



Universitat
de les Illes Balears

BACHELOR'S THESIS

HORIZONTAL INTEGRATION IN THE TOURISM SECTOR: THE CASE OF AIR EUROPA AND IBERIA

Bárbara Arrufat Montoya

Degree in Tourism

Faculty of Tourism

Academic Year 2020-21

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Key words:

Horizontal integration, merger, hub, airline

Tutor's Name Elpiniki Bokouka

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Author		Supervisor	
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Abstract

This paper consists of an explanation of how the process of horizontal integration between the two most important Spanish airlines suffers advantages and disadvantages due to their fusion, based on the characteristics of mergers and acquisitions. Finally, given that the merger happened no longer than a year ago and results are still being updated day by day, this paper provides a clear explanation of how two multinational organisations can merge.

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1. INTRODUCTION

It is important to study horizontal integration to understand why companies merge. This project will investigate what mergers and acquisitions-M&A-are, through assets, shares or simply the merger between two firms. Profits and barriers that take place when this process occurs, like the increase in income or cost reduction as well as the regulation barriers that the government imposes and some voluntary barriers such as poison pills or golden parachutes will be explained. This will be followed by a brief definition of vertical and horizontal integration. The study will then focus on horizontal integration, which, therefore, will be deeply investigated, identifying advantages and disadvantages of such process.

More precisely, this study will provide an analysis of the 2020 merger between the main Spanish airlines, Air Europa and Iberia. In this merger, Iberia acquired 100% of Air Europa's capital, with the purpose of creating a financially successful corporation with increased market share and competitive advantage. By employing a low-cost business model and through the creation of a very modern fleet, the corporation contributed to the conversion of Madrid Airport into a European hub, offering a higher number of connections between countries, and providing customers with more flexible schedules.

Due to the concentration of two Spanish operators in a single group, the merger could potentially lead the corporation to acquire a monopolistic role with the airport. In light of this, the CNMC study on the merger will be analysed, in order to understand the impact on competition and how Globalia, the parent company of Air Europa, got affected by the merger. The rescues that Air Europa asked for to the SEPI and how they have changed over the time and the effects of asking for money to the government will be analysed, such as decreasing the price of the purchase.

Finally, it will be observed how despite so many barriers due to the Covid-19 situation and rules of the fund to avoid aggressive expansions, both airlines have made an agreement to join and favour the Spanish tourism, enhancing the Madrid Airport to compete with the main European hubs, helping Spain to become more competitive, diversified and recovering faster from the pandemic crisis.

2. THEORETICAL FRAMEWORK

While explaining the profits and barriers generated by mergers and acquisitions, the theoretical framework also gives a definition of horizontal and vertical integration, explains their dissimilarities, and presents the advantages and disadvantages companies acquire once they merge.

2.1 Definitions and classification of mergers and acquisitions:

There are three procedures whereby an enterprise may merge or acquire another enterprise: merge or consolidation, acquisition of assets, acquisition of shares.

Mergers are the union between two or more companies, with the extinction of all or one of them and the integration of their shareholders and assets into one of the existing or new companies. Acquisitions are the property of control of a company by another company, by the total or partial purchase of its shares, assets or by the purchase of a control package. Mergers and acquisitions often are referred as to "M&A".

Mergers and acquisitions differ according to how the operation is managed. In mergers, the management teams of the two companies negotiate previously, and once they reach an agreement, the merger takes place. On the other hand, in the acquisition, the acquiring company usually makes a takeover bid (OPA) to the shareholders, without having made a prior negotiation. An OPA consists of a public purchase announcement at a certain point in time at a certain price.

2.1.1 Merge or consolidation

When one company fully absorbs another, then a merger takes place. All the assets and liabilities of the target company are incorporated into the acquiring company, which retains its identity. After the merge, the target company does not exist anymore. On the other hand, in a consolidation, the two companies disappear and a new one is created.

The main advantage of mergers is that they are very simple in legal terms and less costly, as there is no need to transfer ownership of the target company's assets to the acquiring company.

The main disadvantage is that the merger agreement initiated by the directors of the company must be approved by a qualified majority of shareholders, just 2/3 of shareholders are normally required to carry out the merger agreement and getting that many votes can be costly.

2.1.2 Acquisition of shares

Other possibilities to take control of a company is the Direct purchase of the voting shares of the target company. The acquiring company makes a takeover bid (OPA), and the shareholders of the target company who agree to the offer, sell their shares. One of the main advantages of share acquisitions is that the acquiring company is directly related to shareholders. Regulation in many countries does not allow one company to take control of another by frequently buying shares on the stock exchange but in small quantities. Regulation

requires the acquiring company to report the percentage of shares held by the target company each time the percentage exceeds certain thresholds, for example, the minimum percentage in UK is 3%, the same as in Spain, but in EE.UU the minimum percentage is 5%.

