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Sample Case Analysis #4

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Case: *Ethiopian Airlines: Bringing Africa Together*

ETHIOPIAN AIRLINES

Bringing Africa Together

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Key Issues

The African aviation market is highly competitive, with European, African and Asian companies all fighting for market share (Appendix 1). The future success of the strategy that Ethiopian Airlines (Ethiopian) has planned hinges on the success of the first hub. However, when looking at the possible strategic regions of the country, Ethiopian must consider factors that have influence on the success: the high restrictive regulations of the African countries; the governmental influences; the local competition; the non-African airline presence; the negative position of African airlines in the mind of the passengers; development level of infrastructure; allocation of financial resources for the investment.

Problem Statement

Based on the issues mentioned above, the key problem facing Ethiopian Airlines is as follows:

Which strategic region is the most suitable for establishing a new hub with the right ownership-level to increase Annual Passenger Traffic and create connections within African countries?

Strategic Analysis

Company

Ethiopian Airlines is competing in a market close to perfect competition. In an effort to become successful and profitable, the company set up one of the youngest and most modern fleet of the continent (Appendix 2). It was the first in the African airline market with Boeing Dreamliners in the fleet.

Despite having higher prices compared to European and Asian competitors, Ethiopian still remained profitable thanks to its ancillary services. The company has its own aviation academy where pilots, technicians, crews and management professionals are being trained. Therefore the safety and service-quality level of the company is higher compared to their African competitors.

Service

Ethiopian's passenger transportation service is one of the best among African airlines. The young and modern fleet, together with the aviation academy, contribute to their high level of service. This leads to a competitive advantage against other African companies. The position of the African airlines in the passengers' minds is low, owing to numerous accidents. The safety and quality of the flights result in success. To maintain success, the airline has to continue the differentiation from the competitors by maintaining the quality and safety of their services. This would lead to a move from a low position to a higher position in the passengers' minds.

Passengers

The most sensible target market is the middle class, whose numbers have increased in recent years. Therefore it is a critical that the airline choose a region with high GDP and population. It is also important to have unlimited traffic rights. Those factors will help the company to reach the best target group possible for the first hub.

Regions with high GDP are Northern Africa and Southern Africa. Regions with high population are Western Africa and Eastern Africa. Regions with the most countries with unlimited traffic freedom rights are Western Africa and Middle Africa.

Competition

Competition in Africa is intense. Non-African airlines hold approximately 80% of the market due to their lower prices. However, those airlines do not transport passengers between African destinations. Therefore the main competitors are the African airlines. As the non-African airlines' perception are higher in the passengers' minds, a partnership with one of them can contribute to an increased perception of Ethiopians. The passengers will see the flights safe on the market.

All the airlines suffer from heavy governmental restrictions. Thus, it is reasonable for Ethiopian to consider focusing on regions where there are no local airlines in order to gain competitive advantage. This can be reached by a share in the ownership of the new hub with the governments to be a local operator. This will lead to lower restrictions and sustainability in long term. Moreover, the financial stress can be reduced by governmental investments.

Alternatives

Three alternatives offer viable solutions. A detailed description of these alternatives can be found in Appendix 3. An explanation of the decision matrix can be found in Appendix 4.

Alternatives	Measurability	Government influence	Economic growth	Competition	Profitability	Total
New hub in North Africa	2	1	5	1	2	11
New hub in West Africa	4	5	3	5	5	**22**
New hub in Central Africa	5	4	2	3	4	18
New hub in South Africa	1	3	4	4	1	13

Recommendation

Based on our Decision Matrix (Appendix 3) we recommend that Ethiopian Airlines establish a new hub in West-Africa. The most suitable location is Nigeria; it has the highest population and is one of the most developed countries in the western region. The attractiveness of this location also derives from the Non-African airlines' presence and the lack of a local airline.

Ownership of the new hub should be divided three ways. One third of the share will be given to the government and one third to a non-African airline, Air France. This airline is one of the biggest in Europe and has numerous flights between these two continents. This will reduce the financial stress of Ethiopian when establishing the new hub.

Governmental participation in the ownership structure is beneficial because it incentivizes a reduction in restrictive regulations and lowers operational costs. Ethiopian will function as a local airline and the government will gain one third of its revenue. By having Air France in the partnership, Ethiopian will have direct access to its European travellers. The hub will function as an intermediary and the airline will fly them to their African destinations under the reach of Ethiopian. Likewise, Air France will have access to passengers who wish to travel to Europe.

Ethiopian should perform market research in order to identify the airport with the highest aviation traffic, to determine where the new hub will be built. The relationship with the two other parties should be established and maintained by two key account managers. They should be responsible for conducting the negotiations with partners, and supervising the partnership under the direction of Ethiopian's senior management.

