



# Network of International Business Schools

## **WORLDWIDE CASE COMPETITION**

### *Sample Case Analysis #3*

Qualification Round submission from the  
2015 NIBS Worldwide Case Competition, Ottawa, Canada

**Case:** *Ethiopian Airlines: Bringing Africa Together*

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# ETHIOPIAN AIRLINES

*Bringing Africa Together*

*Submission prepared for the Qualifying Round of the*  
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## Executive Summary

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During 2007, Yissehak Zewoldi, VP of alliances and corporate strategy for Ethiopian Airlines, needed to create a strategic plan. National airlines were slowly shutting down as the market was being taken by international airlines. In this context, Zewoldi theorized that establishing a hub would improve the company's current situation. However he faced the main problem of deciding where in Africa he would like to place it, and the ownership structure he would apply to it.

We recommend that the hub be placed in Middle Africa. In addition, a joint venture should be established with a Gulf airline, under the condition that travel within Africa be left to Ethiopian Airlines and international travel is left to the strategic partner. We expect greater operational efficiencies thanks to the cost reductions that this would entail. Revenues would also increase due to larger amounts of travelers given the strategic location of the Hub, thus increasing overall profit margins.

## Problem Definition

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Due to increased international competition, and increased development in Africa generating a growing market, it is of great urgency that Ethiopian Airlines implement a strategy that both helps it become competitive with international airlines whilst taking advantage of the growing demand and market (Annex A). The firm is keen to pioneer the HS model in Africa due to its operational and economic benefits. However, it needs to define the region and city in which to implement said strategy according to: market size, GDP per capita, geographical conditions, political environment, company presence, and available resources. Furthermore, Ethiopian needs to decide whether they desire to pursue this venture jointly with a strategic partner, or independently having sole ownership of the model. Otherwise they need to decide the ownership if they were to have a partner.

## Analysis

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**Industry:** European-based airlines have traditionally dominated African skies. Several African carriers have recently closed down due to high operational costs (e.g., airport charges, taxes, and fuel costs). Other problems include: underdeveloped infrastructure, limited access to capital, human and technical resources, and government restrictions. More directly, the mediocre market share of African carriers can be attributed to higher fares than competitors, and poor safety and security records (37% of fatal accidents worldwide).

Nevertheless, the industry affords numerous opportunities due to the high rate of economic growth, which facilitates trade and inflow of investment. Aside from this, there has been an average annual passengers traffic growth rate of 5.6%. Intercontinental growth rate of 11.4%, whilst intra-continental travel has increased 10.2% (2004-2007).

**Competition:** International airlines enjoy a strong presence, and benefit from economies of scale which allows them to offer lower fares and higher capacity. In southern and Northern Africa, pioneering airlines have remained stable. European based airlines have traditionally dominated African skies (France, Britain and most recently middle eastern airlines). African carriers have low market share in comparison to other airlines. European and Gulf carriers have richer worldwide networks. Some major African airlines have global aviation alliances.

**Culture:** Africa is the second largest continent in the world with the highest economic inequality rates on the globe. According to Hofstede's 5 dimensions of national culture, African countries are characterized by high power distance and low individualism. This implies that people in these countries act in a

collective way, having a rightful place in a social hierarchy, accepting and giving authority naturally. This reflects the high authority and the importance of governmental regulations.

## Location of Possible Hub

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The evaluation of the possible destination was evaluated according to several criteria such as: region homogeneity, connectivity, political environment and regulations, current airline presence in the region and GNI per capita. Based on this the chosen destination was Middle Africa (Annexes B, C and D). Even though the region presents essential disadvantages, it has determinant advantages that create a suitable opportunity. First of all, it has a strategic location that allows high connectivity with other regions. In addition, its high population, growing GDP, and GNI per capita (PPP) create an attractive market. Furthermore, the region has high government liberalization regarding air transportation. This had a great impact on the decision, taking into account the power distance of the African culture.

## Alternatives

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1. **Hub via sole proprietorship:** Create a new hub in Middle Africa in order to implement a hub-and-spoke network. This will increase connectivity among African countries in all regions. The model will reduce the number of flights needed to connect locations, thus reducing operational costs, and generating higher profits. The disadvantages of this alternative are the high costs of creating, operating and maintaining the hub.
2. **Joint Venture with a Gulf Airline:** Create the previously mentioned hub, leveraging all its benefits, but differing in the negotiation of a joint venture with an international airline. These will distribute the costs of the hub, and potentiate the number of customers. The best

alternative would be to establish it with a gulf airline, taking into account the region's economic development. This will allow international travelers to have easy access to the African country.

