

Strategic Management 2<sup>nd</sup> term and Sample Final Examination Question

Weighting : 50% of total course mark

# AEROFLOT – MARCHING TOWARDS THE WORLD AVIATION ELITE

**Aeroflot – Russian Airlines** is a leading air carrier in Russian Federation and all post-Soviet airspace as well as one of the most dynamic airlines in Europe. We fly passengers and cargo to 88 destinations in 42 countries around the world. Aeroflot, with its history dating back to the dawn of civil aviation in the Soviet Union in 1923, is one of the world's longest-established carriers. But nevertheless, despite of its venerable age, the company shows strong results. Quickly shedding the image of cold soviet-style airline, within the last five years Aeroflot boosted its annual after-tax profits by more than 21 times – from \$6.1 million in 1999 up to \$128.3 million in 2003. By 2003 its results put Aeroflot among the 15 top world airlines by net profit. Under the new market oriented management, the company capitalization doubled last year.

Today the Russian domestic air transportation market is developing very dynamically, growing by 10-11% annually within the last three years alone. Therefore Aeroflot's intermediate term plans are based on boosting its activities in the Russian home market. By 2010 the company intends to increase its share in this market to above 20%.

In addition to Russia and the CIS – the main "battlefield" for Aeroflot is still the international market where its prime targets are Western Europe, South East Asia, the Far East and North America. During the last three years Aeroflot was busy reforming its network, including cutting unprofitable routes. As a result the geography of the flights became more compact, but the network is better controlled and much more efficient.

## IMPROVING THE IMAGE

The airline has also boosted its image with radical improvements in quality and redesigning of the whole look of the company.

A brand new concept of premium-class in-flight service was introduced on flights to New York, LA, Tokyo, Vienna, Zurich, Munich, Brussels, Geneva, Helsinki, and Hong Kong. By the end of 2005 it will cover all routes. This project is accompanied by an intensive cabin crew retraining programme.

## JOINING THE ALLIANCE

In May 2004 Aeroflot and Air France signed an MoU to pave the way for the Russian flag-carrier to join the SkyTeam alliance. Aeroflot will become a full member most probably in 2005, the first Russian airline to enter a global alliance.

Invitation from the SkyTeam is a recognition of the Russian flag carrier's high standards, graphic evidence of its success.

## HUB IN MOSCOW

Aeroflot believes its further and successful development depends on having a modern hub linking Europe and Asia.

The airline believes its future is in transit traffic and convenient connections, considering Moscow as strategically promising hub for the markets of Russia, the CIS, Europe and America as well as Far East and Southeast Asia.

The airline has plans to participate in the reconstruction and expansion of Sheremetyevo airport – still its main operational base.

Aeroflot's strategic goal is to construct the new terminal and increase its business activity at Sheremetyevo.



After Aeroflot becomes a full member of SkyTeam, the volume of traffic at Sheremetyevo can be increased dramatically, to up to 22 million passengers a year. Aeroflot is planning on Terminal 3 commencing operations in 2007

## CARGO

Aeroflot has four DC-10-40F freighters. These aircraft make scheduled flights between Oslo, Hahn, Tokyo, Seoul, Beijing, Shanghai, Hong Kong and Helsinki. Aeroflot's favourable position between the Far East and Western Europe helps to reduce costs and offer competitive prices. The carrier also has a time advantage on the Europe/Asia route, as most carriers fly around Russia to avoid overflight fees. Last year the airline carried 114,000 tons of cargo, up 4% on 2002. Within the first six months of 2004, freight flown by Aeroflot increased by 30,3 % in comparison to the previous year. The carrier expects to double cargo revenues within the three years. There are plans to upgrade its freighter fleet with MD-11s increasing the number of freighters to 6.

## AIR FLEET

The company's air fleet consists of 92 aircraft (owned and leased), including the latest models of Airbus and Boeing jets.

As a result of a two-year-long air fleet restructuring, by the end of 2004 Aeroflot's foreign fleet will include two Boeing 777-200ERs, seven 767-300ERs and eighteen Airbus A319/320/321s that replace less effective A310-300s.

Aeroflot still uses over 20 home-built Tu-154Ms that were re-engineered in order to meet all international standards on noise and emission. In January 2004 Aeroflot signed a leasing contract for six more Il-96 airliners to add to the existing six.

By 2007 Aeroflot needs to acquire up to 29 additional modern medium-haul airliners. Shortly, Aeroflot intends to open a tender for acquisition of 50 short-range aircraft.

