OnLine Case 11.1

British Airways

This case tracks a number of strategic changes at BA as the airline has attempted to remain profitable in a competitive industry affected by a turbulent environment. BA has competed internationally, Europe-wide and on domestic routes. Internationally it has had to deal with the growth of Virgin Atlantic as well as flag carriers from around the globe; within Europe the low frills airlines such as Ryanair and EasyJet have become very powerful. The nature of competition is not the same. At the same time – and this is documented in a separate case – BA brought difficulties on itself with the troubled opening of Heathrow's new Terminal 5, when flights were cancelled and bags lost. It has long been reported that BA wanted to become a truly global airline, but this has yet to happen.

The background

John King (later Lord King) was recruited from outside the industry to become Chairman of the then nationalized British Airways (BA) in 1981. Supported by Chief Executive, Sir Colin Marshall, he turned the ailing company around and, in 1987, BA was successfully privatized. By the early 1990s, BA was ranked seventh in the world in terms of revenue, but fifth in terms of passenger miles flown (behind the four leading American carriers with their huge domestic networks). Only Swire Pacific (of Hong Kong) and Singapore Airlines were more profitable. In fact, many of the world's largest airlines were being run at a loss, many of them subsidized by their governments.

By 2000, Lord King had retired. He had been succeeded by Marshall, who had in turn been replaced by Robert Ayling. Growth and prosperity had fluctuated in the intervening years. BA had been affected by the expansion of Virgin Atlantic and had 'lost the war of words' between these two rivals, fuelled originally by the tension in the relationship between Branson and King. Capacity globally had expanded to exceed demand, but airlines were still being propped up – as a result prices had fallen, in some cases to uneconomic levels. BA had changed many of its tailplanes, using designs from around the world to replace the Union Jack symbol. Popular outside the UK, unpopular at home, criticised by Margaret Thatcher, this was always controversial and eventually abandoned. An acrimonious strike by cabin crew, handled clumsily by BA, left Ayling's reputation tarnished. After BA's profits and profitability fell dramatically, Ayling resigned in 2000. His replacement, Rod Eddington, came from Qantas. He stayed until 2005 when he opted to return to Australia. His replacement was unexpected by many – Willie Walsh, an ex-pilot, had been crdited with turning rond Aer Lingus. The general consensus, nevertheless, was that BA's corporate and competitive strategies remained relatively strong for much of this period.

Whatever the general consensus, there were some key problems and issues. First, BA's costs remained high. When demand dropped after 9/11, and prices fell across the world, BA struggled to make a decent operating margin. Walsh wanted to achieve an ambitious 10% margin to fund the necessary fleet renewal. Second, costs were under further pressure from fuel cost increases – which had to be passed on as surcharges. It appears that BA collaborated with Virgin to fix the level of surcharges, which is illegal. Virgin ‘blew the whistle’ and escaped without penalty; BA were fined heavily. In addition four BA executives have faced criminal charges for their role in the price fixing. Third, regulation in the UK and US has prevented BA from developing the global alliances it sought and probably needed. Because of these pressures Walsh looked to reduce the number of jobs, which, not unexpectedly, caused problems with employees and trade unions.

The corporate strategy

Lord King always wanted BA to become the ‘world’s first truly global airline’. Progress has been made towards this vision, but it has not been achieved. Maybe it is not even achievable. In line with this, BA adopted the advertising slogan: ‘The world’s favourite airline’ which has on occasions come back to haunt its managers.

King and Marshall realized that BA needed to establish a strong presence in Europe, North America and Asia/Pacific if it was to be a global carrier. It endeavoured to achieve this with a series of acquisitions, alliances and franchise arrangements.

In the early 1990s BA purchased 25% of US Air, then America’s fifth largest airline, which has hub bases in four eastern American cities: Pittsburgh, Philadelphia, Baltimore and Charlotte. BA crew then flew the existing scheduled US Air services between London Gatwick and these American cities; joint ticketing arrangements allowed BA’s passengers to enjoy easier onward travel, albeit not across the whole of the USA. The benefits, therefore, were clear but limited. In 1996 BA began to talk with American Airlines, number two in the market, with a view to a much stronger and more beneficial arrangement.

