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American Airlines and British Airways: The Death of Co-opetition

Benjamin Gomes-Casseres

No, that's not a typo. An idea dubbed "co-opetition" died this week, even if you never knew it existed. It was born in the roaring 1990s, when companies declared that they would cooperate with each other while at the same time continuing to compete with each other.

Many a high-tech CEO cited this oxymoron with a straight face, perhaps to comfort us that a new alliance would not lead to collusion between partners. Yes, Adam Smith did say that "people of the same trade seldom meet together" without it leading to "some contrivance to raise prices." But that was oh so Old Economy—times have changed, we were told.

The Justice Department does not think so. On Monday, it advised the Department of Transportation to reject a proposed alliance between American Airlines and British Airways, because the alliance "threatens a substantial loss of competition which would likely result in higher air fares and reduced service."

In other words, it does not believe that AA and BA could cooperate in an alliance and still compete against each other on transatlantic service and fares. In the language of the go-go 1990s, Justice does not believe in co-opetition.

American Airlines said it expected this view from "an agency that has traditionally taken the hardest line in previous airline competition matters." Is the Department of Justice being too hard on the would-be marriage partners? Or are the airlines attempting in vain to prolong a myth that competition can survive despite widespread cooperation in their industry? The lawyers will fight this one out, but managers can use the opportunity to think again about whether the idea of co-opetition makes any sense.

Robert Frost's dictum that "good fences make good neighbors" is as true for business alliances as it is for New Hampshire farmers. Reams of research confirm this. The most successful partnerships are among firms that do not directly face each other in the market.

When direct competitors do find good reasons to cooperate, they will generally succeed only if they manage to reduce their rivalry. Short of carving out geographic territories, which is legal only in some contexts, former competitors are well advised to shape the scope and intent of their alliance in a way that minimizes friction.

Making war and love at the same time is a recipe for failure. Just look at what happened when Sun and Microsoft signed a deal to share Java – they ended up in court. Or ask yourself why AOL and Microsoft declined to repeat their marriage vows when their old alliance came up for renewal earlier this year – they had become arch-enemies in cyberspace. Like these, there are countless others: Well-intentioned allies that neglect to defuse their own rivalry at their own peril.

The co-opetition of the 1990s never really worked: You can't both fight'm and join'm at the same time. But wait: If a successful alliance between corporate giants requires them to squelch their rivalry, then isn't competition doomed? Isn't Adam Smith right after all?

No, but not because of the myth of co-opetition. Allying with a firm while still trying to compete against that same firm doesn't work; that was the mistake of the boom years. But allying with a firm in order to compete better against *other firms* does work.

What's more, companies are now finding that the less they compete internally with their partners, the better they are be able to compete externally against third parties.

You have to kill internal competition to sharpen external competition. That is the argument that giants IBM, Apple, and Motorola used with the anti-trust authorities in forming their PowerPC alliance several years ago— they promised to create a combination that could challenge the dominant powers in their industry. That part was brilliant. But then the partners failed actually to bury their hatchets. That tore them apart.

The airlines are trying to do it better. AA and BA explain that they face formidable challenges from other airline alliances, in particular from Star (led by Lufthansa and United) and Wings (led by Northwest and KLM). They complain that the authorities have granted anti-trust immunity to the members of Star and of Wings, which helps these groups compete.

This is part of what American calls "the reality of network-to-network competition." Regardless of how the legal battle shakes out, it is clear that the airlines are facing a new type of competition that is transforming their playing field.

This new type of competition is different from Adam Smith's world. In network-to-network competition, single firms do not do battle against other single firms. Instead, groups of firms face off against other groups of firms. The success of each group then depends on how well it is managed – including how effectively it reduces rivalry among its members.

Paradoxically, the more each group squelches its internal rivalry, the fiercer will be the rivalry between the groups. This is how competition in the industry can survive despite cooperation among firms.

Business thinking has not yet absorbed the implications of the new rivalry among alliance networks. CEOs first tried to deal with it by inventing new words; that did not last. The current battle among airline alliances is likely to yield a more lasting change to our perspective. Co-opetition is dead, but network-to-network competition is just stretching its wings.

Benjamin Gomes-Casseres is a professor at Brandeis University's Graduate School of International Economics and Finance, and author of *The Alliance Revolution: The New Shape of Business Rivalry* (Harvard Press, 1996), an early study of competition among alliance networks. His work can be found at www.alliancestrategy.com.