	2003	2002	2001	2000	1999
<b>Financial (\$ million)</b>					
Total revenue	1,716	1,563	1,558	1,406.9	1,166.2
Net profit/loss	128.3	91.3	21.8	10.9	6.1
<b>Operating</b>					
Passengers (000s)	5,844	5,489	5,830	5,101	4,609
RPKs (million)	18,203	17,647	18,943	17,434	16,409
Cargo (tons)	114,200	109,500	101,600	107,400	89,500

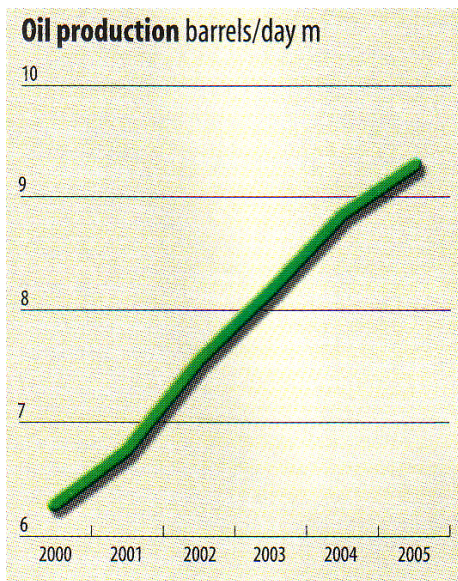
Source: Aeroflot

Additional Information2005 Forecast for Russia and Other useful data

GDP growth : 5.8% (7.3% in 2003)  
 GDP : 623bn \$  
 Inflation : 9.9%  
 Population : 143.7m (160 different nationalities, 73Million live in cities)  
 GDP per head : \$4330  
 Geography : 89 administrative areas and 11 time zones  
 Big cities : Moscow-10.4million people, St Petersburg: 4.7million people, 11 cities are over 1 Million people  
 Territory : just over 17M sq. km  
 Literacy : 99.5%  
 No. of airports: over 460

The Economist Predictions for 2005

Vladimir Putin will clamp down on civil liberties, increase state control over the economy (especially the energy sector) and concentrate even more power in the Kremlin. Bad news for democracy and the business environment but so far voters don't seem to care.



The tax burden will shift to natural resources. The government may dip into its Oil Stabilisation Fund to finance increased defence and security, as well as social-welfare spending. High oil prices and production (see graph) will make this strategy possible at least for now.

Global spending on hotels and restaurants will hit \$1.7trn in 2005, also travel is back. After a few disastrous years, tourism returned to growth in 2004 and the trend will continue in 2005 – unless new terrorist atrocities scare travellers away. The well-managed hotel groups and no-frill airlines will prosper while most full service airlines will continue to bleed.

Other Useful Information

**Internet.** Internet access is readily available either via dialup (from a hotel or an apartment) or through internet cafes. According to statistics, more than 14 Mln Russians are online (that is about 10% of the population), most of whom are from Moscow (30%) and

St. Petersburg (20%). **Internet Cafes** in Russia are usually opened 24 hours a day and offer many additional services like scanning, saving data (disks, cds, zips), business conferences etc. One hour of connection usually costs about 30R-60R (\$1-\$2 US), discounts are available during the night and for students. There are internet cafes also almost in every other Russian city or town (Novgorod, Samara, Novosibirsk, Ekaterinburg, Irkutsk etc.), but they are harder to find.

**National Holidays**

**31st of December- 1 of January - New Year's Day**, which is the main holiday in Russia, everybody's happy because people wait for the great new life in the new year and give each other presents. There's no Father Christmas, there's Father Frost in Russia. He comes on new year's eve and gives presents. Traditionally people gather with family or friends.

**7th and 8th of January - Orthodox Christmas.** In Russia, contrary to many western countries, Christmas is being celebrated not on 25th December but on 7th January, because it's orthodox' Christmas. And the New Year is much more celebrated than Christmas.

**8th of March - Women's Day.** Flowers are sold for doubled prices, and men suddenly realize the importance of women.

**1st and 2nd of May - May Day & the Day of Spring.** In the Soviet times they called it The Day of Labor, but it was a holiday for all. Now it's just May Day - another free day to meet friends.  
**9th of May - Victory Day.** The day of victory in World War II.

**12th of June - Independence Day** Still not everybody knows exactly why this date was chosen, but we reckon that this is the day when the first president of the Russian Federation was selected.

**7th of November - Day of Reconciliation and Harmony.** After 1917 until 1992 that was the Day of the Great October Revolution (1917). It's a wise decision to rename the day when the civil war began to the Day of harmony of the whole society.

**12th of December - Constitution Day.**



### Questions

1. You are asked to propose a five year strategic plan for Aeroflot in which the main goal is to consolidate the results shown above (50%).
2. Provide a list of strategy development tools you would use to analyse possible scenarios. Explain why you suggest these tools and briefly discuss the pros and cons of such tools (20%) in the given context.
3. Making reference to at least two different schools of thought for strategy briefly show and then discuss how these schools fit with the strategy development process (20%).
4. What do you believe have been the main elements for the turnaround of Aeroflot and what do you believe their main competitive advantage has been do far (10%).