Combined, these two would have enjoyed enormous power, and consequently the American and European competition authorities were interested. America wanted a more open-skies arrangement allowing more US airlines access to Heathrow as well as Gatwick; the European Competition Commissioner was insisting that BA give up slots at Heathrow. London Heathrow is the busiest international airport in the world, and the fourth busiest overall. It is the preferred port of entry to the UK and is also a gateway to and from the rest of Europe. BA had control over some 36% of the flight slots in and out of Heathrow – a hugely valuable asset, but one which has proved a drawback with certain negotiations. This discussion partly involved a debate over whether they could be sold or had to be given away. In the event the alliance that BA and American envisaged never happened, but seven years later (in 2003) they were allowed to sell seats on each other’s flights. When Delta merged with Northwest in 2008 the possibility of this merger was resurrected. At this time the interpretation of competition regulations was generally being relaxed.

Meanwhile, BA sold its shareholding in US Air, which had objected to the ongoing discussions with American. In addition, in 1999, BA, American, Canadian Airlines, Cathay Pacific and Qantas formed the Oneworld alliance, and they have since been joined by Iberia (Spain) and Finnair. Arguably this alliance (like the rival Star Alliance) provides seamless global travel for passengers through interchangeable ticketing, shared air mile programmes and the use of each other's lounges. Passengers can reach a wide variety of destinations with what amounts to a single ticket.

In 1992, BA bought a 25% stake in the Australian national airline, Qantas, from the Australian government. Also in 1992 it acquired 49.9% of the French regional carrier, TAT. BA bought the remaining shares in 1997 and linked TAT with Air Liberté, which it had acquired in 1996. In 2000 the subsidiary was sold to SAir Group in Switzerland. Again in 1992 BA purchased a German airline, Delta, which it rebranded Deutsche BA. This has also been sold – to a German company, although at one stage EasyJet was the preferred buyer. A minority stake in Iberia followed in 1998 – and this grew into a formal joint venture to consolidate their operations in 2003. In 2004 a year-old alliance with Swiss International Airlines collapsed – SIA had pulled out as they were unwilling to join the larger Oneworld alliance of which BA is a leading player. One positive outcome for BA was that they had been able to buy 8 pairs of take-off and landing slots at Heathrow.

Once Rod Eddington became the new Chief Executive (in 2000), he struck quickly. A merger with KLM (of The Netherlands) had been discussed and abandoned in 1992, but the idea was resurrected in a different market situation. Together they would be the third largest airline worldwide when measured by passenger miles. Clearly, there is some route overlap, and it was anticipated that the European Commission would, at the very least, require BA to divest Go and KLM its similar no-frills subsidiary, Buzz. Again the merger plans were abandoned largely because of reservations from the European Competition Commission. And yet Air France and KLM have since been allowed to merge.

By this time BA also owned a minority stake in Eurostar and it had divested both its in-flight catering business and its ground fleet services. These are now both bought in from the specialist alliance partners to whom it sold the businesses.

In 2008, and after a lengthy history of 'collaboration with operational difficulties' BA and Iberia announced they were planning to merge. Both operated around the world, but Iberia had a particular strength in Spanish-speaking countries, especially much of South America. BA is roughly twice the size of Iberia. To some commentators, this merger seemed almost inevitable as Air France had merged with KLM and Lufthansa had absorbed British Midland. Sales and marketing synergies seemed to be on offer; and some activities could be shared.