2.1.3 Acquisition of assets

This happens when the acquiring company acquires assets of the target company. The acquiring company does not wish to take control of the company that sells the assets but wishes to acquire only certain assets that it considers valuable. This is not an acquisition of one company by another, only those assets that the buyer wishes to buy are sold. Shareholders must approve the sale of the assets, if the sale of assets takes place, the target company becomes empty and then liquidated. The valuation of each asset being transferred is therefore a costly process and requires knowledge of the market in which it is operated.

(Damodaran, 2001)

2.2 Profits generated from mergers

Gains from mergers depend on incremental cash flows from the merger. Mergers are interesting if the value that the target company has for the acquiring company is greater than the market value. For example, the company A acquires company B, this acquisition is beneficial if the value of the combined companies is greater than the sum of the value of the companies if they are separated. When the value variation is positive, the merger generates synergies. Estimating the value variation is complicated, so we need to know the incremental cash flows that the merger will generate. These flows are divided into 4 components:

1. Increases in income.

Profits in marketing, strategic profits or increased market power, lead to an increase in income when a merger is made. Some mergers offer strategic advantages, the aim is to be part of a new industry to exploit opportunities. To enter a new industry, a merger or acquisition can be much more economical than creating a new company from the beginning in a sector that has no experience.

Mergers reduce the number of companies competing in the market. The reduction of competition implies a certain market power of the company, which implies higher prices and higher revenues. Some mergers are detrimental to consumers, so the competition authorities in the developed countries must approve them.

2. Cost reduction

Merged companies operate more efficiently than if two companies work separately. The main reason is because of economies of scale. If there are economies of scale, the size of the enterprise tends to decrease as well as the average cost of production. Mergers can help to restructure the company and to achieve an optimal size.

3. Lower taxes

Through a merger, tax is saved. Tax benefits may arise for the following reasons:

- Tax losses: If a company pays a lot of tax on profits it can merge with a company that has losses to reduce the total amount of tax payable.
- Unused borrowing capacity: Some companies make little use of debt, those kinds of target companies became attractive to the acquiring companies, because they could further indebt the target companies and benefit from tax savings.
- Surplus of funds: When companies generate large cash flows they have different possibilities to use this surplus, such as paying a dividend to shareholders, repurchasing shares or acquiring shares in another company.
- Asset revaluation: the assets of the companies depreciate; this depreciation is reflected in the profit as a cost. When an asset is fully amortised, the tax savings disappear. A merger with the objective of revaluation of an asset is an option to take advantage of tax savings.

4. Net equity investment:

Every company needs to make investments to carry out their activity. In some sectors, those investments are huge, so if two companies of the same sector merge, the save of the investment becomes very important.

(Damodaran, 2001)

2.3 Barriers to mergers

Sometimes a merge or acquisition does not end up taking place, because there are barriers that make the merger process difficult. Those barriers can be involuntary when they are outside of the companies involved in the merger process or voluntary when one of the companies tries to take control unwillingly.

The main involuntary barriers are:

- Regulatory barriers: in most of the countries, the government does not authorize big companies to carry out the merger process because the merge does not ensure free competition, or it leads to monopoly situation.
- Fixed operating cost is too high: when fixed costs are too high, shareholders could doubt of the capacity of the new company to generate sufficient flows to recover initial costs.
- Free-riding: if the shareholders of a target company know that their shares are revalued after the merge, they will be interested in preserving their shares and knowing that the takeover bid (OPA) is successful. However, no shareholder will have incentives to sell its shares at takeover bid prices, because they would rather wait for the takeover bid to materialize. If all the shareholders do the same, any shareholder would accept the takeover bid and it will fail.

Voluntary barriers are defensive strategies. They try to avoid companies to acquire the target company, making it more unattractive. Those strategies are carried out by the directors of the company because this will lead to a loss of control of the company.

The main voluntary barriers are:

- Poison pills: when the directors of a company are afraid of the company to become a target company, they can issue warrants for the actual shareholders. A warrant is a purchase option (call) of shares in a

company. The emission of these new actions can lead to the dilution of the share's value.

- Golden parachutes: companies that can be targeted by takeover bids establish a variable remuneration for senior managers. This remuneration is often carried out through stock options. It is a similar strategy to poison pills, but the ones that get benefit from it are the directors and not the shareholders.
- Restricted voting rights: to certain shareholders with a high percentage of shares of the company who are interested in carrying out a merger or acquisition, the board of directors restrict their vote to decide on mergers or acquisitions.
- Staggered board: consist of dividing the board of directors in several groups and each year renovate a group of the board of directors.
- The poisonous put: this strategy is usually chosen by creditors to protect themselves from leveraged buyouts. It is a clause in the debt contract consisting of a right to sell the debt at a certain price.
- White knights: when a target company is the subject of a takeover bid by an acquiring company, what it can do is to look for a third friendly company to make a takeover bid in better conditions. This new friendly company becomes the white knight.
- Greenmail: the acquiring company launches a takeover bid to the target company; the target company can launch an aggressive takeover bid to the acquiring company.
- Leveraged recapitalisation: this strategy consists of borrowing the company and distributing the resources collected among shareholders through the repurchase of shares or via an extraordinary dividend. The company will be more indebted and less attractive; it is an effective measure against the leveraged buyout.

