Virgin

This case highlights how Virgin grew into and then expanded from a music company to become an international leisure business which later diversified into air travel by starting its own airline, Virgin Atlantic. The case then traces how music and retailing were largely divested leaving Virgin a much more focused business, which then diversified again as it exploited the potential of the Virgin brand. It also discusses how Virgin was launched on the stock exchange and later reprivatized.

It is the study of the growth of an entrepreneurial company and how the need for cash to fund expansion affected the strategic development.

Virgin cannot be separated from its founder and chairman, Richard Branson. Consequently, it is also the study of the motivation and style of a charismatic entrepreneur and strategic leader and his impact upon the culture and strategy of an organization.

Virgin can usefully be studied alongside the Thorn EMI case.

This version of the case was written in 2000 by John L Thompson. It is for classroom discussion and should not be taken to reflect either effective or ineffective management.

History and development

Richard Branson was born in 1950. His father was a barrister and his grandfather a High Court judge. He attended public school, at Stowe; and it was here, at the age of 16, that he started the business that would eventually become Virgin.

Branson's first commercial venture was the *Student* magazine, designed for students worldwide, and with the aim of 'putting the world to rights'. Sales of 100,000 were claimed. The magazine, and the advertising on which it depended, were initially sold from a public telephone kiosk at Stowe school.

The magazine's success was patchy, and to generate a stronger cash flow Branson started selling popular records by mail order, using the *Student* to promote the venture. Certain records were normally sold only in selected London stores, and Branson saw an opportunity in making these more freely available to young people throughout the UK. Cash was required with every order, and the records were bought from wholesalers once a suitable size batch (for discounted prices) could be purchased. However, a number of record companies became suspicious of the venture and Branson had to change tactics and buy only through selected small record shops. The business was named Virgin because Branson saw himself as 'commercially innocent'.

The business expanded after Branson left school, but the prolonged postal strike in the early 1970s threatened its viability. In 1971 Richard Branson, together with his school friend and *Student* partner, Nick Powell, decided to take the lease on a small shop unit in Oxford Street, London, and sell records direct to the public. The partners were joined by a distant cousin of Branson's, Simon Draper, who had come to England from South Africa. Draper started as the record buyer for Virgin, but eventually became Branson's number two and the initial strength behind the enormously successful music business.

The profits from the first store, supplemented by a loan from one of his aunts, allowed Branson to diversify and start a small recording studio in a country house.

Real growth took place after a young musician, Mike Oldfield, approached Branson. Oldfield was an instrumentalist who had been experimenting in the search for a new sound, but whose demonstration tapes had been rejected by several well-known record companies. Branson and Draper saw an opportunity and decided to take the risk. They released Oldfield's music under the title *Tubular Bells*. The first record eventually sold 10 million copies and provided Virgin with its first real cash flow.

Expansion continued steadily through the mid-1970s as new artistes were signed and new stores opened. The company was growing at some 20% per year. In May 1977 Virgin signed the controversial punk rock band, the Sex Pistols, and their immediate success provided another growth surge. Virgin signed the Sex Pistols after they had had two previous contracts with EMI and A&M cancelled within a six-month period. Advertisements for their records were refused by the television companies.

In 1978 Draper became managing director of Virgin Records (as the music division was then called) and Branson ceased to have a day-to-day operational involvement.

The period from the late 1970s to the early 1980s was a difficult one for Virgin, which found its earlier growth hard to sustain. Virgin needed new artistes with true success potential, and this problem was compounded when the whole industry experienced a recession in 1980. Virgin had attempted to penetrate the significant and lucrative American market, but failed. For several other countries Virgin simply licensed its artistes to other companies, but knew this would not be appropriate for establishing a real presence in America. Initially it attempted to run its own US operation to push UK artistes with seconded British personnel.

There were now 16 record stores which were reported to be trading at a loss because of inadequate management control. Retailing demands an attention to detail as well as creative flair and risk taking, which were Branson's main strengths. An attempt to start a new London magazine to rival *Time Out* proved unsuccessful and was closed down. Branson's long-standing partner, Nick Powell, left the organization in 1981. Virgin's image was deteriorating.

Consultants recommended that Virgin should develop complementary activities and Branson determined that the company should become more professional with a clearer strategy and supportive structure. Related music and retailing activities, together with selected parts of the communications industry, were targeted because of the clear potential for synergy. Unrelated small enterprises and Virgin Atlantic Airways (begun in 1984) carried a different level of risk. The airline increasingly became Branson's main interest.

In 1982 Virgin signed Boy George and Culture Club and a third growth surge was provided for the music business. Branson recruited Don Cruickshank as managing director of Virgin (the central holding company) in 1984. Cruickshank, an accountant with an MBA who had previously been general manager of the *Sunday Times*, represented a more professional management style than had been previously associated with Virgin.

In 1983 Virgin was offered the opportunity to buy Our Price Records for £1 million, but was unable to raise sufficient cash. The company was sold to retail rival WH Smith instead.

However, by 1985 Virgin had become the 15th largest private company in the UK, with a turnover of £150 million and pre-tax profits of £12 million. For many years Virgin had been restricted by its bank to an overdraft limit of £3 million, but was now able to borrow £25 million from City institutions (in the form of convertible preference stock) to fund further growth. Fundamentally, Branson believed in organic growth rather than acquisition.

The continuing need for additional funding persuaded Branson that the time was right for Virgin to become a public company.

Flotation and re-privatization

Prior to the flotation in November 1986 Branson, Draper and a third director, Ken Berry, who was deputy to Simon Draper at Virgin Music, purchased certain Virgin assets and formed a new private company, Voyager, which provided an umbrella for amalgamating Virgin Atlantic Airways, the related holiday business and a variety of small enterprises. A new managing director, again with an MBA and experience in the travel industry, was appointed. These activities, which were essentially unrelated to the mainstream Virgin entertainment businesses, were regarded as too volatile to be floated as part of Virgin.

