International Airlines Group (IAG)

A Strategic Vision During the Covid-19 Crisis

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Dissertation written under the supervision of Professor Nuno Cardeal

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Abstract

The following thesis, presented in the form of a case study, focuses on International Airlines Group's strategic decisions to adapt to one of the industry's most severe crises, which had unprecedented consequences. The case is supported by some theoretical concepts that provide tools for better understanding the context in which a leading airline group operates, and its respective response to the Covid-19 crisis.

The airline industry has been going through uncertain times due to new variants, constant restriction changes, government-imposed lockdowns, and so on. These, along with other variables, may have permanently altered the industry. As a result, to stay competitive and adapt to an ever-changing environment, IAG needed to make quick decisions and rethink its structure.

The case study and resolution notes are expected to be used as a pedagogical framework that can be adapted according to lecture purposes. It is indicated for management courses with an emphasis on strategy, competition, and organizational adaptability. The lecturer can use the guidelines and proposed answers for the questions as support material.

Title: International Airlines Group (IAG) – A Strategic Vision During the Covid-19 Crisis

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Keywords: strategy; airlines; resources; crisis; competition; management; Covid-19; adaptation; competitive advantage.

Resumo:

A presente tese, apresentada sob a forma de estudo de caso, centra-se nas decisões estratégicas do International Airlines Group para se adaptar a uma das crises mais devastadoras para o setor, que teve consequências sem precedentes. O caso é apoiado por conceitos teóricos que servem como ferramentas para uma melhor compreensão do contexto em que um grupo constituído por várias companhias aéreas, e respetiva resposta à crise do Covid-19.

A indústria do transporte aéreo tem vivido tempos de incerteza devido ao aparecimento de novas variantes, alteração de restrições para os viajantes, confinamentos intituídos pelos governos, etc. Estas, juntamente com outras medidas, podem ter alterado definitivamente o setor da aviação. Como resultado, a fim de permanecer competitivo e adaptar-se a um ambiente em constante mudança, o IAG teve a necessidade de tomar medidas rápidas e repensar a sua estrutura.

O estudo de caso, bem como a sua proposta de resolução, devem ser utilizados como uma ferramenta pedagógica, podendo ser adaptado de acordo com os objetivos da aula/sessão. Este é indicado para cursos de gestão, focando-se em estratégia, competição e estratégias de adaptação organizacional. O responsável pela sua utilização pode recorrer às notas de resolução como material de apoio.

Título: *International Airlines Group (IAG) – A Strategic Vision During the Covid-19 Crisis*

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Palavras-chave: estratégia; companhias aéreas; recursos; crise; concorrência; gestão; Covid-19; adaptação; vantagem competitiva.

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List of Abbreviations

BA – British Airways

DC – dynamic capabilities

Etc. – etcetera

IAG – International Airlines Group

IB – Iberia

ICAO – International Civil Aviation Organization

LCC – Low-Cost Carrier

LHG – Lufthansa Group

M&A – Mergers and acquisitions

R&C – resources and capabilities

RBV – Resource-Based View

RPK – Revenue Passenger Kilometers

UN – United Nations

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I. LITERATURE REVIEW

1. Porter's 5 Forces

According to Michael Porter, five forces shape strategic thinking – the threat of new entrants, supplier power, buyer power, the threat of substitutes, and industry rivalry. As a result, one must be aware of how these forces interact and determine the amount to which they affect the industry. His approach focuses on external elements that influence industry attractiveness – customers, potential entrants, substitute products, suppliers, and competitors – rather than internal characteristics. The purpose of this perspective is not simply to identify threats to profitability, but rather to devise methods to maximize performance and stay ahead of the competition (Porter, 1979).

A profitable industry will attract more companies looking for higher profits, therefore new entrants represent a threat to incumbent firms. New players will increase capacity, affecting profitability unless the entrant faces at least one of the following major entry barriers: economies of scale; product differentiation; high investment; know-how; access to distribution channels; government policies; and retaliation. Supplier and buyer's power depends on price sensitivity, relative bargaining power, and existing switching costs. Substitute products shape the industry's attractiveness by limiting prices and, therefore, profits. The rivalry between established competitors is determined by the combination of the above-mentioned forces, which leads to concentration, existing products (differentiation), cost conditions, etc. (Porter, 2008).