2.4 Horizontal or vertical integration

Acquisitions and mergers can be classified according to the way they operate and if they operate in the same industry or not.

Horizontal integration

“This occurs when a company acquires another company competing in the same industry, so they are competitors. The objective of this kind of acquisition is to increase the market power of the company.” (Tarver, 2021)

Vertical integration

“This acquisition occurs when the companies operate at different stages of the production process.” (Tarver, 2021)

The present work will focus on the horizontal integration. It is important to study horizontal integration since globalization forces to adopt changes in the organization of enterprises and this integration is a way to adopt these changes. Horizontal integration is important for oligopolistic markets or in markets where one company has more power than the others, producing efficiently within a single company the same good. It is a common business practice that many

multinational and local firms follow to increase their market power and to increase the variety of their products. Firms prefer to horizontally integrate because the size of the company grows and product differentiation increases. Companies horizontally integrated achieve economies of scale, reduce their competition and help them to access new markets.

2.5 What is horizontal integration?

When companies acquire another company of the same industry and same level of value chain, their purpose is to position its products in new markets and increase their level of sales. This acquisition process leads to an increase in the production of goods and services to gain competitive advantage in the industry. Economic profitability is reached through this competitive strategy that creates a monopoly; this strategy is called horizontal integration. It is successful because companies use the same research and development strategies, as well as marketing procedures, leading to a cost reduction. It is important to understand horizontal integration because the merge or acquisition of two companies can have so many impacts in an industry and in the market. Firms horizontally integrate when they grow. It is an attractive process when economies of scale can be achieved, and the company can manage the operations after the integration. It is important to horizontally integrate when the company has enough funds to acquire or merge with their rivals and enough technological capacity, human talent and other resources to complement the merger.

There are three types of horizontal integration: Acquisitions and mergers, joint ventures, and strategic alliances. An acquisition occurs when one company takes control of another one, while a merge occurs when two or more companies combine their assets, those can be carried out in an aggressive or friendly way, depending on if they are a threat or not. Joint ventures occur when two companies agree to engage in a commercial activity, sharing benefits, and providing services on a temporary basis. They share risks, investments, profits or losses. Strategic alliances are the relationship between two or more companies that develop joint processes to improve efficiency and results. These companies have a common goal but are independent from each other. (Tamayo Plata & Piñeros, 2007 p.29-41)

2.6 Advantages of Horizontal Integration

Horizontal Integration allows companies to have a larger market share combining the product base, technology, and services available on the market when two companies merge. Two companies operating in the same industry could have a different base of customers and when they merge, the customer base becomes bigger. Since they have a bigger base of customers, the new created company can increase its revenue. Usually, they have greater revenues when they join than when they are separated, for example, if the merge is with an organisation abroad, the new company will have an additional foreign market, increasing their base of customers and entering new markets.

Companies that are separated have a lower production than when they are horizontally integrated, leading to a lower cost of production, because a large company has a very low cost per unit of production and better bargaining power between suppliers, causing economies of scale.

Integrated companies can offer a wider variety of products and services to clients, because even if they work together in the same industry, each individual company has different products leading to product differentiation of the resulting company.

Due to the merge, the companies' focus of investment is changed completely. The fact that firms will invest less time and money in fighting their competitors, will not only reduce rivalry in between the sectors but also is going to improve quality and service of products offered by each one of them.

Horizontal integration complements the existing portfolio instead of creating a new brand from zero leading to the growth of partnerships in R&D, production and offering of products and services. The horizontal integration can be the solution of the change towards the new technologies, through the absorption of the companies that count on an organizational structure that favour the innovation and technological development.

The horizontal integration allows companies to avoid problems with the capital needed to offer more goods or services and to establish the necessary research and development required in a globalised market.

There are companies willing to acquire companies almost bankrupt or at very low prices in order to obtain a significant portion of the market, access to a license or obtaining a good amount of assets for increased production.

According to Goldman et al (2003), merging the operation of two firms can reduce duplication, allows fixed costs to expand on a larger product basis, and empowers firms to reorganize services across their combined networks.

2.7 Disadvantages of horizontal integration

Horizontal integration requires legal control since mergers and acquisitions that reduce the competitive power of the market and possibly create a new monopoly, taking advantage of consumers with higher prices and narrow product choices are prevented by the antitrust laws. If the target company threatens to throw out competitors from the market, anti-monopoly laws will be used against it. When companies horizontally integrate, they become larger organizations with more personnel and processes, they become more difficult to manage as they are less flexible in introducing new products to the market, so if the resulting firm becomes too large it would be more challenging to manage, creating unexpected inefficiencies due to the different managerial opinions.

When two companies with unique polices, horizontally integrate, they are forced to work uniformly, and this could be a risk for the new company. There is a lack of competition with horizontal integration because usually mergers occur between the best performed companies in an industry, leaving the others in weaker conditions to compete. This is a big disadvantage to consumers because they have to deal with higher prices goods and services with low quality.