The main benefits for Ethiopian Airlines resulting from this project would be: Increasing connectivity, enlarging local and international market share (due to the international arrivals and departures), lower initial and operational costs of the hub, and improving brand value by creating a strong relationship with a worldwide known company.

3. **Conduct joint venture with an international cargo agency:** Similar to the previous alternative, this would involve the creation of a new hub in Middle Africa to increase connectivity in Africa. The possibility of creating a joint venture with an international cargo agency allows the company to grow its cargo business and widen its access to international clients. In addition, the joint venture helps reducing the initial investment and operational costs of the hub.
4. **Create Low Cost Airline:** This alternative would allow the company to enter a new market that will possibly attend the rising middle class demand. This project will focus in the Ethiopian territory, where the company has high dominance. This initiative will imply a high investment.

## Decision Criteria

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**Quantitative Criteria:** Market Share, Connectivity, and Costs

**Qualitative Criteria:** Brand Value, Customer Satisfaction, and Ease of Implementation

## Recommendation

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After due consideration and analysis, we advise Mr. Zewoldi to place his hub in middle Africa, whilst conducting a joint venture with what he considers would be the most strategic Gulf Airline (Annex E). This action would entail leaving all inter-Africa travel markets to said airline, while leaving the intra-African market to Ethiopian Airlines. This would improve efficiency for both airlines since both would be concentrating on their core business, and applying costs only where they need it. This, in effect, will reduce operational costs for both firms, whilst increasing revenues for Ethiopian Airlines given the increase in travel. The central location chosen would ensure travel within, inside, and out of the region, increasing total passengers drastically. This will increase operational efficiency, increasing profitability and profit margins (Annex G), creating a platform of a replicable model for future HUB creations.

## Action Plan

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1. Take all of the required actions to obtain the IATA Operational Safety Audit certificate, to create a competitive advantage in comparison to other African carriers.
2. Negotiate a joint venture with a gulf airline. The negotiation will imply a 20%/80% distribution of the hub ownership. The 80% corresponds to the Ethiopian Airline participation in the initial investment and upcoming revenues of the flights that arrive and depart from the hub. The other 20% correspond to the initial investment and revenue participation of the international airline. The agreement will state that Ethiopian Airlines will operate all intra-continental flights, while the international airline will be exclusively for intercontinental flights.

3. Define the city in Middle Africa to build the hub according to the following parameters: city development, population, GNI per capita in city, political stability, and adequate infrastructure.
4. Build a new hub in the selected city. The hub will help the airline implement an HS model, increasing connectivity, and reducing operational costs.
5. Recruit and train people from the region to work on the hub. This is important due to the collectivist spirit of the population. By allowing an involvement of the local community on the project, and generating employment, its level of acceptance will be higher.
6. Open more hubs in the long run.

## Expected Outcomes

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After creating a joint venture with a gulf airline and building a hub in Middle Africa, we expect the following outcomes: An increase in market share (reflected in the cities of operation, and the number of African and non-African passengers), higher performance and efficiency (derived from the safety measurements taken, the increase in flight frequency, and decrease of operational costs and expenses), greater coverage / market presence in Africa and worldwide, and brand name improvement. Although this project involves some risks (Annex F), its long-term benefits make it very attractive to Ethiopian Airlines.

## Annexes

### Annex A: SWOT Analysis

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>• Award winning company (2006-2007)</li> <li>• First in Africa to have Dreamliner (modern aircrafts).</li> <li>• Backward integration (HR training)</li> <li>• Fairly new Airport in Ethiopia.</li> <li>• 35 modern aircrafts.</li> <li>• Flies to Africa, Europe and Middle East.</li> <li>• Maintained positive profitability while competitors fail.</li> <li>• Government owned company.</li> </ul>	<ul style="list-style-type: none"> <li>• Not a member of any airway alliance.</li> <li>• Low market share compared to non-African carriers.</li> <li>• Higher fares than non-African carriers.</li> <li>• High costs (operational, airport, etc.)</li> <li>• Smaller size and capacity than European carriers.</li> <li>• Decreasing profits. Increasing expenditure.</li> <li>• No IATA operational safety certification.</li> </ul>
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>• Rapidly growing middle class population.</li> <li>• African economic development: Increased trade and investment.</li> <li>• World's top aviation growth regions. Average annual passenger growth rate 5.6%. Intra African travel grew 10.2%. Intercontinental travel grew 11.4%.</li> <li>• Africa= second largest and populous continent (660 city pairs).</li> <li>• Potential growth and expansion (only 3% of world travel).</li> <li>• Increased relations between African countries.</li> </ul>	<ul style="list-style-type: none"> <li>• Restrictions to access most countries 'skies.</li> <li>• High industry costs (taxes, airport, fuel).</li> <li>• Deficient infrastructure.</li> <li>• Insufficient point to point models.</li> <li>• Limited access to human, technological, and capital resources.</li> <li>• Increased international competition. (They exercise economies of scale).</li> </ul>

