and Northwest respectively. To operate effectively they installed a joint database system. Questions about who is contributing what to the alliance disappeared. Each partner obviously contributes the difference between its traffic revenues and operating expenses to the JV. These differences did not provoke any conflict because the top managers jointly decide the flight schedules.

<sup>1</sup> These series of protocols could be seen as unwritten rules of behavior as well as formal written procedures that have been formulated based on the best practices and the best procedures gathered from experience. These protocols are refined over time depending on the changing environment.

Regarding the expectation and the real contribution, KLM and Northwest expounded that there could always be a difference in expected contribution and actual contribution of the partner to the alliance. Unexpected factors could put the contribution of one partner under pressure e.g. the value of the dollar, Schiphol problems, strikes, the September 11 attacks in the United States. All these issues could cause tension between the partners. There has nevertheless always been an inclination to settle for a mutually acceptable arrangement. If it is a major point of concern, both companies will find a solution to compensate each other.

The alliance performance is evaluated every three months. During this periodical evaluation, both airlines openly assess and discuss whether their expected contribution has been attained. If not, they strive to discover the bottom line of the issue and do their utmost to find an acceptable mutual solution. The two carriers underline the importance of mutual open communication in the assessment of the partner contribution so that they can develop a strategic perspective based on the capabilities of each carrier.

#### *Control*

It is very interesting that KLM's ownership in Northwest did not have a significant impact on its control position. Both parties basically have an equal power of control. The settlement of control can be divided into three aspects:

1. In general, the Alliance Steering Committee overlooks the overall control of the alliance. The division of power is clear: each party has an equal balance of power in making decisions.
2. Control is slightly different when related to the market. The party who has more knowledge in a particular market will also exerts more power of control over that market. Northwest has a higher degree of control in America than in Europe and vice versa.
3. Both partners have dissimilar expertise and different division of control. That in itself created the need for a mutual exchange of expertise.

Due to the huge scope of activities in this alliance, the focus of control covers the overall activities of the business that can be categorized in three foci of control: *Strategic control, operational control, financial control*.

Although both partners are working in the same industry but the fact that they are serving different routes indirectly makes them each other's competitor. Nevertheless, till 1998 Northwest and KLM faced difficulties in managing the competition at sales level. Although they instructed their sales department to sell the JV's entire product, the KLM sales people sometimes preferred to put passengers on KLM's plane and vice versa with Northwest sales people. Therefore in 1998, both airlines integrated their sales forces and applied the "economic path indifference". It means that there is no difference for the JV whether passengers fly in a KLM or Northwest plane. All the JV's revenues will go to the same pool and in the end both partners will share equal profit. By applying this system, both partners are not only able to optimize the utilization of the network but also eliminate the tension of competition among them. This is one of the unique characteristics of KLM-Northwest alliance, which is never happened in the history of airline business

Regarding the fear of spill-over of control, KLM and Northwest stated that they did not have a problem with confidentiality because in the service industry openness of all the participating companies is a vital ingredient. Whatever they keep secret today will not be a secret anymore within one year's time. Furthermore, the long-term commitment and the huge scope of their partnership require them to share information and no specific information is withheld.

#### *Communication*

Since the airline business covers a great number of linked activities, both companies have to assure an intensive daily contact between all the counterparts. At management level, they appointed a few people who were located in the headquarters of their partner. In addition, KLM has an alliance department that works closely along with Northwest's alliance department to make sure that the communication is optimal. They organize a formal Alliance Steering Committee meeting every three months which always end in a joint dinner so that everyone can meet and develop social relationships with other team members.

*There is a friendship that develops over the years. Sometimes people go for holidays and stay at each other's places. There is a lot of interchange between these two companies.*

(KLM Alliance Director, 24 October 2001)

Trust and friendship that developed over the years obviously have a positive effect on the alliance. This human chemistry proved to be an important for a smooth alliance. Both parties stressed the importance of excellent communication and a good relationship to prevent any conflict.

*To make the alliance work, we need a lot of trust and a lot of communication. If you don't have communication, you don't have trust. You have to have a lot of communication. With communication, you understand the issues, you talk to each other very openly and then you develop trust.*

(Northwest Senior Vice President of Alliances, 14 May 2002)

KLM and Northwest have relied heavily on communication as a way to settle conflict resolution and to develop trust between them. Open communication allows them to sincerely talk to each other, build trust and reduce uncertainty in their partnership.

#### *Conflict*

Although they both stressed the importance of perfect communication, like any marriage, the alliance experienced a lot of sparks. The huge scope of the partnership precipitated an abundance of intricate issues. Of the ten issues that had to be settled under the period of review, six of them led to a conflict. However, both companies interpreted the disagreements they had as positive conflicts because it led to another round of talks about certain issues, how things were done and how things should be done.