2. Resource-based view

In contrast to Porter's industry analysis, the Resource-Based View (RBV) provides a firm's internal point of view, focusing on the firm's resources and capabilities. These should be at the core of strategy formulation since they are a key source of profitability, while the external environment is difficult to manage and constantly changing. Resources and capabilities are likely to confer a sustainable competitive advantage to firms when they have the following features: durability, replicability, transferability, and transparency (Grant, 1991). Firms can both develop their resources organically (internal) or acquire them from competitors through mergers and acquisitions (M&A), however, it does not ensure capabilities. M&A is used to complement domestic and/or international expansion by acquiring complementary businesses and assets. (Lockett & Thompson, 2001). It is also a way to expand a firm's existing portfolio or to get into a new market – market penetration (Ansoff, 1957).

Resources are either tangible or intangible assets and can be considered as a firm's primary source of competitive advantage. Barney (2001) suggests that companies can generate a sustainable competitive advantage if their resources are valuable, rare, imperfectly imitable, and organized. Strategically valuable resources are difficult to copy, not easily substituted, depreciate slowly, are owned by the company and they should be superior to competitors' (Collis & Montgomery, 2008).

Because position barriers restrict competitors from accessing resources, the first-mover advantage might be critical. Customer loyalty, installed capacity, and technology are obstacles incumbents develop since they are difficult, if not impossible, to purchase (Wernerfelt, 1984).

3. Dynamic capabilities

The world is changing at a fast pace these days, and organizations must quickly adjust their plans, re-allocate resources, and boost competitiveness if they are to survive. According to Teece and Pisano (1997), dynamic capabilities (DC) are at the basis of a firm's competitive advantage because they are difficult to replicate and costly. Furthermore, their nature endows them with unique traits because it is hard to reproduce a firm's routines, experience, and, most importantly, culture. As a result, DC have taken a particular interest in strategic management. Barreto (2010) contended DC as a *"firm's potential to systematically solve problems, shaped by its ability to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base."* DC, on the other hand, refers to a company's ability to remain competitive over time, either by improving current resources or combining them in novel ways. They play an essential role in international business contexts with demanding clients and a high supply level. This framework is based on the company's ability to adapt operations to environmental changes and rearrange its structure to have an impact on competitiveness by changing the status quo (Teece, 2007). Thus, top managers must be aware of the company's needs to keep investing and strengthening its assets, either through internal development or direct purchase. As a commonly adopted framework, DC consists of organizational processes essential for the creation of routines and expertise within a firm (Eisenhardt & Martin, 2000). Cepeda & Vera (2007) suggest that DC embodies four key features: it consists of processes and routines rooted in knowledge; reliance on firm's resources and routines; involves transformation; and the output results in a new configuration of resources and routines. Capabilities can also be seen as ordinary, which are short-term and operational related, whereas DCs are long-term as well as specialized, and simultaneously reshape, enhance, or create ordinary ones (Winter, 2003). It is linked to the process of using existing resources and expertise to build or rebuild company's assets and routines. A recent approach conveys that DC aims to renew, modify, update, or replace existing firm's resources and capabilities (R&C) as a response to a changing environment, emphasizing the importance of constant adaptation to sustain competitive advantage (Tallman, 2015).

4. Horizontal Integration

As a result of globalization and deregulation, competitiveness has increased throughout time. Companies today confront strong rivalry, and many small businesses are frequently acquired by larger players. Mergers and acquisitions are becoming popular growth and diversification strategies, and the European market is no exception.

Companies that adopt an asset-heavy strategy have a larger number of assets generated organically. Adopting an asset-light strategy, on the other hand, generally involves holding fewer capital assets and investing more in technology and goodwill through M&A from existing firms rather than building them organically. This allows a company to grow at a faster rate than those that grow organically. Furthermore, rather than creating a new brand from scratch, it is a far quicker tool for diversifying the existing portfolio (Datta, 1991).

Horizontal integration takes place when two companies from the same industry merge or one acquire the other. It represents a threat to competitors due to higher concentration levels within the same value chain. This strategy is often used to block competition on the account of the elimination of a potential entrant or an established rival (Pilsbury &

Meaney, 2009). Integration often outperforms organic growth in terms of financial and operational flexibility and confers lower profit volatility because companies with high fixed costs strongly depend on revenues to be profitable (Kachaner & Whybrew, 2014).