The Virgin shares were sold by tender, with prospective investors invited to offer to buy a particular maximum number at a certain price. The price was struck at 140 pence, which valued the company at £240 million. Branson, Draper and Berry had retained 63% of the shares, and control. Some 60,000 small shareholders bought in to Virgin but the institutions were less enthusiastic. After expenses the flotation raised £55 million, half of which was injected immediately into Virgin. The remainder went to the directors, with Branson investing most of his £20 million share into Voyager.

Some of the money invested in Virgin was directed towards securing the elusive US presence. The company had learnt from its previous failure and now sought to establish a more permanent business with both US artists and locally recruited executives. Branson made no secret of the fact that he expected it would take a number of years before the venture turned in its first profits. The investment in the USA, and Virgin's increasing dependency on revenues from the USA, provoked Cruickshank into joking that Branson would have to moor his houseboat in mid-Atlantic. (For many years Branson ran Virgin's head office from a houseboat moored on a canal in West London.) Branson recognized the value of the back catalogue owned by EMI Music, a subsidiary of Thorn EMI, and contemplated how he might acquire the company to establish Virgin properly among the largest companies in the industry. It was rumoured in Autumn 1987 that Virgin would bid for the whole of Thorn EMI and divest the non-related businesses. However, the stock-market crash in October 1987 saw Virgin's share price marked down from 160 to 83 pence almost overnight, and Branson's opportunity to acquire EMI had vanished.

Meanwhile, Branson caused unease in the City when his first attempt to cross the Atlantic by balloon ended with an emergency landing. (Branson has set world records for trans-Atlantic crossings by both hot-air balloon and power boat.) Institutional investors were concerned with succession in the company if anything went seriously wrong. In a number of other ways Virgin settled uncomfortably as a public company. Branson, together with most of his colleagues, enjoyed an informal style of management; for example, they tended to dress casually rather than formally. They also claimed that they found it difficult to explain the uncertainties of the pop music business to City analysts. In reality, the links with the institutions were mainly forged by Cruickshank (who arguably did feel at ease), but inevitably Branson and Draper had to involve themselves.

Virgin felt that its real value was not being recognized by the City and that this was reflected in a low share price. It had introduced more robust management controls and was concerned to demonstrate that they were genuinely committed to 'the bottom line' and the interests of shareholders. Initially Virgin's shares had traded above the offer price, but once they fell below it they underperformed against the FT All-Share index.

> *Being public is incredibly time consuming . . . every single thing has to be vetted by lawyers. You are tied up in tape. Around 50% of our time was spent worrying about going to stockbrokers' meetings, analysts' meetings, institutional meetings . . . and worrying about the next quarter's results . . . rather than planning for the long term. We thought: 'Let's try to get out of this'.*
>
> (Richard Branson, quotation summarized from material included in: *Richard Branson and the Virgin Group*, Manfred Kets de Vries, Insead-cedep, 1989)

Virgin announced a fall in profits of 22% when it declared half-year results early in 1988, and this drove the share price down further.

> *If anything goes wrong in a public company, it goes wrong very publicly and happens very quickly – and everybody panics and pulls the rug out.*
>
> (Richard Branson, quotation taken from *Richard Branson and the Virgin Group*, op cit.)

The US music business was losing some £2–3 million on a turnover of £16 million, and Branson, who was perhaps too honest about the situation, commented that it would take another two years to move into profits. Branson also announced that the directors would buy back the 37% of the shares they did not have at the offer price of 140 pence.

The buy-back was completed in July 1988, and required a £182 million syndicated loan. One positive benefit to emerge from the period when Virgin was a quoted company was that the City insisted on sound control systems. They expected, for example, that Virgin would know the weekly turnover of each of its stores. These systems had been strengthened, and Virgin was therefore a sounder business when it was re-privatized.

Branson's problem now, though, would be funding the continued expansion of Virgin. Prior to going public he had often experienced difficulty in extending his overdraft facility.

Some time later Don Cruickshank left Virgin and he has since held a number of senior public-sector appointments, including Director-General of OFTEL, the telecommunications regulatory authority.

Exhibits 1 and 2 summarize the financial results for Virgin for the mid-1980s, and provide a comparison of Virgin's performance with that of the total leisure industry in 1988.

Exhibit 2 Comparison of Virgin management with the total leisure industry

	Leisure industry co. average	**Virgin**
	12 months to 30.6.1988	12 months to 31.7.1988
Return on net assets (%)	16.5	9.3
Return on equity (%)	13.8	1.4
Stock-days	42	40
Debtor days	51	125
Creditor days	56	70
Interest cover – times	2.7	1.7
Sales/employee – £'000	68.4	153.6

Joint ventures

As one source of money Branson has entered a series of joint ventures and sold minority interests in several of his subsidiary businesses.

The Virgin group of companies, which remained separate from Voyager, was split into three distinct divisions: music, retail and communications. Voyager

Exhibit 1 Virgin management – financial analysis for the five years before reprivatization (figures in £ millions)

	12 months to 31.1.1984	**12 months to 31.1.1985**	**18 months to 31.7.1986**	**12 months to 31.7.1987**	**12 months to 31.7.1988**
Turnover	99.6	152.8	312.2	299.7	377.0
Profit before Interest and tax	11.2	14.2	23.1	34.5	17.7
Interest	1.1	2.2	6.2	3.5	8.5
Earnings	4.1	6.6	9.3	16.9	1.0
Profit after extraordinary items	4.1	5.2	7.5	21.5	(3.9)
Fixed assets	14.5	45.4	78.8	55.8	74.4
Current assets	37.7	51.2	100.4	167.6	194.0
Current liabilities	35.8	50.4	67.7	68.5	78.6
Net assets	16.4	46.2	111.5	154.9	189.8
Equity	5.3	10.8	33.3	74.9	70.8
Loan capital	11.1	35.4	78.2	80.0	119.0

still encapsulated the airline, the holiday company and a variety of other enterprises. Each division comprised a series of small, autonomous businesses. More recently, Voyager has been renamed Virgin Travel Group.