3. THE CASE OF AIR EUROPA AND IBERIA

Airlines choose horizontal integration processes to obtain airport infrastructure, traffic rights and slots, in order to beat entry barriers. Those are some of the reasons why airlines decide to perform horizontal integration. Hence, this project will focus on the process of integration between Air Europa and Iberia.

3.1 The merger

According to the official web page of Air Europa, the airline is based in Madrid-Barajas Airport and it was founded in 1984. The company was acquired in 1991 by the tourist group Globalia Corporation Empresarial S.A. It is one of the main airlines in Spain, operating in Europe, Latin America, the United States of America, the Caribbean and North Africa. It operates into 69 destinations.

As stated on the official web page of IAG, the international airlines group is a holding company due to the merger of Iberia and British Airways in 2011.

Iberia is considered the largest Spanish airline and leader between Latin America and Europe, while British Airways is a UK airline, and it operates in the global market.

IAG was also integrated with three airlines: Aer Lingus, the national airline of Ireland. Vueling, the major low-cost airline in Europe and finally Level, the IAG's low-cost long-haul airline.



Figure 1: IAG Airlines

Source: IAG

According to Hosteltur, in november 2019, IAG, the parent company of Iberia, acquired 100% of the capital of Air Europa. The initially agreed acquisition price was €1b, and the operation is successful, Air Europa will become the sixth airline integrated in IAG. Air Europa brand will be initially preserved, and the company will remain an autonomous revenue centre with Iberia, directed by the CEO of Iberia, the cost and revenue synergies will be conserved as in previous IAG transactions.

(Ramón Vilarasau, 2019c)

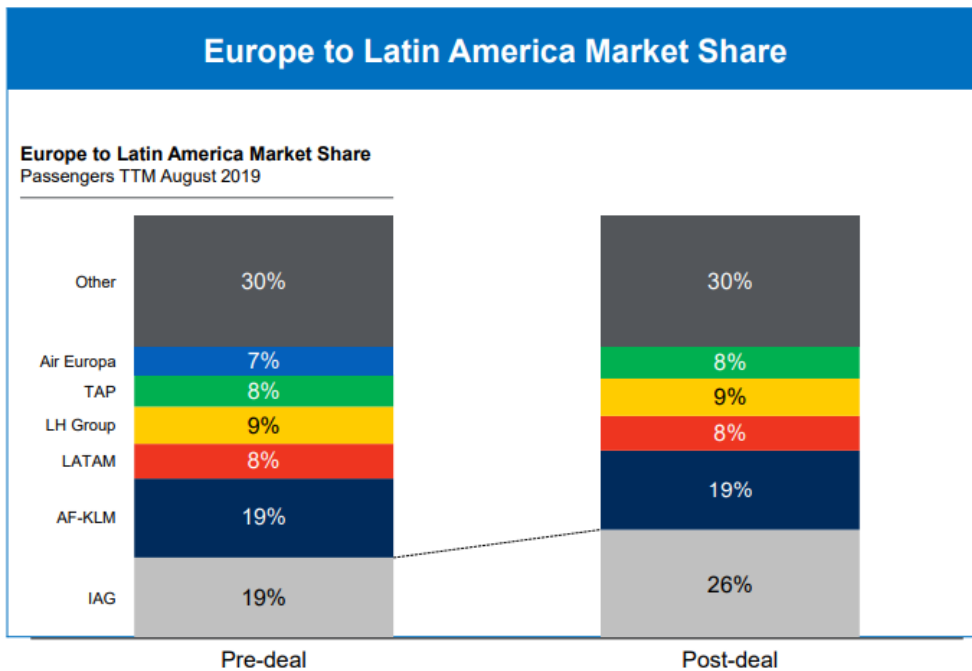
3.2 Advantages of the merge.

“The purchase operation, if successful, will allow attracting to the group an airline with successful financial results, locating the two companies, previously competitors, in a position of dominance in the market, with certain low-cost features in its business model and a very modern fleet.” (Canalis, 2019)

IAG will be the leader of the air connections between Europe and Latin America with the purchase of Air Europa through Iberia, since Air Europa became a member of ALTA (Asociación Lationoamerica y del Caribe del Transporte aéreo) in 2015, the market share in air connectivity between Europe and Latin America will be 26%, when previously it was 19% competing against Air France KLM (19%), Lufthansa (9%), TAP (8%) or Latam Airlines (8%). (Lyonnet, 2020)

This merger, will allow Iberia and Air Europa to compete with the North American, European and Asiatic groups, leading to a tourism with greater purchasing power.

