

Paper Reference(s)

**6126 Advance Information**  
**Edexcel GCE**  
**Business Studies (9076)**  
**Advanced**

Advance Notice of Case Study for  
Unit 6: Corporate Strategy  
June 2005

This paper may be opened on 21st March 2005

**Information for Candidates**

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In preparing for the Case Study paper, candidates are advised to undertake general revision as well as detailed investigation of issues related to the Case Study.

This Advanced Notice should **not** be taken into the exam. The Case Study is reproduced in the exam paper.

Printer's Log. No.

**N21439A**



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## CONTEXT

### Fly-U-There plc

Fly-U-There is a typical low-price, ‘no-frills’ airline. Free in-flight refreshments are not offered, aircraft are turned around in as little as half an hour and most bookings are taken on-line with no tickets issued, meaning that specific seats are not allocated. Connecting flight agreements with other airlines are not made. Labour costs are kept to a minimum and the short aircraft turnaround time ensures intensive use of its assets. Fly-U-There currently employs 2 400 staff, of whom 60% are pilots and cabin staff. The company operates mainly out of smaller airports in the south-east of England and several UK regional airports. In 2002 it had gained some ‘slots’ at London Gatwick, and at the principal airports in some major European cities, such as Barcelona, Geneva, Rome and Lisbon. 5

Fly-U-There plc originated from a private company, set up in 1992, that was floated on the Stock Exchange in 2000. The company was founded by Daniel Thompson in response to the European Union Commission’s decision in 1987 to open up the air routes within the EU to competition. Before this date, the governments of the member countries fixed by negotiation the routes, schedules and fares. The majority of the airlines involved were the national airlines, such as British Airways, Lufthansa and Air France. Smaller, privately-owned airline companies usually existed only in niche markets, where the number of passengers was relatively small, or in the holiday charter business. After 1987 many new airlines were set up offering scheduled services with cheap fares. These new airlines were largely excluded from the major airports, such as London Heathrow, so had to be based at and operate to and from provincial airports. In addition, flights between major cities often had to use secondary airports, such as Luton and Stansted in the London complex, or Paris Orly rather than Paris Charles de Gaulle. This was not necessarily a problem in the early stages, as these secondary airports were cheaper for the airlines to use. Many of the new airlines became successful, causing considerable problems to the national airlines, several of whom felt forced to launch their own cut-price subsidiaries, such as KLM’s ‘Buzz’ and British Airways’ ‘Go’. 10 15 20 25

Fly-U-There started operating with two leased aircraft and one domestic route. By 2004 Fly-U-There owned 30 aircraft, with a book value of £0.75 billion, operating on 80 routes throughout the UK and the rest of Europe. Fly-U-There had taken over several less successful rivals and, until 2003, had recorded impressive profits (see **Appendix 1** for some details of annual profits). The company was highly geared in the early years and the need to increase funding, together with its record of success, led to the decision to go public in 2000. Daniel Thompson still owned 35% of the shares after going public and, together with the other original shareholders, maintained a controlling interest of 51% of the total issued shares of the plc. 30

The airline industry throughout the world has suffered severe problems following the terrorist attacks in the USA using hijacked aircraft in September 2001. This led to an increased fear of flying, which added to the existing problems of overcapacity and competition within the industry. Several major USA airlines, including United Airlines, Northwest Airlines and American Airlines, either went into administration or imposed redundancies and pay cuts. 35

In 2003 the Severe Acute Respiratory Syndrome (SARS) epidemic originating in the Far East created further problems. Spreading epidemics by air travel became a scare story in western newspapers. There was also the continual fear of further terrorist incidents involving aircraft, with reports of security measures still being inadequate in some countries and in smaller airports. These problems were less severe in the short-haul European sector, but they were by no means irrelevant. Swissair and the Belgian national airline, Sabena, went into liquidation and others struggled to survive. Major European airlines were also adversely affected by the growth in competition from the low-price airlines, whose passenger numbers steadily increased. Wider problems affecting the airline industry included a general slump in share prices throughout the world, worsened by the Iraq war and the general economic decline in many major economies. Consequently, share values of airline businesses fell considerably.

In 2004 Fly-U-There reported its first major trading loss since becoming a plc. Consequently, its share value fell. Industry analysts blamed over-expansion, plus the increased competition from major airlines that were beginning to market low-price services aggressively, taking advantage of their economies of scale. Fares had been cut to extremely low levels as competition intensified, for example the fare from Luton to Glasgow at off-peak times was as low as £6. Although passenger numbers continued to increase, profit margins were reduced and even full flights made little profit.

The low-price airlines, although remaining popular with both holidaymakers and business travellers, had come in for criticisms over the years. Some of their European destinations, although advertised as major cities, turned out to be small airports sometimes as far as 50 miles from the city centre. This aided the development of these smaller airports, not least in providing employment. However, from the point of view of passengers, the cost of taxi, car hire or bus travel, plus the inconvenience and extra time spent travelling from airport to city, outweighed the cheaper price of the flight. The quick turnaround times sometimes led to inadequate cleaning of the aircraft. Some of the cut-price companies had a reputation for poor customer care, for example in tracing lost luggage or giving compensation for delayed or cancelled flights.