### Annex B: Region Comparison

	<b>Advantages</b>	<b>Disadvantages</b>
<b>Northern Africa</b>	<ul style="list-style-type: none"> <li>• Homogenous states</li> <li>• Fastest growing economic development (GDP5.77%)</li> <li>• Largest sub region in Africa.</li> <li>• Population growth rate: 1.8%</li> <li>• Access to skilled human resources.</li> <li>• Better infrastructure encourages investment.</li> <li>• Proximity to Europe.</li> <li>• Unexplored market.</li> <li>• Potential high aviation demand.</li> <li>• Highest GNI / capita in continent.</li> </ul>	<ul style="list-style-type: none"> <li>• Ethiopian only flies to one destination (low presence).</li> <li>• Presence of strong carriers in the region.</li> <li>• Lack of brand awareness.</li> <li>• Least liberal region in terms of air transport.</li> </ul>

<b>Middle Africa</b>	<ul style="list-style-type: none"> <li>• Population of 118 (2.2% growth rate)</li> <li>• GDP growth 8.28%</li> <li>• Ethiopia flies 6/9 countries.</li> <li>• 7/9 countries are French speaking.</li> <li>• Centrality (allows travel from/to and across Middle Africa).</li> <li>• Region needs safe and reliable carrier. (Due to newly bankrupt carriers of the region).</li> <li>• High liberalization on air transport.</li> <li>• Good average GNI per capita.</li> </ul>	<ul style="list-style-type: none"> <li>• Two continental giants already flying to several cities in the region.</li> <li>• Inadequate infrastructure.</li> <li>• Governmental restrictions for out of region travel.</li> </ul>
<b>Western Africa</b>	<ul style="list-style-type: none"> <li>• Most populous area of Africa (growth of 2.5%).</li> <li>• Strong presence of Ethiopian (flies to 6 countries).</li> <li>• Absence of strong carrier (vacuum for other airlines to fill).</li> <li>• Proximity the Americas.</li> <li>• Potential future foreign investment.</li> <li>• Large customer base and adequate access to HR.</li> <li>• States in this region want to establish own national carriers.</li> <li>• European giants only connect region to Europe, not rest of Africa.</li> <li>• Relatively high flight liberalization.</li> </ul>	<ul style="list-style-type: none"> <li>• Lowest rate of GDP growth (4.64%).</li> <li>• Political instability: Large scale social unrest and civil war.</li> <li>• Too many languages in the region, too heterogeneous.</li> </ul>
<b>South Africa</b>	<ul style="list-style-type: none"> <li>• Regions GDP growth of 4.7%</li> <li>• Fairly developed infrastructure.</li> <li>• Possibility to connect south to south (Americas, Asia, Africa).</li> <li>• Homogeneous language (English)</li> <li>• High GNI per capita.</li> </ul>	<ul style="list-style-type: none"> <li>• Smallest population of all regions (55 million growth of 1.4%).</li> <li>• Industry dominated by a single carrier.</li> <li>• Ethiopian flies to only one destination (low presence).</li> <li>• Mild flight liberalization.</li> </ul>

### Annex C: Region Evaluation

	<b>Region Homogeneity 10%</b>	<b>Connectivity 25%</b>	<b>Political Environment and Regulations 30%</b>	<b>Airline Presence 10%</b>	<b>GNI per Capita 25%</b>	<b>Total</b>
<b>Northern Africa</b>	10	7	0	2	10	5,45
<b>Middle Africa</b>	9	10	8	8	5	7,85
<b>Western Africa</b>	2	6	2	6	1	3,15
<b>South Africa</b>	10	6	4	2	9	6,15

\* Scale from 0 to 10, being 0 the lowest score

### Annex D: Middle Africa PESTLE Analysis

**Political:** Governmental restrictions to operate out of the region.

**Economic:** GDP growth of 8.28% (2005-2007 highest level in all regions of the continent). Average GNI per capita of 3,942USD\$ (PPP).