Managing the individual company's objectives and the joint venture's interest appeared to be a burden in this partnership. Regarding the manifest conflicts in the alliance, Pieter Bouw exposed,

*We had a number of different perspectives related to:*

1. *The short-term orientation of Northwest and the long-term orientation of KLM.*
2. *Positioning the alliance in the competitive market. Are they going to position themselves on the high level of the market by offering an excellent service at a good price or are they just going for the cheapest market where quality is relatively not important? KLM believes that it should go to the higher level of the market by offering a great connection, an excellent service and ask a good price for that. Northwest prefers to posit itself toward the price sensitivity of the market. They tried to solve this issue by taking the middle solution. As far as the World Business Class is concerned, they apply KLM's perspective and for the tourist class they follow Northwest's direction.*
3. *The strategy of how to deal with the competing alliances such as Lufthansa/United Airlines, Delta/Air France, and so on.*

(Pieter Bouw, 30 October 2001)

These types of conflicts are occasionally occurred in their alliance. Both airlines stressed that they had to focus their attention not only on their company's objective but also on the alliance's objective. Another manifest conflict in the alliance was the pricing policy in the United States, which is more volatile than in Europe. Network was also another prominent conflict, which was related to the decision whether they wanted to fly, stop flying or increase/decrease the frequency of flying to particular destinations.

Apart from these two issues, both companies faced very difficult situations during the period of 1994-1997 that eventually had a substantial effect on the alliance relationship. This period

could be seen as the most critical part of their co-operation. During 1994-1997 both airlines had some disagreement about what had to be done for the alliance. For example, KLM wanted to introduce standardization in the economy class but Northwest refused to invest in it because it did not provide any additional revenue. Furthermore, there were also some tensions in the top-level management because Northwest was afraid that KLM ( who planned to purchase 5% of Northwest share) would like to have more control over their company. As Gary Wilson, one of Northwest's shareholders, said to Fortune (1996),

*They can wrap themselves in tulips all they want. Their real agenda is controlling Northwest Airline.*

---Gary Wilson (Fortune 1996)

The fact that Northwest accused KLM, deteriorated the trust between the top-level management of both companies. On the other hand, KLM was very much concerned about the long-term development of Northwest because all the actions the stakeholders undertook indicated that they would like to sell their stocks as quickly as possible. It meant that KLM and Northwest would possibly face a difficult situation. By increasing its stake in Northwest, KLM hoped that they could influence the long-term destiny of the KLM-Northwest alliance.

*We never wanted to control Northwest. We only wanted to protect the alliance. That was our main objective because the alliance was a lifeline for us. Being a small airline, we were highly dependent on the North Atlantic Route. For Northwest, the Atlantic Route was interesting but not their lifeline. That's why we wanted to protect the alliance because this is our lifeline and the only way to protect the alliance was to buy out participating shareholders.*

(Pieter Bouw, 30 October 2001)

In KLM's view, their strategic alliance could only work if partners had a share in each other's companies. This opinion gradually changed because in 1997 they realized that it was not important to have an equity stake in their partner if both partners trusted each other.

*We came to the conclusion that a strategic alliance can be very successful without having an equity share. It can help in some cases but having an equity share in your partner does not mean that you have a successful alliance. Trust depends on common agreement of objectives and how we can get along together in the relationship. This is more important than having a stake.*

(KLM Director of Corporate Strategy, 24 October 2001)

To solve this dispute, KLM's top management decided to sell back their entire share and changed the composition of contribution from 60 (KLM): 40 (Northwest) to 50-50. At that time, the price of Northwest shares had increased significantly. The Dutch carrier gained an enormous profit directly from the stock price and created a win-win situation for both companies. KLM's decision to sell their share proved to be a wise solution for the alliance. Both airlines decided to sign a long-term alliance agreement that followed by sales integration in 1998. We therefore call this period as the beginning of second operational phase of KLM-Northwest alliance.

### ***Evaluation Phase***

#### *Alliance Performance*

Both companies perceived this alliance as a successful co-operation. Operating as a true joint venture under which both airlines share profits equally, the alliance's operations have more than doubled since 1989 and now encompass 32 daily flights serving 162 cities. Figures 2 reflect the development of the JV's network. KLM and Northwest so far achieved the objective of this alliance, which is to increase the revenue of the trans-Atlantic market and to expand their worldwide network. Results demonstrate that their alliance was growing beyond their expectations.

***Daily Frequencies***

	1989	1992	1997	2000
MSP/DTW/MEM-AMS	0	2	6	8
AMS-US Gateways	7	8	10	11
DTW/MSP-Euro Gateways	3	3	6	7
BOS/JFK-Euro Gateways	4	4	0	0
<b>Total US-Europe</b>	<b>14</b>	<b>17</b>	<b>22</b>	<b>26</b>
AMS-Canada/Mexico	-	-	4	4
AMS-India	-	-	2	2
<b>Total Joint Venture</b>	<b>14</b>	<b>17</b>	<b>28</b>	<b>32</b>

Source: KLM and Northwest management.