But in December 2008 it was reported that BA and Qantas were in preliminary merger discussions. In terms of revenues, fleet size and staf levels BA is some 15% larger than Qantas, so this might well be described as a merger of equals. It would create a different type of global airline as it would be the first merger of two sizeable airlines from quite different parts of the world. Some analysts felt BA would soon have to choose between Iberia and Qantas – it would not have the capability to deal with two major mergers simultaneously. Any reports had to be read as speculative as this particular merger would involve some quite serious regulatory hurdles. Although, for many, it did have an endearing strategic logic, it always looked unlikely to happen. Merger with Iberia was more feasible – but which was more appropriate strategically?

Following a drive to more ‘open skies’ in 2007, BA had started to fly to New York from Paris. To consolidate this BA bought L’Avion which flies an all business class service from Paris Orly to the US. During the early 2000s, BA also opted to give up operating a number of short-haul domestic UK and European routes – in part to reduce overheads but also to allow concentration on major European cities and the long-haul routes to the rest of the world – and entered into franchising arrangements with other airlines who would fly the routes but retain BA flight numbers and use BA’s livery on their aeroplanes. These arrangements included British Mediterranean Airways (who fly some London to Middle East routes), British Regional Airways (Scottish routes), Brymon (Channel Islands) and Comair (internal routes in South Africa). BA later bought Brymon and British Regional Airways (2001) but they remained relatively independent subsidiaries. It also owned CityFlyer Express, which flew to Europe from Gatwick and which Virgin was interested in acquiring. These were all consolidated into BA Connect, which was a loss-maker. In 2007 Flybe took over BA Connect to become Europe’s largest regional airline. Flybe is more like the no-frills carriers, as it charges for hold baggage and in-flight refreshments.

In the late 1990s BA established Go as an independent, low-price, low-cost, no-frills airline which would fly within the UK and between the UK and Europe from Stansted, in competition with Ryanair and EasyJet. After two years of trading losses, Go started breaking even. Go soon carried some 2 million passengers a year between its 20 destination airports. This move arose hostility, especially from EasyJet, which believed Go would be unfairly subsidized by BA. In the end BA decided to sell Go, and it was acquired by venture capitalists, 3i, who encouraged the existing management to stay on and to become shareholders. Barbara Cassani, an ex-BA employee, was CEO. Within a couple of years 3i agreed to sell Go to EasyJet for a handsome profit. Cassani left the company.

All-in-all, these strategic moves continue to provide BA’s international passengers with access to a very wide spectrum of routes and destinations.

The competitive strategy

As well as opting to focus on major world cities, and cover the rest with a variety of different arrangements, BA wanted to increase its flight revenues on its major long-haul routes in particular. Overall capacity was cut. Some routes were abandoned; others had a reduced frequency. In 2002 the in-flight service package was cut on a number of short-haul routes to cut costs and improve BA’s competitiveness against the no frills carriers.

In 1999 a decision was made to increase the number and quality of first- and business-class seats on each aeroplane, in particular business class: BA’s ‘Club Class’ which has been given flat bed seats. The intention was to reduce by 15% the number of heavily discounted economy tickets being sold. This was combined with a stated intent gradually to change the fleet and replace some larger Boeing 747s with smaller aircraft such as the new Boeing 777. In addition, a new class and cabin, World Traveller Plus (for full-fare economy passengers) would provide a higher level of economy service in a segregated and quieter area on the plane. This strategy started to work – but in the 2008 economic recession the number of passengers willing to pay premium prices fell, as people traded down for lower fares.

BA has also found an Internet booking partner in its quest to sell more tickets over the Internet and thereby reduce costs.

Changing relatively expensive work practices, that were once the heart of its high service offering, has proved troublesome for BA in recent years. Go staff, for example, were on lower pay rates that mainstream BA staff when that airline was set up. Ground staff walk-outs have brought bad publicity as flights have been cancelled and passengers left temporariliy stranded.

Questions: Why do you think BA’s alliance strategies have changed as much as they have? Given national resistances, and the desire of many countries to have their own international airline, has BA developed as far as any airline realisically might in the quest to become global? Faced with a choice between Iberia and Qantas – should such a choice have to be made, and should both mergers be possible – which partner should BA choose?

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