This method facilitates geographic expansion for enterprises with growth ambitions. Again, the takeover of R&C from an existing firm is faster than setting up a business from the start since infrastructure and expertise are already available**.** It confers greater market power to the parent company, which benefits from economies of scale and scope, and reduces costs per unit produced improving cost efficiency (Akhavein et al, 1997). The acquirer takes advantage of both cost efficiency and product development or diversification through economies of scale and/or scope and exploitation of new resources, respectively (Capron, 1999). Moreover, the author emphasizes the role of M&A in the reconfiguration of R&C through redeployment and divestiture. However, adjustments are necessary to guarantee an efficient resource allocation when recombining existing resources with acquired ones. It is strategically important that a firm withdraw obsolete resources to avoid unnecessary costs (Capron & Swaminathan, 2001).

The integration process is often complex and comprises numerous adjustments inside the organization. Not all integrations result in synergies, and there may be setbacks. Negotiations are usually conducted under tension and with the desire to complete it as soon as possible, which reduces the likelihood of a successful outcome. It may also end in an overestimation of organizational fit – companies' cultures are mismatched, or the parent company cannot manage additional complexity (Jemison & Sitkin, 1984; Datta, 1991).

5. Ansoff Matrix

Strategic planning is used to identify priorities and guarantee that businesses work toward achieving long-term goals. The Ansoff Matrix can be used to successfully measure the strategic direction of firms either through existing or new products and markets. It distinguishes four growth strategies: market penetration, market development, product development, and diversification (Exhibit 1).

Market penetration: this strategy is used by a company to explore the potential of an existing product in an established market. It is usually used to increase market share through aggressive pricing policies, an increase in supply to either boost sales volume to existing customers or to attract new ones.

Market development: involves offering existing products to new segments and geographies (new markets).

Product development: occurs when a company introduces new products into existing markets.

Diversification: is the riskiest strategy in the matrix because it implies introducing a new product into a new market. Diversification can be classified into two types: related and unrelated. In related diversification, the company develops its activity within the industry, whereas in unrelated diversification, the company expands its activity to a different industry (Ansoff, 1957; Lohmann & Spasojevi 2018).

II. CASE STUDY

1. Company Overview

The International Airlines Group (IAG) was founded in 2011 as a result of the merger of British Airways (BA) and Iberia (IB), the flag carriers of the United Kingdom and Spain, respectively. The merger was made as a strategic move to compete with rising low-cost carriers (LCCs) such as Ryanair and EasyJet.

The group made an operating profit of €3.3 billion in 2019, but after a tumultuous year due to the pandemic, it made an operational loss of €4.3 billion in 2020. Through an asset-light strategy, the holding airline group has rapidly expanded its portfolio (Exhibit 2), becoming one of the world's largest airline groups. Its market presence is strengthened by a varied brand portfolio that includes two full-service carriers (BA and IB), two value carriers (Iberia Express and Aer Lingus), and two low-cost carriers (Vueling and LEVEL). The group relies on the IAG Platform, an integrated system with technology, finance, procurement, and loyalty services. This platform is a fundamental tool that helps with resource allocation and assures that every operating company works towards achieving a common goal. IAG Loyalty offers loyalty services across the operating companies and is responsible to manage the British Airways Executive Club, Iberia Plus, Aer Lingus AerClub, and Vueling Club (IAG Annual Report and Accounts, 2020).

IAG's leadership in critical areas derives from a diversified portfolio that includes a significant presence in the North and South Atlantic, as well as in Europe, via its primary hubs in Madrid, Barcelona, London, and Dublin. It benefits from a flexible network and capacity to fulfill customers' needs, enabling them to compete in a large range of markets. It was the first airline group to support United Nations' goal to achieve net-zero carbon emissions by 2050. To do so, it relies on strong incentives and funding to get sustainable aircraft and fuel solutions (IAG, website).

2. Operating Companies

BA is a London-based carrier with a major presence in Heathrow, London City, and Gatwick airports. It is notable for offering a wide range of travel classes, from "Economy" to "First-class," as well as a versatile fleet that allows it to serve a global network of destinations (British Airways, website).

IB is the largest Spanish airline and the leader between Europe and Latin America. Aside from its core business, it also provides maintenance and handling services at Spain's busiest airports, namely Madrid-Barajas and Barcelona-El Prat. In 2012 the group launched a low-cost branch, **Iberia Express**, operating short-haul and medium-haul flights. The Madrid-based LCC covers the Spanish market, being one of the principal airlines in the Canary Islands, and some international routes in Europe. It is an important hub feeder and performs point-to-point flights competing with other LCCs for price-sensitive customers. Its fleet of 23 aircraft comprises three Airbus types (A-320, A-321, A321neo) assuring cost-efficiency and reduced emissions (Iberia, website). One month later, the group acquired British Midland Airways from Lufthansa, utilizing its resources but extinguishing the brand, so consolidating BA's leading position in the UK. In the following year, it consolidated its presence in the low-cost segment by acquiring the Barcelona-based LCC – **Vueling**. It plays an important role in the French and Italian markets, extending its routes throughout Europe and North Africa.