At the end of the 1980s, Virgin consisted of some 200 subsidiaries. Each time a company expanded beyond a staff level of 80 Branson split it up and separated the people, perhaps into different premises. He believes that this prevents impersonality and maintains motivation.

In October 1989 Fujisankei of Japan bought 25% of Virgin Music for £96 million. Virgin as a whole (including retailing and communications as well as music) had been valued at £248 million when it was reprivatized in 1988.

In December 1989 Virgin formed a joint venture with Telfos Holdings for the manufacture of computer disks, videos and cassettes which would be sold under the Virgin label.

A joint venture with Marui of Japan followed in April 1990. Marui is a leading Japanese department store which caters mainly for young people. Virgin and Marui would jointly open a Megastore (multiple-products Virgin shop) in Tokyo in September the same year.

May 1990 brought Branson's third alliance with a Japanese partner. Seibu Saison, owner of Inter-Continental Hotels, paid Branson £36 million for 10% of Virgin Atlantic Airways. Branson's commitment to people and the quality of their working life meant that he felt comfortable doing business with the Japanese.

However, Branson bought back the Seibu Saison shareholding in November 1993, at which time he invested more of his own personal fortune in Virgin Atlantic.

Exhibit 3 summarizes the situation of Virgin and Virgin Atlantic in 1991. The joint ventures alone, however, were not going to see Branson through the recession. Divestment and further strategic alliances would follow.

Virgin Music

Virgin Music mainly comprised the record label, recording studios and music publishing (finding opportunities for composers in recording, television,

Exhibit 3 The Virgin group – situation summary for 1990/91

	Virgin Music	Virgin Retail	Voyager Travel Holdings	Virgin Communications
Activities	Recording (80%) Music Publishing (18%) Studios (2%)	Megastores and Gamestores Europe and Japan	Virgin Atlantic (80%) Virgin Holidays (17%) Aviation Services (3%)	Computer games TV post-production Publishing and distribution
Turnover (£ million)	350	175	383	140
Pre-tax profit/(loss) (£ million)	18	(1*)	6.2	14
Outside shareholders	Fujisankei (25%)	UK: WH Smith (50%) Japan: Marui (50%) Europe: Consortium (20%)	Virgin Atlantic: Seibu Saison (10%) Voyager Hotels: John Laing (50%)	–

*Profits in UK and Japan subsidizing expansion into Europe.
Source: *Financial Times*, 21 February 1992.

films and advertising). In addition, Virgin held merchandizing rights to sell a variety of products and publications at selected concert venues.

Virgin grew to become the 'largest second division' record company, smaller than the four majors (Warner, Sony, Polygram and EMI) and substantially bigger than most of the independent labels. Virgin's UK market share maximized at around 10% for singles, and 8% for LPs, cassettes and CDs. Over the years Virgin developed a reputation for picking 'winners', artists whose recordings would prove successful; and during the late 1970s and 1980s it obtained contractual rights for the music of Genesis, Phil Collins, Human League, Simple Minds, UB40 and many others in certain territories worldwide.

A record company contracts with an artist to exploit his or her talent in exchange for royalty payments. Normally a fixed number of albums and a number of years are agreed. The most successful companies are able to spot artists whose popularity will last for several albums (together with linked singles) and several years, and balance 'yesterday's winners' with future potential in a varied and extensive portfolio. Virgin had around 100 contracted artists on its various labels. In addition, Virgin enjoyed considerable success from a joint venture with EMI for a series of compilation albums in the series 'Now That's What I Call Music'. In the early 1980s Virgin acquired a number of small, independent record companies.

Virgin's early expansion abroad was through licensing agreements. After its initial failure in the USA the company realized that it would be increasingly profitable if it exercised greater control over marketing and promotion, and systematically it switched over to controlled subsidiaries. The USA was, however, always the prime target, and by the late 1980s Virgin was trading profitably with a wholly owned subsidiary employing experienced US staff. Ironically, the company became profitable earlier than Branson had anticipated.

The sale of Virgin Music

By 1990 the total Virgin Group was experiencing cash problems again. This became more critical when the Gulf War hit airline revenues, and throughout 1991 it was speculated that Branson might be willing to sell all Virgin's music interests in order to support the retailing, communications and airline businesses.

During 1991 Sony, Polygram and Walt Disney all expressed interest before withdrawing from any negotiations. Bertelsmann (Arista and RCA labels) was also a serious contender. Since Branson's failed attempt to acquire EMI Music, Thorn EMI's chief executive, Sir Colin Southgate, had more than once tentatively approached Branson. EMI had already bought Chrysalis Records, and the acquisition of Virgin would elevate it to a position alongside the world leaders. The early overtures had been rejected, and throughout 1991 Branson remained undecided about whether he would actually sell. Early in 1992 Branson was seriously interested in a deal. Negotiations with Southgate finally took six weeks, and Thorn EMI agreed to buy Virgin Music for £560 million in cash. Southgate had wanted a deal involving both cash and shares, but Branson had demanded future compensation if Thorn's share price were to fall. The £560 million bought £3 million tangible assets, £507 million intangible assets (back catalogue material) and goodwill, and £50 million debt. The figure represented 1000 times Virgin's after-tax earnings in 1991.