Fig. 2. The Development of the Network

*When we started this cooperation, there was no direct flight from Amsterdam to Minneapolis and Detroit. Then we established a new flight once a day, quite quickly it was increased twice a day and even went up to three and later four times a day. The number of passengers that were traveling through the hubs of Amsterdam-Minneapolis-Detroit has increased immensely. The costs and the revenue synergies created by the alliance were far better than predicted.*

(KLM Director Corporate Strategy & Business Development, 24 October 2001)

Both companies remain very optimistic about the alliance. In general, KLM and Northwest are also satisfied with the alliance relationship. There are many advantages both airlines derive from this alliance. Apart from achieving the goal of partnership, this alliance has also proved to be the supreme strategy for both companies to prevail in the competitive market.

#### ***Further Development of the Alliance***

The above description clearly shows how both airlines have been able to pass through the difficult period of their partnership. Figure 3 illustrates the ups and downs of the KLM-Northwest relationships. The alliance graph indicates how since its initial stage there was an excellent relationship. In 1997, the situation changed as the alliance graph plunged indicating the deterioration of the relationship. KLM and Northwest faced a serious equity dispute. The tension within their relationship increased. KLM top management finally decided to withdraw its financial contribution and improve their commercial participation by selling back the entire stock to Northwest and established an evergreen contract to their alliance. This new settlement restored the trust in 1997 that had deteriorated for a while and gave new energy to both parties to further solidify their alliance. Figure 4 is measured qualitatively based on our interviews with the respective managers of KLM-Northwest alliance.



Fig. 3. The Process Development of the KLM-Northwest Alliance

The KLM-Northwest alliance can be explained as follows:

19 June 1989 KLM took 19.3% stake in Wings Holding Group (the holding company of Northwest).

1991 The first code-share flights KL/NW

1992 Open Skies Agreement

Anti-trust Immunity and North Atlantic Joint Venture

1994 KLM and Northwest launched the World Business Class (WBC) together.

Stock repurchase agreement and long-term alliance agreement

In the period of 1994-1997, KLM and Northwest faced a difficult time. Both airlines started having some disagreements about operational aspects and shareholder issues. On the other side, Northwest was afraid that KLM wanted to obtain more control over their company. KLM finally decided to sell back their entire share and changed the composition of contribution from 60 (KLM): 40 (Northwest) to 50-50. Both airlines signed a new contractual agreement and committed to intensify their relationship to a more fruitful cooperation.

Two axes of Figure 3 indicate time and the intensity of relationship for the alliance partners. We use the term "intensity of relationship" to describe a positive sense about the relationship that increased in strength, as indicated, by increasing commitment and trust

It is apparent that both airlines are becoming more integrated with each other. The management of Northwest and KLM declared that they are committed to develop the alliance to become even stronger and more profitable. Both parties are fully aware of the importance of this alliance to their business. For KLM, this alliance means their lifeline because 17% of their revenue depends on the trans-Atlantic market. Similarly, Northwest believes that this alliance is essential for them. Although the revenue from this alliance is about 10% and worth over \$10 billion in revenues, it constitutes 100% of their European revenue.

After experiencing difficult and glorious times in their partnership, both companies are committed to work together on a long-term basis. It is like being in marriage. It takes so many years to learn how to make a family work together, so that to break it up and start all over again is too much trouble. It is easier to fix problems immediately.

### ***Crisis***

After the evaluation phase, this alliance enters to the second operational phase, which apparently run not without a problem. The alliance has been challenged with several crises:

***The first crisis*** occurred in September 1998 when Northwest was hit by a one-month long strike by their cockpit crew. At that time, there was no aircraft from Northwest and only KLM's aircraft operated for the JV, which resulted in an imbalance of partner contribution. Northwest had to deal with the enormous influence and demand of their cockpit crew. Nobody was happy when it happened but they fully understood that every business always has a risk. KLM provided support to Northwest and the alliance by not sticking rigidly to the contract. They tried to compromise in solving issues that unexpectedly popped up in their partnership.

***The second*** difficult time emerged during the terrorist attacks in the U.S. on September 11, 2001, which almost crashed the airline industry. At that time the JV operations were shut down for a while for security reasons. Each day that passed meant losses of tens of millions dollars. To keep the airline business alive during this difficult period, the Dutch government injected an amount of €26.7 million into KLM and the U.S. government granted \$461 million to Northwest. Inevitably, there were many discussions and settlements needed for the JV that somehow caused tensions for both companies.

Those crises did not make the alliance fall apart. Although the alliance was shut down for couple of weeks it did not mean the end of the story. KLM and Northwest strives to find a way to make the alliance survive. It eventually made the alliance more mature, experienced and committed to each other. This learning experience provides a significant influence on how they resolve some unexpected crisis such as SARS and the war in Iraq that later crash the airline business.