In 2015 took place the acquisition of **Aer Lingus**, previously owned by Ryanair and the Republic of Ireland. The takeover was of utmost importance for the group to reinforce its position in Ireland and the UK. The Dublin-based carrier works along with its full-service sister, BA, to cover a larger number of segments.

The launch of **LEVEL** in 2017 was a game-changer that allowed the group to diversify its portfolio through a long-haul low-cost proposition. The operating airline was created to serve price-sensitive customers, enabling the group’s full services to focus on their customers. Its operation is primarily focused on America, and benefits from IAG’s commercial cooperation, extending its connections to destinations such as New York, San Francisco, Punta Cana, and Buenos Aires (IAG, website).

3. Aviation Industry

Significant changes have occurred in air transport markets and the airline industry over the last 40 years. Consumers have reaped the benefits of a large rise in the number of travel alternatives provided by a greater variety of destinations, frequencies, and business models, all of which are available at cheaper rates, greater safety, and a smaller carbon footprint. According to recent studies on air connectivity, the aviation industry accounts for around 3.6 percent of global GDP and employs 65.5 million people worldwide. Not only does passenger and cargo transportation have an economic influence, but so do activities generated by airplane manufacturers, consumer product producers, the development of the tourism industry, and so on. In Europe, air transport supports 12.2 million jobs and generates over €700 billion in GDP (ICAO, 2019).

At the beginning of 2019, the European airline industry was dominated by 5 major airline groups: Ryanair, EasyJet, Lufthansa Group (LHG), IAG, and Air France-KLM. Their ability to adjust to consumer demand through pricing and differentiation strategies improved their dominance. These companies hold together more than 50% market share, and in a fragmented European market, there is still space for consolidation, which represents an opportunity for IAG's growth. Until recently, the industry was one of the fastest-growing economic sectors. In 2020, the Covid-19 crisis had an impact on revenue passenger kilometers (RPK) with a registered drop of 66%. Many airlines struggle to keep their operations and some have had to exit the market. IAG experienced an 88% drop in revenue due to a heavily struck by large flight cancellations and was compelled by European Union law to provide passengers with full refunds (IATA, 2020).

4. Competition

The Chicago Convention, held in 1944, was a landmark in the history of aviation. It founded the International Civil Aviation Organization (ICAO), a United Nations (UN) agency in charge of international air travel coordination and regulation. The transfer of power from the Member States to ICAO was a defining moment that established global air navigation standards. Later, the Deregulation Act of 1978 supported deregulation and liberalization, causing the market to move at unprecedented rates and driving airlines to adopt growth strategies and establish synergies to meet global demand (ICAO Council Passes Chicago Convention Resolution, website). In terms of passengers carried, Ryanair and EasyJet are the leading airlines in Europe today, followed by LHG, Air France-KLM, and IAG (Statista, 2021). Ryanair and LHG are further addressed to provide a perspective of two contrasting business models, namely an LCC and an airline operating under a business model similar to IAG's.

Ryanair is a leading European low-cost carrier headquartered in Dublin and with its primary operational base at London Stansted. The no-frills carrier is the largest operating company within the Ryanair Group, connecting over 242 destinations across 37 countries. Its fleet is composed of 450 Boeing 737s and 29 Airbus A320s, and it recently placed an order of 210 new Boeing 737s “Gamechanger” (Ryanair, website). Traffic was reduced by 81% in 2021 (fiscal year) from 149 million passengers to 27.5 million passengers transported and accounted for over €1 billion loss in the same year (Ryanair Annual Report, 2021). Its business model is characterized by using fewer types of airplanes; filling the airplanes with more seats; one type of class available; abolishment of business class; absence of airport facilities, such as lounges and check-in counters; luggage fees; and an aggressive sales strategy onboard. This, together with a cost-oriented airport network (secondary and far from city centers) allows Ryanair to target price-sensitive customers with the proposition of offering low fares. Its point-to-point model is a great fit for the European market with coverage of a considerably high number of city pairs with fewer connections compared to the hub-and-spoke model (Ryanair Annual Report, 2021). Ryanair stands out for low prices and its ancillary revenues represent a sizeable share of its total revenues. However, its brand reputation stems from a “low-quality service” and represents a concern for the company (Malighetti et al., 2009). For this reason, the company is focused on prioritizing customer service by restoring its routes, lowering fares, opening a Covid Help Centre, issuing travel vouchers, and cutting cancellation/rescheduling fees due to Covid-19 contingencies, among other measures (Ryanair Annual Report, 2021).