Fujisankei received £120 million, Draper and Berry £70 million jointly and Branson £320 million. This allowed Branson to pay off all Virgin's remaining debt (£119 million) and support his airline further.

Perhaps not unexpectedly, Simon Draper subsequently left the more formal and culturally different Thorn EMI, but Ken Berry stayed and was instrumental as Thorn EMI proved that it could extract additional synergy from linking Virgin Music with EMI and Chrysalis. (The relative success of Virgin Music after the acquisition is discussed in the Thorn EMI case.)

Branson had obtained cash to support that business activity which he now cared most about, and although Virgin had sold the business for which it was best known the company was still a diversified leisure group with strong businesses.

In 1997 Virgin returned to the music industry when it set up a new, small, independent label, V2.

Virgin Retail

Branson's challenge from retailing was to succeed with his preferred style of informal, empowered management as the number of stores increased and in an industry characterized by detail and normally making extensive use of control systems backed by information technology. Virgin developed with three different retail formats: specialist record stores, megastores and department store concessions. In 1984 all of the stores were redesigned by Conran to try and give them greater distinctiveness, promote additional business and strengthen the profit flow.

The single-product store format (mostly music plus some specialist games centres) was systematically extended to towns and cities throughout Britain. While they made an impact in terms of market share their returns were perceived as inadequate. In 1988 Virgin agreed to sell 74 specialist record shops to WH Smith's Our Price Music.

Virgin's megastores sell popular and classical music, back catalogue records and tapes, blank tapes, videos, T-shirts, posters, hi-fi equipment, computer games, books and stationery. They have a much greater selling area than the original single-product music stores and they have been concentrated in major cities in Britain, continental Europe, Australia and the Far East. By 1992 there were 14 stores in continental Europe and Australia.

In September 1991 Virgin and WH Smith formed a 50:50 partnership to manage and develop Virgin's UK chain of 12 megastores and seven games centres. WH Smith was providing both finance and retail expertise.

In November 1992 Branson announced his latest joint venture with Blockbuster Video, a Florida-based video-rental company. The purpose was to extend the Virgin megastore format to every large city in the USA as well as further sites in Europe and Australia. Consequently, this deal excluded Britain and Japan.

In simple terms Blockbuster bought an interest for an unnamed sum, and it was assumed that the two companies would jointly fund further expansion. Virgin and Blockbuster would jointly own the European stores and the one in Los Angeles (the first in the USA) on a 50:50 basis, but the new US units were to be 75% owned by Blockbuster. Virgin was to manage every megastore, and video rentals were to be added to the product range.

One year later the Virgin/WH Smith joint venture for megastores and games sold the games outlets, and in March 1994 the joint venture was absorbed into WH Smith's Our Price subsidiary. At this time there were 24 stores in the UK and Ireland. While the two brands remained separated on the high street, management was integrated. WH Smith now owned 75% of the joint venture, Virgin the remainder. No money changed hands and the overseas megastores were not affected. Simon Burke, managing director of Virgin Retail, took over the strategic leadership of the combined operation. (The fortunes of WH Smith deteriorated in the mid-1990s and a new strategic leader was appointed. At this time the main WH Smith retail branches were underperforming but Our Price and the Waterstone's specialist bookstores were profitable.)

At the same time Virgin established another joint venture with a Hong Kong trading company, Wheelock, and it was speculated that a Hong Kong megastore would be opened. In the event, Virgin decided that rents were too high and instead looked to Taiwan and China for expansion.

In 1998 Virgin bought the 75% shareholding held by WH Smith, initially taking out a loan to cover the £145 million price. The group now comprised 88 Megastores and 229 Our Price stores. Almost immediately it was rumoured there might be either a sale, a management buy-out or a management buy-in. None of these has so far happened and the Megastores have been deliberately repositioned to appeal to people in their twenties, thus reducing the early dependency on teenagers.

In 1996 Virgin first developed an Internet portal, Virgin.net; and this was followed in 1997 by on-line sales of CDs, books, financial products and train tickets. In 2000 Virgin followed up with a joint venture on-line wine-distribution business, where the classification was by taste instead of either grape variety or region of origin – 'to make things easier for consumers'.

Virgin Communications

From 1981 Virgin diversified into a series of related communications activities. Branson felt that they offered new opportunities and synergy for his existing businesses.

He began with the distribution of filmed entertainment, arranging, for example, with major film studios to manufacture and distribute video copies of their old and new feature films. A subsequent dalliance with film making was discontinued in 1986. Virgin also provided services such as editing to the television and video industries, and acquired a company which produced television commercials. The film-distribution business was internationalized before being sold in 1989 for £50 million.

Virgin bought MGM Cinemas for £190 million in 1995; Branson believed that he could find new and distinctive opportunities for adding value and differentiating. Branson tested out a Virgin retail outlet in foyers and a premium-service cinema (as part of a multiple) with a personalized cloakroom, special snacks and waitresses serving drinks. Virgin only kept the largest MGM cinemas, including all of the multiplexes, and sold the others for £83 million, some of which it invested in new cinema complexes. The number of Virgin multiplex cinemas in the UK and overseas continued to grow, but the UK and Irish cinemas were all sold in 1999, and the money was used to repay the loans taken out to buy back Virgin Our Price.

Virgin entered broadcasting through an involvement in satellite television, and in November 1988 formed a partnership with the Italian television company Videomusic. The aim was to strengthen its European satellite business which at the time was failing to generate sufficient advertising revenue. In 1991 Virgin was part of a consortium which bid for (but failed to win) the franchise for a regional independent television channel.