(Ramón Vilarasau, 2019e)



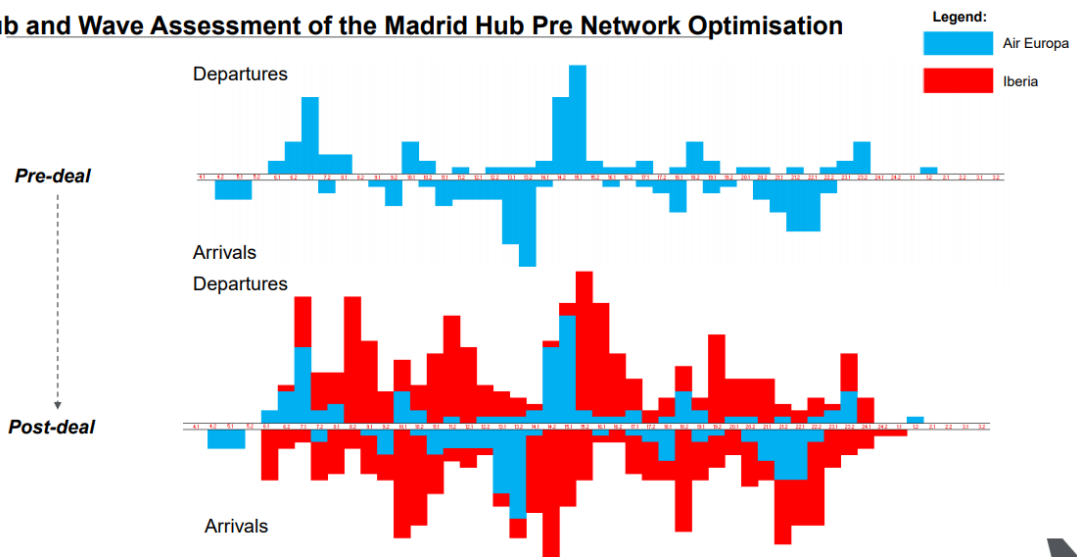
Graphic 1: Improved IAG position in the Europe to Latin America market.

Source: IAG

Note: Europe including Russia and Turkey. Latin America includes South and Central America excluding the Caribbean.

As stated by Hosteltur, Madrid airport will have the opportunity to compete against Frankfurt, Amsterdam, Paris Charles de Gaulle and London Heathrow, making Madrid airport an efficient and a European hub (operations centre), offering more connectivity between countries and growing in different markets. This operation will allow for the development of Madrid airport in a proper hub, meaning that the purchase will add to IAG a new competitive and profitable airline, making Madrid a leading European hub, that reaches regions until now unattainable for the group.

Hub and Wave Assessment of the Madrid Hub Pre Network Optimisation



Graphic 2: Enhanced effectiveness of the Madrid hub

Source: IAG

Note: assuming a peak day of arrivals and departures into Madrid Barajas. Excludes codeshares. Flights are shown in 30 minutes slots starting at 04:00.

As reported by Hosteltur, this operation will bring important benefits to customers, such as the provision of more flexible schedules and options as well as more opportunities to earn miles at lower prices. It will offer better services to the client by offering more routes and more opportunities to travel. However, in the short run, this merger could result in a reduction of personnel and the cession to other airlines in codeshare of routes that until now were hegemonic of Air Europa.

IAG and Air Europa together can lead to an increase of 12 million passengers, 10 new long-haul destinations and 22 more airplanes. Its network will be increased by 12 additional long-range destinations assuming a 15-30% growth. In terms of traffic revenue, Iberia will experience a 50% increase, while IAG a 10% increase.

(Ramón Vilarasau, 2019b)

Dentro de IAG para construir un hub de Madrid más eficiente

Para 2024, juntas Air Europa e IAG pueden sumar hasta:



Figure 2: With these numbers IAG convinced the market.

Source: Hosteltur

3.3 Disadvantages of the merger

The acquisition of Air Europa by IAG will lead to a high concentration of Spanish operators in a single group, leading to negative impacts especially in the domestic market, affecting consumers, this is because, Iberia, Air Europa, Vueling and Air Nostrum hoard the 72% of the domestic flight market according to FACUA and the 84% of the seats sold in Spain according to the CAP aviation Centre. (Ramón Vilarasau, 2019d)

This fact results in a big disadvantage when accepting the purchase proposal by the CNMC (national commission of markets and competency) since the operation will affect residents of the territories outside the peninsula even more, who already pay very high prices for flights. This would also lead to a monopoly at Madrid airport, especially in the short radio market, without making the necessary provisions to ensure that competition is not affected.

IAG notified the EC about the transaction considering that it must be sent to the CNMC of Spain if the transaction affects competition in the Spanish market.

“The European Merger regulation implements that it must be notified to the EC when the total worldwide turnover of all the undertakings concerned exceeds 5 billion and 250 million individually at Community level, of at least two of them.” (Ramón Vilarasau, 2019a)

If the transaction is of community dimension, meaning that “the total worldwide turnover of all the undertakings concerned exceeds 5 million and the total Community turnover of at least two of the undertakings concerned exceeds 250 million, unless each of the undertakings concerned by the concession achieves more than 2/3 of its total turnover in the Community, in the same Member State” (Garcia Vicente, 1991) the EC could report all or part of the case to the national authority. Instead, if the concession causes adverse effects on competition in a market in that Member State, the CNMC analyses a concentration operation if the resulting company has 30% of the relevant market of product and geographically or if the total turnover of the companies merged in the last exercise exceeds 240 million. (Ramón Vilarasau, 2019a)