LHG is one of the largest airline groups in Europe headquartered in Cologne and parent company of Lufthansa German Airlines, Swiss International Air Lines, Austrian Airlines, Brussels Airlines, and Eurowings. Besides the operating companies, Lufthansa Cargo AG for airfreight, Lufthansa Technik for maintenance, and LSG group for in-flight services such as catering, are also part of the LHG. The number of passengers carried fell 69% compared to 2019 from 145 million to approximately 36 million in 2020. This unfavorable scenario has had serious repercussions of a €6.7 billion loss at the end of the same year (Lufthansa Group Annual Report, 2020).

Its diversified portfolio allows LHG to cover a wide range of segments and have a leading position in the European market. The group takes advantage of a leading position in Germany, Switzerland, Austria, Belgium, and northern Italy from its hybrid model, using both hub-and-spoke and point-to-point strategies, and extended market scope from a multi-branded portfolio. Their multi-hub strategy based in Frankfurt, Munich, Zurich, Brussels, and Vienna, is operated by a fleet of 757 and over 110,000 employees (Lufthansa Group, website). As one of IAG's greatest rivals, LHG aims to become customers' first choice across a wide range of business segments. To do so, the group is focused on increasing its market share through a diverse portfolio that covers a premium, high-quality service to price-sensitive customers (Lufthansa Annual Report and Accounts, 2021). The group went through an enforced restructuring process to fight the pandemic to address both government measures and customers' needs (Exhibit 3).

5. Strategic Priorities

January 2020 marked the beginning of a global crisis with long-term consequences for the aviation industry, and no one can predict when it will come to an end. We are witnessing the greatest worldwide crisis to date and airlines needed to restructure their strategies quickly to adapt to the pandemic.

The group's strategy is based on three cornerstones since long ago, and the crisis has not changed them. However, the company changed the paths to achieve its proposition of being a world-leading airline group while managing a crisis.

IAG's strategic priorities (Exhibit 4):

1. Strengthening a portfolio of world-class brands and operations.
2. Growing global leadership positions.
3. Enhancing the group's common integrated platform.

The first strategic priority has been at the core of the group's purpose since its formation, and its origin exemplifies the group's focus on standing out through an unrivaled customer proposition. Through successive acquisitions, the business has been consolidating its portfolio, increasing its capacity to serve a demanding European fragmented market and capture consumers from a wide range of segments. This customer-centric approach has remained at the heart of its strategy and was unaffected by the pandemic because it is important to remember that there is no business without consumers. A fast expansion and global reach were possible because of a great network of resources owned by each operating company, making it possible to address customers' needs.

Collaboration is a key source for reinforcing a global position and provides a mechanism that produces better results for both customers and airlines. The group collaborates with Oneworld, one of the biggest airline alliances, and many Joint Businesses to benefit from members' resources, increasing connections and shared revenues. These partnerships improve customer satisfaction and loyalty, through access to more destinations and smoother traveling conditions.

The expansion of global leadership positions is the second strategic priority. The business has increased its presence in home markets such as Spain, the United Kingdom, and Ireland through both organic growth and the acquisition of other companies. IAG's vast portfolio is prepared to receive a new operator, Air Europa, a leading airline in Spain with international routes to Latin America, the Caribbean, North Africa, and the United States of America. The group takes advantage of its financial strength to solidify its leadership position and elevate one of its most important hubs – Madrid.

Lastly, the third strategic priority is to increase efficiency and innovation by investing in IAG's common platform. Digitalization has been a valuable driver for cost-optimization by introducing and exploiting process automation, reducing paperwork, increasing price transparency, and integrating customers' data from all operating companies to increase engagement. An integrated platform enables the group to centralize its bargaining power, whereas individual negotiations would provide worse outcomes. The Group is responsible for capital allocation and stakeholder relationships, leveraging from its integrated dimension to obtain greater flexibility and reduced costs from suppliers (IAG Annual Report and Accounts, 2020).