Virgin Radio began broadcasting in the UK on medium wave in April 1993. This was an independent national radio station with a brief to provide 'popular music from the last 25 years'. It was a joint venture between Virgin and TVam, previously the provider of breakfast television for the ITV network. There was a lengthy delay before Virgin was able to acquire a national FM radio wavelength. After disc jockey Chris Evans left BBC Radio 1 he joined Virgin Radio, where he dramatically – but sometimes controversially – increased the morning audience figures. Later, when he realized that Branson was willing to relinquish control, he bought an 80% shareholding. Branson retained 20%.

The fourth arm of Virgin Communications was publishing. Virgin acquired WH Allen, and was also active in the manufacture and distribution of computer software games, many through its own stores. Virgin offered computer versions of Monopoly and Scrabble and, since 1989, had an agreement to distribute Japanese Sega games in the UK until the launch of Sony Playstation. Sega was number two to the then world leader Nintendo.

In 1994 Branson sold a 19.9% shareholding in Virgin Interactive Entertainment (VIE) to Blockbuster, in exchange for Blockbuster shares. VIE develops games software for, among others, Sega and Nintendo and has a lucrative licensing deal with Walt Disney for producing games which feature Disney film characters. Some time earlier 15% of VIE had been sold to Hasbro, the US toy company, and commentators began to speculate that VIE would eventually be floated as a separate company in the USA.

One major benefit for VIE was the 1993 merger between Blockbuster and Viacom, the US cable television company, which was developing rapidly in the field of multimedia. Six months later Branson (together with other smaller shareholders) sold a further 55% of VIE to Blockbuster; Virgin received $125 million and retained a 10% stake in VIE.

Virgin Enterprises

This division was originally part of Voyager and embraced those entrepreneurial activities which could not be fitted elsewhere. If employees or outsiders attract Branson's interest with a new good idea that is likely to prove profitable he has generally been willing to provide venture capital and establish new small companies within the Virgin group. Those with the ideas are normally given shares in the new business, but not in Virgin overall. Early successful examples included a traditional pub, night clubs and a business set up to develop an electronic synthesizer controller.

In September 1994 Virgin finalized an agreement with ICL (itself majority owned by Fujitsu) whereby ICL would manufacture Virgin-branded desktop, notebook and games computers for marketing through Virgin megastores and mail order.

Earlier that year Branson was part of a consortium which bid unsuccessfully against Camelot for the right to run the UK National Lottery. A second bid was again unsuccessful in 1989.

In September 1994 Virgin launched a new range of externally sourced consumer goods branded with the Virgin name. A new business, *Virgin Retail Brands*, was established. Typically these developments have involved joint venture partners from the outset and, quite frequently, Virgin owns under 50% of the business. The first product was Virgin Vodka, a joint venture with William Grant, soon followed by Virgin Cola. Virgin Cola is mixed and canned by various companies from a concentrate produced by the Canadian company Cott (another joint venture arrangement), which also produces the concentrate for Sainsbury's Classic Cola. The timing seemed good; the cola market was expanding. Distribution through Tesco and a range of petrol forecourts was quickly secured; and Virgin used its own fleet of vans to collect supplies from cash and carry warehouses and deliver them to independent retailers. Virgin Cola was marketed as a quality product at a low price; Coca-Cola and Pepsi prices have always been higher, partly because of the money that they spend to promote the brand. Herein lay a problem: Virgin realized that it needed to undercut Coca-Cola and Pepsi but it still had to spend substantially on brand promotion. It did not enjoy the inherent benefits of a supermarket own-label product. Branson's declared aim was worldwide coverage using independent distributors who would invest most of the funding required. Coca-Cola was sceptical about this new form of consumer goods network, commenting that Branson was 'either very brave or uninformed'. Virgin Cola made an immediate impact and its market share reached 5% at one stage. However, its initial success has not been maintained and its share is now between 2 and 3%. The alliance with Cott was not successful and Virgin took over control of the business.

1995 saw Virgin enter the financial services market with a 50:50 joint venture with Norwich Union. The first product was a personal equity plan sold direct over the phone; personal pension schemes and insurance plans would follow later. Characteristically, Virgin planned to 'undercut competitors and remove the jargon and gimmicks from the products'.

In 1997 Virgin took a small shareholding in a floated company, Victory, set up by a ballooning friend of Branson. In turn, Victory owned two Virgin-branded businesses: Virgin Vie (not to be confused with VIE, Virgin Interactive Entertainments), which marketed a range of Virgin cosmetics, and Virgin Clothing, which began with jeans but later moved more up-market. Later the same year Virgin increased its stake to 46%, and thus became the largest shareholder.

In 1999 the Virgin brand was added to mobile phones with a 50:50 joint venture with One-2-One. The phones were an ideal product for Virgin Megastores and its other retail outlets. There were some operational hitches at the beginning but things settled down. In 2000 Virgin announced that it was entering into another joint venture to distribute mobile phones in Australia.

Virgin Atlantic Airways

Branson's business interest in a cut-price trans-Atlantic airline was triggered by a US lawyer, Randolph Fields, although his enthusiasm had earlier been stimulated by his mother, an ex-air stewardess. Simon Draper was sceptical. Fields originally hoped to operate a Boeing 747 service from London to New York which was exclusively business class, but he was refused a licence. Branson typically set out to gather the information that he needed to reach a decision, and within a matter of weeks he had committed himself.

A major aspect of Branson's approach was an assessment of Freddie Laker's Skytrain – why Laker had failed, and what lessons could be learned. (The demise of Laker Airways is described in Minicase 17.1 in the main text.) Branson agreed with many other analysts that Laker had attempted to grow too quickly, and determined that his airline would stay relatively small. He also felt that Laker had made a mistake with his choice of aeroplane. Laker had flown DC10s, which are smaller than Boeing 747 jumbo jets, and Branson believed that in a tight price competition the airlines with the most seats available would have an advantage. Laker's competitive advantage was based wholly on his low prices, which he was able to offer by providing only the most basic of services. When the major carriers retaliated by discounting, Laker's initial advantage was unsustainable. Learning from this, Branson has ensured that Virgin Atlantic offers a high quality of service as well as competitive prices.