This process affected the parent company of Air Europa as well, Globalia. According to the official web page of the group, the company is a leading leisure and tourism group in Spain with an annual turnover of 3.9 billion with six business units spanning hotels, handling companies and high street travel agencies. Globalia was highly affected by the acquisition of air Europa because it left the company without their greatest source of income. In 2018 Air Europa earned more than 50% of Globalia’s billing and the airline grew 9.3% while the group just 4.3%. The rest of the companies that form Globalia group, such as Halcon Viajes, Viajes Ecuador, Globalia Corporate Travel and Tubillete, suffered a €60m cut in sales. Travelplan experienced a 4.8% decrease in sales but Be Live Hotels’s sales reached amounted to over €132m. (Ortega, 2019)

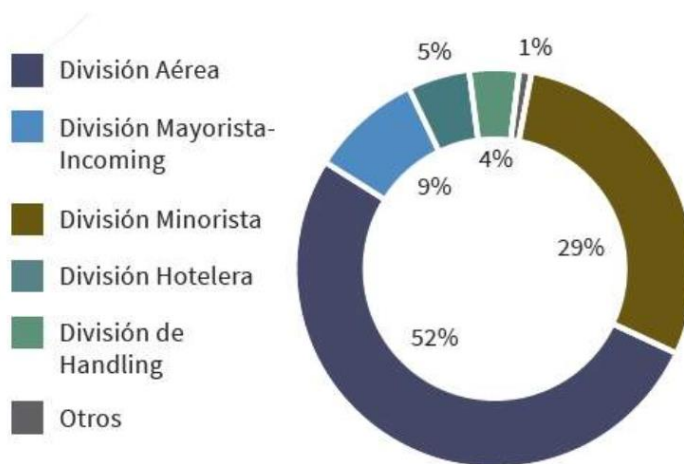


Chart 1: Percentage of Globalia revenue by division in 2018.

Source: Hosteltur

According to Unite, the largest trade union in the UK and Ireland, this acquisition will lead to severe problems. IAG will dominate the flight market from Europe to South America, occupy the position at the Madrid Airport and it will

create a monopoly in the Spanish domestic market together with Iberia and Vueling. These problems will lead to a higher price on flight tickets and a decrease in competition on several routes where the Spanish operators coincide, such issues will result in the European Commission making the acquisition difficult to approve.

On July 30th of 2019, Unite organized a manifestation in front of the Spanish embassy in London, criticizing the fact that IAG receives state aid to carry out the acquisition of Air Europa, while dismissing staff and also to denounce that British Airways wants to carry out a staff adjustment process to dismiss and re-hire more than 30.000 workers with the aim of decreasing their working conditions when workers return to their jobs. The European commission and Unite will act jointly in the investigation on the purchase of Air Europa from IAG. (Vargas, 2020d)

The operation was pending approval by the EU competition authorities, while air Europa and Iberia tried to solve liquidity problems along with some portfolio-related activities. For example, IAG will have to carry out the restructure of the airlines that compose it -Iberia, British Airways, Vueling, Aer Lingus and LEVEL- through the reduction of fixed costs and making fleets more flexible. According to the employers. However, IAG will have to adjust its establishment plan when the ERTE's no longer exist and customers that have cancelled the tickets, will get a refund when requested, but IAG will return the tickets in the form of vouchers to preserve the profits and minimize risk. (Hosteltur, 2020)

Globalia airline asked for help from the SEPI to survive the crisis Covid-19 crisis and for the preparation of the merge with Iberia due to its economic and financial situation. On the other hand, IAG did not asked for help from the SEPI rescue fund, a fund based on 10 million euros, created by the government to help strategic companies in distress to guarantee their survival. There is no maximum amount fixed as it will depend on the financial needs of each company, but the amount requested may not exceed the equity of the company stated last year. IAG has a stronger financial position than other European airlines that are going through a similar situation due to the pandemic, according to Hosteltur.

On the 8th of September IAG increased its capital by 2.750 billion euros to improve its balance sheet and liquidity, since the company lost more than 3 billion euros due to Covid-19, however the purchase of Air Europa was not made through the increase of capital, it was supported by the largest shareholder of the group, Qatar Airways, that controls one quarter of the capital. This capital increase would improve the group's ability to adapt, and it will help the airline to end the crisis in a more flexible and capable way, this operation will be ensured by Goldman, Sachs, Morgan Stanley and Deutsche Bank and to which they have also committed to support the members of the board of directors and the management team of the group. (Vargas, 2020b)

Globalia requested 400 million euros to the fund of rescue of strategic companies, divided into an equity credit and an equity loan. The amount was ordered to recapitalize after the fall of the activity by the pandemic, this process must be accepted by the regulation of the European domestic market and as the aid is more than 250 million euros it must be notified to the European commission. Companies applying for aid form the rescue fund must submit a viability plan with: measurable business forecast objectives and the assets and

financial situation of the company. If within five years the beneficiary company has not repaid at least 40% of the aid, they will be subject to a 10% penalty. If seven years have passed and they have not repaid everything, the fine will be 10% on the participation at that time. The rules of the fund prevent the beneficiary companies from carrying out aggressive expansion policies that distribute dividends to their shareholders and their directors from collecting bonuses or any variable remuneration until at least the repayment of three quarters of the aid. (Vargas, 2020a)