6. Strategy Under Covid-19

6.1 Building Customers' Trust

When the planes started taking off again, health precautions had to be implemented and kept up to date. Carriers across the Group were required to adhere to worldwide sanitary standards to ensure that operations ran smoothly, and that consumers' trust was restored. Before traveling, passengers are required to show proof of vaccination, recovery, or a negative Covid-19 test, as well as fill out Health Declarations. Face masks became mandatory for people above the age of six and queuing systems and other similar measures were implemented to ensure social distancing and avoid physical contact. Disinfection was reinforced both on contact points at the airport and onboard, including increased air renewal in the cabins (Iberia, website; British Airways, website).

Aside from safety enhancements, the Group concentrated its efforts on minimizing changes by implementing flexible policies for clients impacted by Covid-19. Customers were given the chance to change their booking date and destination until a certain timeframe. In the event of a flight cancellation, customers were offered the option of requesting a voucher for future travel or even a cash refund. For example, BA has already refunded over €2.8 million and issued 2 million travel vouchers that can be used until April 2023 (IAG Annual Report and Accounts, 2020).

6.2 Cargo Operations and Repatriation Flights

Global air traffic was severely affected by the pandemic and constant changes in travel restrictions were imposed by governments, which kept people reticent about traveling. Air travel passenger demand fell exponentially, and measures had to be taken to adapt capacity levels. The group seized the opportunity to use its resources and increase cargo flights to meet the market's demand for air freight transport. Operating companies restructured some of their aircraft, removing seats and obtaining regulatory approval to comply with cargo specifications whilst IAG Cargo grew at an unexpected rate. Additional flights were scheduled to transport equipment and supplies to fight the pandemic, such as ventilators, Covid-19 testing kits, sanitizer, and other personal protective equipment across the world. The Group operated more than 4000 cargo flights in 2020, increasing the branch's revenue by 16.9% versus 2019 (IAG Annual Report and Accounts, 2020).

IB has operated more than 50 repatriation flights through more than 20 destinations in collaboration with the European Union, assisting many people in returning to their home countries. It also performed more than 100 flights to China to bring medical supplies to both Spain and Latin America (*Informe de sostenibilidad*, 2020). BA has flown over 130 repatriation flights from 21 countries, bringing over 40,000 Britons home (British Airways Annual Report and Accounts, 2020).

6.3 Fleet and Route Management

The Group has been trying to minimize costs as much as possible and fleet retirement was an important step forward. Over the year 2020, a large part of the fleet was grounded and parked (241 out of the 533 in-service fleet), starting with the less efficient aircraft. BA retired its fleet of 32 Boeing 747 and welcomed 15 new aircraft for both short and long-haul operations, namely the new Airbus A350, investing in superior fuel efficiency and reduced emissions. IB also accelerated the retirement of its Airbus A340 fleet and operates long-haul flights with more efficient aircraft. It transformed three of its Airbus into cargo-only aircraft. Aer Lingus carried many cargo flights and received four new aircraft in 2020, whilst Vueling received three new reinforcements for its fleet. The reduction was more significant in terms of long-haul operations with 71 aircraft pending disposal or being returned to lessors earlier than expected (IAG Annual Report and Accounts, 2020).

The route planning had to be adjusted as a result of constant changes in government travel policies. BA was harmed by the UK's travel rules and had to adapt to domestic demand, as Britons avoided overseas destinations, by offering new routes within the country, such as Newquay. Long-haul flights, which account for up to 80% of BA's activity, were the most affected and will recover slower than short-haul flights (Willie Walsh, interview 2020). In Q2 2020, BA operated charter flights to the Caribbean, and in Q3 2020, it resumed regular services to the region as well as Latin America. After ceasing to fly new routes to Africa, the Middle East, and South Asia (AMESA) previously established in 2019, it only resumed operations in Q3 2020 for destinations such as Dubai, Kenya, and

India. Aside from the difficult travel restrictions, BA restarted operations to China, Tokyo, and Hong Kong. IB restructured its operations to Latin America in Q1 2020, establishing new routes and increased frequencies to Colombia, Peru, and Brazil, as well as resuming regular services in AMESA to destinations such as Senegal, Morocco, and Israel. LEVEL was forced to cease operations in Vienna and Amsterdam in Q2 2020. However, it reinforced Latin America's connections, namely in Argentina and Chile, as well as North America with routes to New York, Boston, and San Francisco. As a strategic response to the pandemic, it has also increased its presence in Europe. Vueling took advantage of leisure travel, connecting Spain to the Canary and Balearic Islands, and opted not to resume AMESA flights in 2020. During the summer, Aer Lingus used its London-Belfast route to capitalize on domestic holidays and canceled most of its flights to New York, Chicago, Washington, and Boston (IAG Annual Report and Accounts, 2020) The reopening of transatlantic routes gives IAG hope in its most profitable market, and it plans to raise flight schedules to 100% until summer 2022, allowing a return to profit (Georgiadis, 2021).