## Analysis and Conclusions

KLM and Northwest have been able to pass the critical path of their partnership and overcome problems of competition between them. Recorded in history as the first airline alliance in the world, this alliance apparently colored with a lot of sparks. However, the lessons learnt from their alliance have proved invaluable. Although both airlines announced the JV formation since 1993, interestingly they did not have any legal agreement until 1997. In managing the JV, KLM and Northwest created a series of protocols about how things should work in their partnership. This case provides an important message that contract is not always need it to realize a sound cooperation. A strategic alliance is a simple human business and not legal matters. In this respect, trust, mutual understanding and reciprocal communication are even more important.

Other important lesson we learnt from this alliance is the danger of competition that may occur between airlines alliances. From this case, we can see that until 1998 KLM and Northwest face difficulties in managing competition at sales level. Although after the JV's formation in 1993, they declared that all the JV's revenue would be accumulated in the same pool; but still their sales people tended to put passengers on the flights that were operated by their own company. Finally in 1998, KLM and Northwest decided to integrate their sales force by closing their sales representative offices in their host country. This situation had a tremendous impact on solving the problem of competition. It precluded the development of pressure that might at some point have caused the alliance to falter.

The above "color-blind sales approach" of KLM and Northwest is a unique characteristic of this alliance which is rarely developed in other aviation. Most airlines cooperate in some particular areas but they are still competing in the rest of the world. Therefore, KLM's decision to merge with Air France is a proper strategy to cope with competition that prevails in the airlines business. By merging with a strong carrier, KLM is not only strengthening its position in the market but also trims down its financial problems and illuminate a likeliness of competition in the future. However, this new partnership with Air France will not give a guarantee that everything will run smoothly. Within the context of the airline industry, the KLM-Northwest alliance is recognized as the most integrated and the most long lasting, but the realization of their partnership was not without problems. The KLM-Northwest case shows that there are a great number of issues that can cause conflict. The broad scope of their partnership and a high interdependency between both partners in this alliance are the explanatory factors behind the high density of conflicts. Obviously, the more complex coordination mechanisms will increase the need for human intervention and contact. The intensity of direct contact between the partners increased the likelihood that differences between the interacting members would surface thereby increasing the possibility of conflict. Conflicts in this alliance ranged from strategic matters, financial problems to operational aspects of the alliance. Throughout the years of their partnership, KLM & Northwest were tested by a number of difficult periods. The evolution of this partnership provides a lesson on how relationships can fluctuate. It is apparent that a strong interdependency in this alliance becomes a powerful weapon for their solid relationship. What emerges in this partnership is the saga of a wealthy household that manages to prevent itself from being torn apart.

Looking at the above case, we envisage that the merger between KLM and Air France will even bring both carriers in a strong bond of interdependency. This alliance, while stopping short of a full merger, will go significantly further than the traditional airline partnerships by uniting two carriers under the same corporate umbrella. This type of situation could bring a high level of conflict as a result of reciprocal interdependency and the high level of contingency. To counter the complexity in the coordination mechanism, this new merger requires a high degree of mutual adjustment. Of course, it is too early right now to oversee whether this Dutch carrier and its French partner will fail or reach success in implementing the necessary adjustment needed for their partnership. Time and experience will play role in answering those questions. At the same time, we should not underestimate the KLM long-standing experience with Northwest. Even without any legal binding agreement (for almost 7 years in the early years of their partnership), the KLM-Northwest case shows how committed this alliance is. This case also supports our theoretical argument about the importance of communication in managing a successful alliance. A lack of

communication would provoke conflict in the alliance, whereas continues open communication could held an important role in solving a problem. If we look at the broad scope of KLM and Northwest partnership, we could immediately see how complex this alliance is. The integration of strategic, operational and financial settlements had the potential to produce a great number of conflicts in this partnership. This situation will likely happen in KLM-Air France partnership. Therefore, in reducing disagreement and increasing mutual understanding, they have to build a good relationship and excellent communication at all levels of management. Other imperative characteristic of the KLM-Northwest alliance is the use of consensus to solve issues in their partnership. In reaching a consensus, nobody can force a solution on the other. If this pattern can be implemented in the new partnership with Air France there is a great possibility that this merger will lead to an optimum success. KLM and its French mate should realize that a mutually acceptable solution is indeed necessary in order to prevent a problem escalating into a conflict. An even position should be built in this relationship. KLM long-lasting relationship with Northwest will therefore be a valuable asset in its merger with Air France. We believe that KLM's past experience will provide a significant influence on how they deal with its French partner. Their merger already provided a history in the airline industry. How they transmute the history into a success or failure story is one of the challenges KLM & Air France still has to prove!!

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