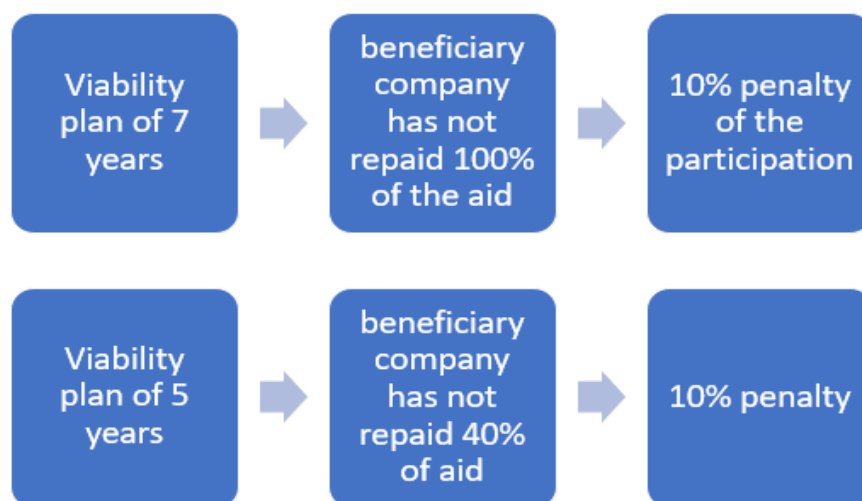
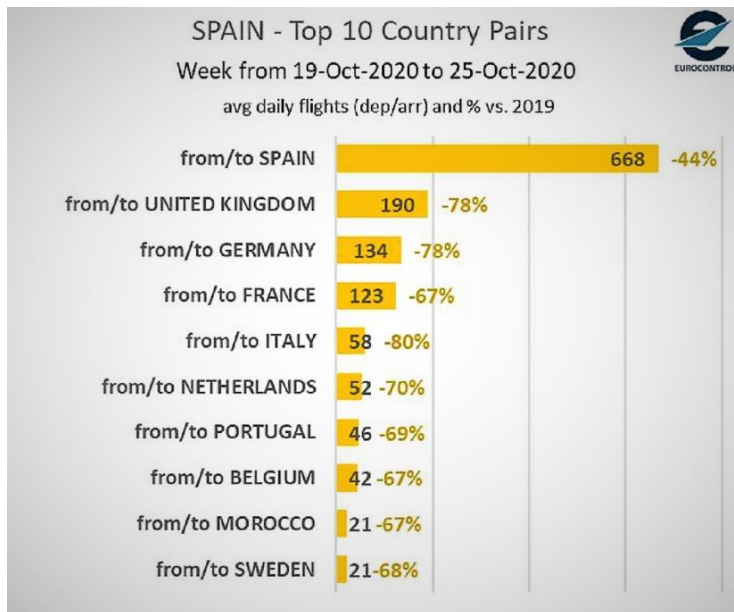


Figure 3: Rules of the fund to avoid aggressive expansions.

Source: own elaboration

On the 8th of September 2020, the purchase of Air Europa was reduced to 500 million euros due to the crisis of the pandemic since Spain occupies the third position in Europe, just behind the United Kingdom and Germany, according to the loss of flights, with a reduction of its traffic by 150 million passengers. (Ramón Vilarasau, 2020b). According to Eurocontrol, the largest decrease in Spain occurred in April 2020. The main Spanish airlines have been affected by the situation, leading to a huge decrease of number of flights, for example Ryanair had a decrease of 71% of the number of flights, Vueling had 189 less flights compared to March 2019 and Iberia had a decrease of 72% leading to a decrease in the number of total passengers by 83%.



Graphic 3: Domestic and european traffic flows
Source: Eurocontrol

As stated by Hosteltur, on the 29th of October 2020 Air Europa analysed the conditions imposed by the SEPI for a rescue of 475 million euros. Previously, the airline asked for an injection of 400 million but finally the amount increased by 75 million euros more because the recovery provisions of the traffic air are unrealistic due to the second wave of Covid-19. According to the UE, the operation should not be accepted because the injection of funds is bigger than 250 million euros, besides, the rescue of Air Europa had already obtained in the middle of May 2019 a bank credit of 140 million by ICO. (Ramón Vilarasau, 2020a). The IAG advisor wanted to revise the purchase terms since Air Europa now has a debt of 600 million euros, so it is an indebted company that asks the government for help not to fail, therefore the conditions of the merge have change dramatically as Air Europa does not have the same power as before. (Ramón Vilarasau, 2020c)

On the 3rd of November 2020, the government approved the rescue of 475 million divided into an equity loan and an ordinary loan, to be returned on six years. The government accepted the proposal since Air Europa operates in 130 destinations and 60 countries, so it has an important impact on the Spanish tourist sector, it is an essential service to make sure that there is connectivity between Spain and the rest of the world.