6.4 Human Resources

IAG relies on a strong corporate culture from which employees play a key role. Therefore, the Group recognizes the social impacts Covid-19 had on its workforce and is committed to improving employee engagement. Support initiatives were made to guarantee employees' wellbeing and efforts have been made to maintain as many jobs as possible. However, uncertain times require extra flexibility and liquidity and the Group had to rethink its cost structure and increase the proportion of variable costs. Cooperation with governments and trade unions has made it possible to secure jobs through retention schemes that covered almost 50.000 workers. Those considered furloughed were eligible to receive a partial share of their salary and were integrated into layoff programs with reduced schedules. Unfortunately, bigger sacrifices had to be made and the Group was forced to reduce its workforce by 20%, which represented close to 12.000 people. The Management Committee was no exception on cost reduction actions with salary cuts. Also, a new position on the Management Committee was created, and Fernando Candela, Chief Executive Officer of LEVEL, was named as the Group's Chief Transformation

Officer, directing transformation projects, specifically to deal with the pandemic (Marston, 2021; IAG Annual Report and Accounts, 2020).

6.5 Liquidity

Preserving cash and reducing costs are important actions to strengthen IAG's financial position. Its long-term sustainability has been protected through measures like lowering operational costs, job retention schemes, fleet reduction, government support, etc. The unforeseen economic downturn led the Group to seek alternatives, resulting in a proposed capital increase to raise up to €2.75 billion through the issuance of new shares. The measure was supported by IAG's largest shareholder, Qatar Airways Group (over 25% holding), and approved at the General Shareholders' Meeting in September 2020 (IAG Proposed Capital Increase, 2020; Powley & Rovnick, 2020).

Companies explored alternative funding through state aid schemes. BA used the UK's Coronavirus Corporate Finance Facility to raise €328 million, whereas IB and Vueling received a five-year loan from the *Instituto de Crédito Oficial* of €750 million and €260 million, respectively. At the end of the same year, BA received a five-year loan of £2 billion from the UK Export Finance, and the Irish Strategic Investment Fund approved a €150 million facility for Aer Lingus (Gunning, 2020; IAG Annual Report and Accounts, 2020).

6.6 Acquisition of Air Europa

IAG planned to acquire Air Europa before Covid-19 spread out worldwide in an attempt to consolidate the industry. The initial agreement was made in late 2019 under a transaction value of €1 billion and was later negotiated to €500 million during the following year. The Group believes that the acquisition is still aligned with its strategic priorities, despite the impacts of the pandemic, and is willing to use its financial robustness to seize this long-term investment. Therefore, IAG is committed to takeover Air Europa as it represents a growth opportunity to make Madrid more competitive and stand up against rivals such as Amsterdam, Frankfurt, Munich, and Charles de Gaulle (IAG Air Europa Acquisition Press Release, 2021).

7. Future Trends

The pandemic appears to have no end in sight, and the contraction of economic activity prevents a return to pre-crisis demand levels, even as lockdowns and travel restrictions are eased in many countries. The industry must brace itself for continuous outbreaks and changes in travel restrictions that might persist for years. This means that vaccine rollouts and pandemic management will eventually drive the sector's recovery, but these have differed globally and may continue to shift over time (WTTC, 2021). As a result, the industry may be forced to manage fundamental demand changes such as the major increase in remote working, more regionally oriented supply chains, and an emphasis on sustainability. Therefore, it is expected that the increase in leisure travel will surpass the recovery of business travel (Molenaar et al., 2020). Another significant challenge will be to tackle the undersupplied air freight industry, which has been rising as e-commerce sales increase. Commercial flights carried almost half of all air freight, and while operations are restarting, there is still a gap to fill. Carriers can increase their flexibility by investing in freighter conversions of existing passenger aircraft in a flexible manner that allows them to meet the needs of the market while avoiding the risk of investing entirely in cargo-only aircraft (Krishnan et al., 2021). Several airlines have had to borrow substantial quantities of money to stay viable and deal with significant daily expenditures, using state-aid assistance, credit lines, and bond issuances. This, along with the need to restore capacity, return aircraft to service, and retrain/rehire crew, will likely imply an increase in ticket pricing to rebalance debt levels. Alliances and collaborations are crucial for expanding global reach to emerging segments and presence in "non-home" markets, as well as developing a sustainable business in tackling climate change. Changes in customer behavior, as well as governmental and environmental policies, require corporations to take action to promote alternative fuels, carbon offsets, stakeholder engagement, and so on (IATA, 2020; OECD 2020).