Daniel Thompson, who had remained as Managing Director after the launch of the plc, was regarded as an ebullient, ‘larger than life’ character in the industry. Despite the setbacks, he strongly believed in the future of both the industry and the low-price segment in which Fly-U-There operated. Several studies had predicted steady rises in the demand for air travel, with the relative decline after September 2001 being merely temporary. Daniel also agreed with the Cranfield University study of 2000\*, which predicted that low-cost airlines could carry as much as 15% of European air passenger traffic by 2010.

In 2004 Fly-U-There took over EuroAir, a continental low-price airline based in France. Fly-U-There had taken a large bank loan and issued another tranche of its authorised capital in order to finance this. In addition, it had dropped six of its less profitable routes. Daniel Thompson had big ideas for this first venture into routes that did not involve UK airports. In 2004, the European Union admitted ten new member states, including eight in eastern Europe. With this eastwards expansion of the EU into former Communist Europe, Daniel saw great opportunities to introduce large-scale, low-price services to this region. He predicted increased demand for travel, especially from business customers, and thought that travellers from the weaker economies in the east would welcome lower fares. He had already negotiated the rights to fly to the major cities in the countries concerned from France, Germany, Netherlands and Belgium, as well as from some UK airports. However, Daniel thought that the most important thing that Fly-U-There could do was to establish a base in eastern Europe, both for administration and for servicing the aircraft.

The EuroAir base in France would be closed. It would be necessary to transfer some key personnel, especially aircraft engineers, to eastern Europe and to recruit locally. All previous mergers and takeovers in the airline industry had seemed to result in redundancies. There had been over 80 000 redundancies in the world's airlines in recent years, so Daniel saw no problems in recruiting staff if some of the existing Fly-U-There and EuroAir employees refused to transfer. There would also be local labour available for training in the areas of eastern Europe which had high unemployment. Fly-U-There's Finance Director, Arshad Khan, was worried about the plan. He had tried, not always successfully, to rein in Daniel Thompson when the latter brought forward ambitious and risky plans. Arshad saw problems in relocating, recruiting and training staff. The Personnel Director, Elizabeth Coombes, was also worried about the effects on morale and motivation in the newly expanded company. Morale was low amongst the former EuroAir staff, who feared for their jobs. Even Fly-U-There had been forced to make 50 employees redundant recently and there had been murmurings amongst the workforce about excessive hours and work pressure as Daniel, who regularly worked 16-hour days and seemed to thrive on pressure, and Arshad continually tried to drive down unit costs.

Daniel Thompson had been rather surprised that his negotiations with the government of Poland, which he saw as an ideal place for his new base, had not yet brought agreement. The Polish government had expressed initial reservations, in particular about providing financial support. Daniel was considering other sites, such as the Czech Republic or even the eastern part of Germany, which had remained less economically developed after German reunification than the western part of the country. Fly-U-There was offering jobs and development to a provincial airport in a relatively economically underdeveloped area and Daniel was surprised that his ideas were not being welcomed with open arms.

Some of Fly-U-There's directors had worries about the scheme to establish a base in eastern Europe. Indeed, Arshad Khan had support for his opinion that Daniel was being too optimistic about the future of the industry. Arshad would rather the company developed by diversification, as some other low-price airlines had done. He has sent Daniel a memorandum (see **Appendix 2**).

Arshad and his colleagues were not confident of convincing Daniel, as they knew that his heart was set on expanding his airline business in eastern Europe.

\* 'Europe's Low Cost Airlines – An analysis of the economics and operating characteristics of Europe's charter and low cost scheduled carriers', Air Transport Research Report 7, Cranfield University, January 2000.

## APPENDIX 1

### Revenue and profit figures of Fly-U-There plc, 1998–2004

Year	Revenue (£m)	Profit (£m)
1998	62.8	4.9
1999	99.4	8.1
2000	121.2	10.5
2001	198.3	20.3
2002	214.4	25.7
2003	183.2	6.2
2004	167.4	(20.1)

## APPENDIX 2

### FLY-U-THERE MEMORANDUM

**To:** Daniel Thompson  
**From:** Arshad Khan  
**Dept:** Finance  
**Copies:** Elizabeth Coombes  
**Ref:** Diversification  
**Date:** 04 April 2005

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In the light of the Polish government's reservations, we would like you to consider the following alternatives for expansion.

- Buy into one of the cross-Channel ferry groups. These have faced competition from rail companies using the Channel Tunnel for nearly a decade.
- Set up or sub-contract business with bus companies or car hire firms which serve some of the out-of-town airports we fly to in Europe.
- Use our expertise in on-line booking to set up Internet cafes or similar facilities at some of the airports we use.
- Consider bidding, perhaps as a member of a consortium, for one of the rail franchises in the UK. Most came up for renewal in 2004, but other franchises are due for renewal in 2006 and 2008.

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