**Social:** Homogeneous language and culture. High power distance and collectivist society.

**Technological:** Deficient infrastructure.

**Legal:** High liberalization of air transportation.

**Environmental:** Very rich in natural resources and mineral wealth. Top producers of oil, gas, diamonds and iron. Extensive oil reserves.

### Annex E: Evaluation of Alternatives

	Costs 15%	Market Share 20%	Connectivity 25%	Brand Value 15%	Ease of Implementation 25%	Total
<b>JV with Gulf Airline</b>	3	9	10	10	7	8
<b>JV with International Cargo Agency</b>	3	8	10	8	6	7,25
<b>Low Cost Airline</b>	0	9	8	7	0	4,85
<b>Sole Ownership Hub</b>	1	6	6	7	3	4,65

\* Scale from 0 to 10, being 0 the lowest score

### Annex F: Risks

Risks	Likelihood	Mitigation
Rejection of the proposal by gulf airlines	Low	<ul style="list-style-type: none"> <li>Restructure the ownership proposal according to the counterparty needs</li> <li>Look for partners from other continents</li> </ul>
Decrease in customer satisfaction due to HS model	Medium	<ul style="list-style-type: none"> <li>Marketing efforts highlighting benefits of the model (connectivity, and wider traveling options)</li> <li>Create a customer loyalty program to increase customer benefits.</li> </ul>
Possible insufficient cash flow to make initial investment	Low	<ul style="list-style-type: none"> <li>Ask for bank loan (accessible due to high project margins)</li> </ul>
Overload of passengers in hub	High	<ul style="list-style-type: none"> <li>Increase flight frequency</li> <li>Constant evaluation of logistic processes</li> <li>Create more hubs in the long run</li> </ul>

## Annex G: Financials

### Note:

White Cells: past years

Blue Cells: construction and implementation

Green Cells: future years

HYPOTEHETICAL SCENARIOS WITH & WITHOUT HUB IN RECENT PAST & PROJECTED FUTURE						
	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011	2011/2012
Destination cities	47	49	51	58	66	75
<b>BEFORE HUB</b>						
Routes	1.010,5	1.053,5	1.096,5	1.247,0	1.418,2	1.612,8
Aircraft Departures	37.829	37.544	39.959	45.444	51.681	58.775
Historical average flight departure	37,4	35,6	36,4	36,4	36,4	36,4
<b>AFTER HUB</b>						
Routes	46	48	50	57	65	74
Departure factor	1.722,1	1.710,6	1.822,1	2.077,2	2.367,3	2.697,3
Total departures	29.276	29.081	30.977	35.314	40.246	45.855

\*taking into account a proportional increase in the frequency of flights

\*Routes defined with given formulas  $(n(n-1)/2)$  for No hub and  $n-1$  for hub

ETHIOPIAN BUSINESS STATISTICS 1						
	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011	2011/2012
Number of passengers	1.763.000	2.096.000	2.487.746	3.226.299	4.184.111	5.426.275
Average passengers per destination	37.511	42.776	48.779	55.626	63.433	72.337
Passenger load factor	65,0%	63,8%	76%	98%	127%	165%
Max capacity	2.711.473,4	3.285.266,5	3.285.266	3.285.267	3.285.268	3.285.269
Number of planes	29,0	33,0	33,0	33,0	33,0	33,0
Number of passengers transported per plane	60.793,1	63.515,2	75.386	97.767	126.791	164.433
Capacity of passengers transported per plane	93.499,1	99.553,5	99.553,5	99.553,6	99.553,6	99.553,6
Revenue	5.399.000.000	6.888.000.000				
Revenue per passenger (ETB)	3.062	3.286	-	-	-	-
Revenue per passenger (USD)	337	361	-	-	-	-

ETHIOPIAN BUSINESS STATISTICS 2						
	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011	2011/2012
Expenditures	5.162.000.000	6.690.000.000	7.940.373.984	6.992.890.310	8.597.452.065	10.678.370.214
%Expenditures of revenue	96%	97%	97%	66%	63%	60%
Total Airplane expenses	4.129.600.000	5.352.000.000	6.352.299.187	5.404.815.513	7.009.377.268	9.090.295.417
Average Expense per plane	142.400.000	162.181.818	142.040.093	142.040.093	142.040.093	142.040.093
Other	1.032.400.000	1.338.000.000	1.588.074.797	1.588.074.797	1.588.074.797	1.588.074.797

\*Assuming Pareto proportions for expenses (80% for airplanes and 20% for others)

\*Assuming expenses as a percentage of revenue