Branson quickly agreed the lease for a Boeing 747-200, and in summer 1984 he began flights from London Gatwick to Newark, New Jersey (which services New York). He added a second plane to the fleet and introduced flights to Orlando and Miami in 1986. In 1988 he received permission for a daily flight from Gatwick to Tokyo. British Airways (BA) had two flights every day from the preferred Heathrow airport. In 1991, after lengthy campaigning, Virgin was also allowed flight slots at Heathrow, competing directly with BA on several of its most profitable routes. Fields had parted company with Branson in 1985, arguing that the rate of expansion was too slow.

Virgin Atlantic now flies from Heathrow and Gatwick to several destinations in North America, and there are also regular scheduled flights to South Africa (Cape Town and Johannesburg) and Asia (including Tokyo, Shanghai and Hong Kong). A seasonal Manchester–Orlando route was inaugurated in 1996; and in partnership with CityJet Virgin also flies from London City airport to Dublin and Brussels.

Virgin launched three code-sharing partnership agreements (for through ticketing) in 1995: with Delta Airlines of the USA, Malaysia Airlines and British Midland.

Virgin's aircraft fleet is now based around Boeing 747s, some of these being the newest 747-400 series, which offers a higher payload and lower fuel consumption per nautical mile than the earlier versions. In addition, thereis a number of Airbus A340s, the largest plane built by Airbus. All Virgin's aircraft are four-engined.

Virgin Atlantic was first profitable in 1986–87 after early teething problems, but this did not last. When Branson had just two aircraft (from 1986 to 1990) he had no spare capacity and, for example, any need for prolonged maintenance inevitably meant long delays for passengers.

Exhibit 4 provides a financial summary for the period 1987 to 1995. The figures for Virgin Travel (the renamed Voyager Group) include both the airline and the associated Virgin Holidays activities; the holiday business has typically been the more profitable activity. However, the airline has been profitable again since 1995. Exhibit 4 also includes data on passenger numbers and market-share achievements in the early 1990s. Exhibit 5 compares Virgin with BA and the complete transport industry sector in 1991. Care should be taken when comparing Virgin's ratios with those of BA, as the latter company is so much bigger and has an extensive portfolio of profitable and less profitable routes around the world. In 1989 Branson recruited BA's head of central marketing as an executive director, but he left after five days, commenting on a 'lack of systems and structure'.

During 1991 and 1992 the airline industry worldwide was hit hard by the economic recession following on from the business lost during the period of the Gulf War. For a period Branson became increasingly dependent on Virgin Travel's non-airline activities, and throughout much of 1992 Branson was reported to be seeking a partner willing to buy a 10–25%

Exhibit 4 Virgin Travel Group (renamed from Voyager Travel Holdings) financial results (figures in £ millions)

	12 months to 31.7.1988	12 months to 31.7.1989	12 months to 31.7.1990	15 months to 31.10.1991	12 months to 31.10.1992	12 months to 31.10.1993	12 months to 31.10.1994	10 months to 31.8.1995
Turnover	84.7	106.8	208.9	382.9	356.9	401.0	503.4	507
Profit before interest and tax (including non-trading income)	12.5	11.6	13.5	12.6	(10.3)	5.5	1.05	38.1
Operating profit	12.0	8.9	10.0	10.7	(9.4)	8.4	1.9	38.7
Interest	2.0	3.2	4.9	5.6	4.0	5.0	4.0	2.76
Profit before tax	10.5	8.4	8.7	6.2	(14.5)	0.4	(2.98)	36.5
Fixed assets	46.6	64.0	89.6	92.1	95.1	97.5	93.5	91.2
Current assets	29.4	68.3	74.4	104.8	110.8	128	137.2	213.4
Current liabilities	29.0	48.5	75.9	99.5	125.6	146.5	145.1	181.8
Net assets	47.0	83.8	88.1	97.4	80.3	79.0	85.5	122.8
Equity	16.4	24.2	30.4	36.1	21.9	34.7	30.3	57.4
Loan capital	30.6	59.6	57.7	61.3	58.4	44.3	55.2	65.4
Virgin Atlantic Airways contribution								
Turnover	75.39	92.29	180.54	336.7	303.4	346.6	444	448
Exports (included)	30.58	30.75	88.16	146.4	127.4	N/A	200	219.5
Profit before tax	10.14	7.19	7.57	0.7	(21.0)	(6.0)	(9.8)	31.6

Source: Company records.

Exhibit 4 (*Continued*)

	Total passengers carried
1990	906,199
1991	1,088,517
1992	1,232,983
1993	1,399,077
1994	1,694,871

Source: *CAA Annual and Monthly Operating & Traffic Statistics.*

	Market share (%)			
	1991	1992	1993	1994
Route	–	–	–	–
New York (JFK & Newark)	18	17.4	19.9	19.2
Florida (Miami & Orlando)	25.2	30.6	34.5	41.1
Los Angeles	25.8	22.3	23.8	24.1
Tokyo	16	17.3	18.3	16.6
Boston	15.3	19.7	23	24.6
San Francisco	–	–	–	15.2

Source: *CAA Nett and Mutual Exchange Statistics.*

Exhibit 5 Comparison of Voyager Travel Holdings with British Airways and the total transport and freight industry

	Transport and freight industry company average	**British Airways**	**Voyager**
	12 months to 30.06.1991	12 months to 31.03.1991	15 months to 31.10.1991
Return on net assets (%)	7.0	8.0	11.0
Return on equity (%)	4.4	9.9	13.7
Stock – days	22	3	5
Debtor days	67	58	38
Creditor days	88	100	48
Interest cover – times	1.8	1.8	2.0
Sales/employee – £'000	53.3	90.7	126.3

stake in Virgin Atlantic in order to help to buy new aircraft and open up new routes. Nevertheless the expansion has continued.