According to Hosteltur, some airlines, such as Ryanair, are against the financing of the Air Europa rescue, since they argued that the process is discriminatory and violates the UE legislation. On the 6th of November 2020, Ryanair presented an appeal to the TJUE an appeal against the authorisation to rescue Air Europa. (Vargas, 2020c)

On the 18th of December Iberia agreed on paying 500 million euros for the purchase of Air Europa, previously the price was 1000 million, due to the pandemic the price had to decrease, and IAG discounted from the final price the 475 million euros of the loan given to them by the SEPI. First IAG proposed to pay this amount through Iberia's shares, but then the groups decided to pay it with cash, but in 2026. The reason being, by then the market should have

recovered. This operation is pending approval, but it is made to cope with the financial commitments made during the pandemic such as the ICO credits and the aids granted by the government.
(Hosteltur, 2021)

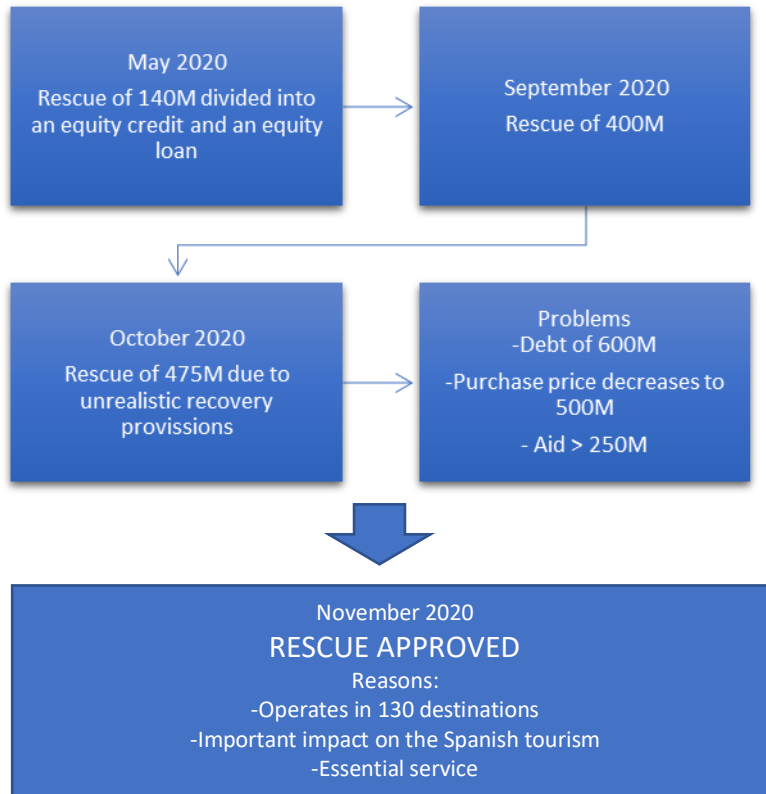


Figure 4: Air Europa rescue process

Source: Own elaboration

In any case, the merge between Air Europa and Iberia will favour Spanish tourism, because it will enhance the Madrid airport since, between the six strengths that hubs must acquire to compete, Madrid only accounts with a favourable geographic position, quality infrastructures and foundations for the local economy. For Madrid to compete with other hubs, it needs to be more efficient, to open new routes focused on Asia, The Middle East and Africa. So the merge between Air Europa and Iberia, will allow the additional connection traffic to open new routes and compete with other European hubs.

This operation will help the development and growth of the airport Adolfo Suarez that became the gateway of connection between Asia and America and between Europe and Africa. It will also lead to the connection of the high-speed train in T4 using European funds becoming more efficient and environmentally sustainable.

(Ramón Vilarasau, 2021)

4. CONCLUSIONS

After studying what horizontal integration is we can understand the merger process between Air Europa and Iberia. Not only this will be a positive process for Spain, since having a powerful domestic aviation industry is critical to the development of any country. It is additionally for Spain, a vital need because of our dependence on tourism. Once we are out of the pandemic the incorporation of Air Europa to the IAG group will allow for an increase in the number of destinations by rationalizing frequencies and the opening of new markets, especially in the long-haul destinations.

All this would provide customers with a wider range of destinations, although the number of frequencies in some of them could be reduced, and increased tariffs on certain routes as competition is reduced.

In the case of employees, despite what has been said from governments and unions, it will be inevitable that redundancies will occur (interpreted as synergies by analysts), which would necessarily lead to an early retirement or redundancies, especially among ground and office staff.

In conclusion, considering the impact of the pandemic on Spanish tourism, the economy and employment, this merger will help Spain to become more competitive by offering long-haul flights, attracting a higher quality and quantity of tourists. Resulting in a more diversified, seasonally adjusted and higher income tourism, recovering faster from the pandemic.

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