A common investment fund should be created which will be managed by 3 board members, one from each party. The new hub should be enforced with personnel trained in the aviator academy in order to keep up the higher service quality compared to African airlines.

In the long term Ethiopian should create new connections with regions not currently served. In this way, annual aviation traffic will be increased and the slogan of the company will be realized, connecting more destinations on the continent.

Implementation Plan

Near-Term (0-1 year)

- Marketing research of Nigerian airports' potential
    - Locate the airport with the highest aviation traffic
- Hire two key account managers
    - One will build a relationship with the Nigerian government
    - The other will build relationship with France Airline
- Negotiate conditions and terms with the Nigerian government
    - Negotiate a reduction of fuel cost
    - Negotiate a reduction of airport charges
    - Negotiate access to airports

Short-Term (1-2 year)

- Sign the contract with the government
    - 33% ownership of the government

- The second key account manager negotiates conditions and terms with Air France
    - Guarantee direct access to each other's travelers
- Sign the contract with Air France
    - 33% ownership of the new hub

Mid-Term (2-4 years)

- All three parties create an investment fund managed by 3 board members from each party, and a Chief Financial Officer elected by the board.
    - Governmental investment share – 33%
    - Air France investment share – 33%
    - Ethiopian Airlines investment share – 33%
- Building the new hub in the area of the chosen airport

Long –Term (4-5 years)

- Training of new personnel in the aviation academy
- Marketing research of aviation demand of local travelers
- Create new connection between the new hub and unreached destinations within African countries
- Projected performance can be found in Appendix 5

Contingency Plan

There are possible negative outcomes where the company may fail to perform as expected owed to external factors:

1. The relationship with the government cannot be established
    a. The airline has to try to work it out with Air France financially
    b. If not possible -> Second best alternative: new hub in Central-Africa (Plan B)
        i. Focusing on the region
        ii. Same strategy – try to build relationship with the local government and Air France
2. Air France will not be able to be in the partnership
    a. Ethiopian has to try to work it out with the government financially
    b. Try to find another non-African airline
    c. If 'a' and 'b' are not possible –> Plan B
3. Expectations are not met regarding the Annual Aviation Traffic
    a. If financially possible -> Plan B
    b. If not -> the airline has to wait until it will regain financial strength on the markets that are successful
4. Future political collapse
    a. The government may shut down in the future
        i. If possible wait for the end of the crisis
        ii. If not -> Plan B if financially possible

If plan B is not possible -> Regain financial stability on the markets that are successful

Appendices

Appendix 1: Porter's Five Forces in the African Market for Ethiopian Airlines

The market is generally extremely competitive, driven by prices and safety considerations. As all the five forces are high the industry is close to perfect competition. However, there are countries where the competition is relatively less intense.

Appendix 2 – SWOT Analysis of Ethiopian Airlines

Strength	Weaknesses
- One of the youngest and most modern fleet in Africa - First in Africa to use Dreamliners - Profitable - Own Aviation Academy - Pan African Network	- High Operation Costs - Higher ticket prices - Not grown to its potential - Decreasing net profit
Opportunities	**Threats**
- Growing market **- GDP, population, Demand** **- Alliances/partnerships** **- Governmental agreements** **- HS network** Yanoussaukro **Growing middle-class population**	**- European, ASian, African competitors** **- Governmental restrictions** **- Underdeveloped insfrastructure** - Limited acces to capital, human and technical resources -Airport charges and fuel costs - Pour safety and security records - Low Customer satisfaction

The SWOT indicates that, to overcome the threats of the market, Ethiopian Airlines should concentrate on markets with low governmental restrictions and developed infrastructure, where there is lower competition. There is huge potential in those countries; demand for air travel is getting stronger due to growth in trade among African countries.

Appendix 3 – Alternatives

New hub in North-Africa

Pros	Cons
- Aviation demand - Highly populated region - More homogeneous countries than in other regions - Economic development - 5,77% GDP growth - Already have a destination of Ethiopian (Egypt) - Great access to human resources - Better infrastructure – encourages investments	- Lack of brand awareness - High competition o Egypt Air, Air Algeria and Tunisair - Low air liberalization - Only 1 destination of Ethiopian

New hub in West-Africa

Pros	Cons
- Highly populated region - Average GDP growth – 4,64 % - Already 6 destinations of Ethiopian - Lower competition of African airlines compared to other regions - Extensive vacuum – bankruptcy of local - airlines - High liberalization	- Unstable political situation in some countries - Language and cultural differences - Lower GDP than Northern- and Southern-Africa