The airline has provided excellent publicity opportunities, and self-publicity is a key feature of Branson's style of management.

From the beginning Branson decided to offer just two classes of travel, Business and Economy. He speculated that they should be named Upper Class and Riff Raff, but was talked out of the latter. His aim was 'the highest quality of travel at the lowest cost for all grades of passenger'. Branson's strategy has always been to discount trans-Atlantic fares, but recently this has been in an environment of low-price special fares offered by BA and all of the major US carriers. Virgin has less freedom for low prices on the Tokyo route. Virgin, however, has a different fare structure, providing its own equivalent of other airlines' first-class seats and service at traditional business-class prices. Virgin calls this its Upper Class service; and it also provides free limousine transport to and from airports for these particular customers, who are also provided with lounges to very high standards at most airports. Economy passengers who pay full fare rather than a specially discounted rate have a separate cabin. Legroom tends to be more generous on Virgin than on most other planes, and Branson has used his expertise in music and communications to pioneer new forms of in-flight entertainment, such as personal videos with a selection of films. The airline has won several awards for the quality of its services.

Branson has been involved in an acrimonious and protracted dispute with BA, whom he accused of discounting fares to uneconomic levels in order to force out any smaller competitors. He also alleged that BA poached his passengers and spread untrue stories about Virgin. In January 1993 BA 'apologized unreservedly' and agreed an out-of-court settlement of £610,000 plus costs. Branson had in turn provoked BA and its then chairman, Lord King, who once described him as a pirate. In response to this, Branson, with the media fully informed, dressed himself as a pirate and draped the Virgin logo over BA's model of Concorde, which is on public display at Heathrow.

Branson's long-term risk has always been that prolonged fare wars on the busy North Atlantic routes could make Virgin Atlantic's profits unsustainable. Flying in and out of Heathrow also brings Virgin into direct competition with the leading US carriers, who are also quite happy to offer special price promotions in order to increase their load factors. In 1999 Virgin was forced to cut its UK/US prices in the face of intense competition and excess supply. Later that year Branson negotiated the sale of 49% of the airline to Singapore Airlines for £600 million. Some of the money was invested in the airline but the bulk was to be used to expand Virgin's new Internet and mobile phone interests. The deal improved Singapore Airlines' access to the important US market.

Virgin has so far expressed no interest in following the hub-and-spoke strategies (several flights into and out of an important centre) of the major carriers. In December 1992 Virgin expanded in Florida, with a new holiday airline, Virgin Vintage Air Tours. Branson uses restored DC3 Dakotas to fly from Orlando to Key West, and saw opportunities for expanding the service to include flights from Key West to Havana, and between Orlando and Miami and Los Angeles and Palm Springs.

Through an acquisition in Belgium (in 1996) Virgin also entered the no-frills, low-price sector of the European market with Virgin Express, flying out of a base in Brussels. Only marginally profitable, Branson has commented that with hindsight he would have been better to have set up from scratch rather than take over an airline with problems. In 2000 Virgin began to set up a similar no-frills business in Australia.

Virgin Railways

When the railways in the UK were privatized in 1992, Virgin bid for a number of operating franchises. It was successful in winning two major (and fixed period) franchises comprising 15% of the UK rail network. Its Cross Country network runs from Scotland through the north-east of England and Birmingham to Cornwall. The primary service on the West Country mainline is Glasgow to London Euston. However, there are also regular services from Liverpool and Manchester to London and some from the north of England to Brighton. The London–Birmingham–Shrewsbury route completes the picture.

Virgin has struggled to run its trains on time and has developed a reputation for unpunctuality. The truth is that the service is variable and sometimes very good. Part of the problem was that Virgin inherited some outdated rolling stock and routes where new track and signalling – in part Railtrack's responsibility – was urgently required. Massive investment is required and the picture will remain uncertain until the next round of franchises are announced. Virgin Rail was first profitable in 1998. During this year a 49% stake was sold to Stagecoach for £158 million. Stagecoach, managed by the well-known entrepreneur Brian Souter, already had a small rail franchise but it had grown through the acquisition of regional bus companies after this industry was also privatized.

Richard Branson

It is impossible to assess the development, strategy and success of Virgin without examining the style and contribution of Sir Richard Branson. Branson began the company some 30 years ago and he still dominates every major move. Although perceived to be unconventional he is clearly astute, and he has become one of Britain's richest businessmen.

Branson is quietly spoken and informal, and he rarely wears a business suit. When Virgin was a public company it was commented that Branson was not very articulate when confronted by a room full of City analysts – a situation in which he clearly felt uncomfortable. His record of success has caused some outsiders to fear that he was always looking to increase his own wealth and reputation rather than develop Virgin in the best interests of the shareholders. Branson is entrepreneurial and a risk taker – arguably it was the City's inability to relate to the risks he took, and to understand properly the risks inherent in the music business, that caused the rift between them to develop.

Yet, despite his quiet manner, Branson is an insatiable self-publicist. His exploits in crossing the Atlantic by hot-air balloon and power boat are testimony to both his risk taking and his publicity seeking. When Virgin Atlantic was launched he invited the press to photograph him in his bath playing with a model aeroplane. He has also taken a personal interest in ventures unrelated to Virgin's businesses, launching, for example, Mates low-price condoms to help in the fight against AIDS.