New hub in Central-Africa

Pros	Cons
- Highly populated area - Average GDP growth of 8.28% (highest) - 6 destinations of Ethiopian - Central location on the continent - Increased aviation traffic - Need for safe and reliable air transportation service	- Underdeveloped infrastructure - Governmental restrictions - Second-lowest GDP

New hub in South-Africa

Pros	Cons
The most developed economy in the region BRICS member Developed infrastructure	- Smallest population - Domination by SAA - Limited presence of Ethiopian o Only 1 destination - Slower rate of economic growth - Low air liberalization

Appendix 4 – Decision Matrix

Measurability: the size of segment, the number of destinations
Government influence: air liberalisation, traffic freedom
Economic development: infrastructure, purchasing power of the segment, natural resources, and, GDP
Competition: Africans airlines
Profitability: aviation demand, flights network with Europeans countries, flights network within Africans countries.

Attractiveness:

| 1 | 2 | 3 | 4 | 5
1: Less attractive 5: Most attractive

Appendix 5 – Projected performance for Ethiopian

currency = Ethiopian Birr				projected performance		
	2004/5	2005/6	2006/7	2007/8	2008/9	2009/2010
consolidated finacial statement						
total revenue	4 328,00	5 399,00	6 888,00	8 058,96	10 726,48	12 751,10
total expenditure	3 950,00	5 162,00	6 690,00	7 827,30	9 157,94	10 714,79
operating profit	377,00	237,00	198,00	496,66	1 568,53	2 036,31
interest and tax	67,00	103,00	67,00	79,00	90,29	101,57
average annual 3 year interest and tax expense			79,00			
net profit	310,00	134,00	131,00	417,66	1 478,25	1 934,74
compound annual growth rate		0,17				
new CAGR (over 6 year period)			0,36			
airline operating statistics						
performance indicators						
break even load factor (%)	52,20	52,77	51,64			
fleet (number of aircrafts)	26,00	29,00	33,00	35,00	40,00	45,00
average revenue per fleet	166,46	186,17	208,73	230,26	268,16	283,36
average 3 year revenue per fleet			187,12			
average operating profit per fleet	14,50	8,17	6,00	14,19	39,21	45,25
fuel cost (percentage of total operating costs)	0,32	0,37	0,39	0,36	0,32	0,29
average fuel cost over last 3 years (%)		0,36				
production						
destination cities	44,00	47,00	49,00	49,00	52,00	54,00
available seat kilometers (millions)	7 473,00	8 973,00	11 357,00			
aircraft departures	34 297,00	37 829,00	37 544,00			
traffic						
passengers carried (000's)	1 552,00	1 763,00	2 096,00	2 213,38	2 337,33	2 468,22
index with previous year as basic (%)		0,14	0,19	0,06	0,06	0,06
average revenue per passenger carried (000's)	2,79	3,06	3,29	3,64	4,59	5,17
passenger seat kilometres (millions)	4 965,00	5 833,00	7 243,00			
passenger load factor (%)	66,64	65,02	63,80			

Explanation of the calculation above:

2007/8

1) 2 extra fleet are in operation
2) the additional aircrafts are new and assumed to be more fuel efficient. This should make the fuel cost at least not more than the existing annual average (taken over the last 3 years of 0.36%)
3) new estimated revenue and expenditure calculated through the CAGR (compound annual growth rate)
4) 2007/8 operating profit has been adjusted (compared with the previous year), by adding the 2007 'Provision for maintenance' (=265)
5) annual passenger growth rate = 5.6% (using the national growth rate as a minimum standard for growth of passengers carried)
6) detination cities for 2007/8 stays the same as in the previous year
7) 2 extra aircrafts in operation should add an aditional average of 350*2 flights
8) reduced fuel cost as 1/8 of the fleet is assumed to be at least 15% more fuel efficient

2008/9

1) 5 Additional aircrafts are adding 14% to the current fleet
2) in addition, those are more efficient and can cary more passengers this should give us at least 15% increase on the average revenue generated per aircraft
3) tax and interest is estimated equivalent to the amount of aircrafts in operation
4) the actual net profit does not include cost towards maintenance and new aircraft personnel are not included. Extra operation cost for those will be estimated at a total of
5) reduced fuel cost as 22% of the fleet is assumed to be at least 15% more fuel efficient
6) 5 additional fleets operating from the new hub should be able to add 2 extra city destinations
7) this will reduce the operation cost and increase its overall efficiency

2009/10

1) estimations are calculated on the same basis as for the previous year
2) Two additional new fleet to their new hub and three new fleet to their Ethiopian base