The publicity has had a major impact. Branson is well known and easily recognized. Mrs Thatcher selected him to chair an independent committee to examine ways of clearing up the environment, on the grounds that he was a role model for young people. Branson has at the same time been able to direct the publicity for the benefit of Virgin. Before Virgin started flights to Tokyo Branson capitalized on his public image and gave numerous interviews in Japan.

Branson personally owns, among other things, an island in the British Virgin Islands (which people can rent from him), a South African game reserve, a castle in Morocco and 50% of the Storm modelling agency. He was very anxious to win the franchise for the UK National Lottery, putting forward proposals for a non-profit lottery – the People's Lottery.

Branson's management style

For many years Branson ran Virgin's head office with very few staff from a houseboat moored on a canal in West London. The various divisions and businesses operated from offices all over London. Virgin is genuinely decentralized, with each division comprising several autonomous small businesses. The atmosphere everywhere is casual, and pop music is normally being played. Branson's aim is to ensure that people relate to the business in which they work, and feel part of something tangible and handleable. Virgin Atlantic is something of an exception and it is run from a more modern and formal office block near Gatwick airport.

Information flows and management are frequently informal (although there are effective control systems in place), and it tends to work. Branson scribbles endlessly in small notebooks. He is renowned for travelling frequently on Virgin Atlantic, talking to passengers about their expectations and levels of satisfaction with Virgin's service, and making notes of his conversations. Many Virgin employees are given Branson's work and home telephone numbers and encouraged to ring with problems and queries. There is considerable delegation and empowerment.

> *If the staff are happy the business will prosper . . .*
> *You should never really criticize your staff. You should always be praising. If you praise somebody they are going to blossom.*
>
> (Richard Branson, from *Richard Branson and the Virgin Group*, op cit.)

Branson gives away shares in new venture companies within the Virgin group, arguing that this actually costs nothing to do but it acts as a powerful motivator for creating growth and success. He has stated that he believes that successful businesses are created and sustained with:

- quality products and services
- value for money
- innovation and
- an element of fun.

An assessment

It is tempting to argue that Branson has been lucky. For example, he made his first fortune after Mike Oldfield turned up with *Tubular Bells*. However, Branson backed a project that other major record companies had already rejected. His success has been dependent upon his ability and willingness to seize opportunities which are offered to him. Randolph Fields provided the idea for Virgin Atlantic – Branson raised the money and took the risk. Branson's skill lies in taking other people's ideas and really developing them. He seems very astute at judging the implicit risks.

Initially, Virgin's development was haphazard and directionless, with no clear strategy. Joint ventures, partial sales and divestments have been utilized to fund new initiatives, and at times the decisions have seemed inconsistent. The mail-order business was initially seen as a means of raising money to support his *Student* magazine. The record label and recording studio hardly seemed a natural progression from a record shop. However, Branson has later proved very successful at developing one business out of another, and seeing linkages. This has fitted well with his desire to run Virgin as a conglomerate of small entrepreneurial businesses, one which has been described as a 'branded venture capital company'.

Branson has proved himself to be a ruthless negotiator of a good deal, belying the media image of the happy-go-lucky entrepreneur or, as he was once described, a 'hippy capitalist'. But he remains more a deal maker than a detail man. This ability has been extremely valuable in establishing the series of strategic alliances and joint ventures which have enabled Virgin to continue expanding in recent years.

In the end one must question whether the Virgin group's diversification, and pursuit of ideas which interested Richard Branson, such as the airline, inhibited the development of the core Virgin company and ultimately necessitated the sale of Virgin Music. When Virgin became a public company the launch prospectus had stated: 'The Directors aim to develop Virgin into the leading British international media and entertainment group. Virgin will continue to expand those activities in which it has proven skills, knowledge and depth management'. But if this was never achieved, did it really matter? Is business about growth and power, or about pursuing interesting challenges?

> *I never let accountants get in the way of ideas. You only live once, and you might as well have a fun time while you're living.*
>
> (Richard Branson, from: Austin, T (1992) Return ticket, *Sunday Times Magazine*, 6 December)

In the final analysis, Virgin remains a highly complex organization: it is difficult for an interested outsider to obtain accurate financial information as Virgin's finances are controlled through offshore

Exhibit 6 Virgin: selected financial results, 1997

Activity	Revenues £m	Profit/loss before tax £m
Airlines	678.5	45.2
Total for Virgin Travel Group	886.6	67.5
Virgin Retail (UK)	28.5	–7.5
Virgin Retail (overseas)	300.0	na
Virgin Entertainment	30.6	–7.6
Virgin Direct	315.7	–19.7
Virgin Cola	19.3	–2.3
Virgin Spirits	1.9	–2.2
Virgin Cinemas	84.4	–4.7
Virgin Railways	423.5	4.3
Total for Virgin Group (excluding Virgin Travel)	1228.0	–65.3

Source: *The Economist*, 21 February 1998 (p. 83).

trusts and hidden shareholdings. Clearly (as shown in Exhibit 6) most of the profits now come from the airline, the business that once needed substantial investment. Profitable from the mid-1990s it is now subsidizing many of the other businesses. Stung by criticism, Richard Branson insists that Virgin has a positive cash balance which it can use whenever it needs funds.

Virgin http://www.virgin.com

Questions

1. What are the major strategic issues raised by the Virgin case?
2. What do you believe have been Richard Branson's objectives for his business interests?
   Are the objectives consistent?
   What strategies has he followed?
   What difficulties has he encountered?
3. Do you believe that Virgin Group (excluding Virgin Travel) and Virgin Atlantic are efficient and effective?
4. Apply the E–V–R (environment–values–resources) model to Virgin during the period when it was a public company and to the main Virgin businesses (Virgin Group and Virgin Atlantic) at the end of the 1990s.