III. Resolution Notes

1. Introduction/Synopsis

The impact of the Covid-19 outbreak on the airline industry was severe on many levels, and airlines faced challenges never seen before. Many governments banned air travel, and demand in the sector fell as a result of both restrictions and the pandemic itself, among other factors. Airlines' strategies have had to be rethought by industry professionals to remain resilient and emerge from the crisis. The current case study provides insight into how the IAG Group, a major player in Europe, reacted to and strategically adapted to an unforeseen crisis scenario.

This section aims to apply theoretical concepts to a real situation through an industry, strategy, and R&C analysis. Students will understand what mechanisms are crucial for crisis management and what impacts do they have on companies and stakeholders, as well as opportunities that emerged from these events.

Since this case study was conceived in 2021, its analysis may benefit from up-to-date support readings as the situation quickly evolves. Nonetheless, the teaching notes provide general guidelines and suggestions for answering the questions. For this reason, students likely find different approaches to answer the questions that should be discussed in class.

2. Teaching Objectives

The case's purpose is to provide students a better understanding of IAG's strategic decisions in the face of an uncertain crisis and to explore how it managed internal and external environments. Several theories are explored so that students can undertake the case study from the perspective of the literature, but this is not restricted to it. The objective is to be creative and critical while applying in-class theory to a real-world scenario and using frameworks and concepts to the resolution.

The target audience is students pursuing a bachelor's or master's degree in Management and Business Administration, and it is relevant to strategy courses. It does not require any background or work experience, although it is recommended to better understand the case's practicality.

3. Assignment Questions

Question 1: Assess IAG's internal and external environment. Introduce Porter's Five Forces in your analysis.

Question 2: How does IAG use its dynamic capabilities to respond to the crisis? Perform an assessment of strategic adjustments.

Question 3: How do you frame the concept of horizontal integration in IAG's crisis-management strategy?

Question 4: Comment on the future of the industry and IAG's. Provide recommendations and implications as a result of your assessment.

4. Analysis and discussion

1. *Assess IAG's internal and external environment. Introduce Porter's Five Forces in your analysis.*

This question requires an industry analysis and an understanding of the impact of Porter's Five Forces on the company for an external approach, as well as a resource-based review to identify potential threats and opportunities for IAG to recover from this crisis scenario ahead of competitors.

Industry and company analysis

Since the Deregulation Act, the airline industry has suffered various changes, and new players have changed how carriers compete with one another, namely LCCs. The introduction of more destinations, lower rates, and other variables benefited customers while increasing the complexity of business models. Air connectivity was at its peak before the pandemic and the imposed lockdowns by governments. In comparison to the US, where the top five airlines control more than 80% of the industry, the European market has a long way to go in terms of consolidation (the top five airlines have over 50%

market share). This is a significant opportunity for IAG in terms of consolidation, which is relevant to its strategic ambitions. The Group holds a strong position in key hubs such as Madrid, Barcelona, Dublin, and London, and intends to strengthen its presence through both M&A and organic growth. The Covid-19 crisis impacted negatively IAG's business, forcing a strategic shift to adapt to an ever-changing environment.

IAG's competitors include low-cost carriers such as Ryanair and EasyJet, as well as full-service LHG and Air France/KLM. As the sector became more competitive, airlines were forced to lower their fares to stay in business. To that end, efforts have been made to operate more fuel-efficient aircraft, enhance frequent-flyer programs, form alliances, explore ancillary revenues, etc.

Through its operating companies and integrated platform, IAG has a broad product portfolio that addresses several market segments, allowing it to reach a great variety of clients. It leverages the expertise of many executives from across the Group's airlines, who bring know-how and a strong ability to solve problems together. Short and long-haul flights are operated throughout a vast network, with a versatile fleet that has proven to be a valuable asset with the conversion of several aircraft into cargo planes, while others were used for repatriation flights. This diversity, however, has proven to be costly when put into the context of LCCs, which often operate fewer aircraft types to be cost-efficient. The Group is attempting to capitalize on the crisis by making it safer to travel and increasing consumer loyalty by implementing policies that guarantee clients refunds or alterations with no extra fees in the event of canceled flights and potential changes. As the crisis has shown to be lasting, this customer-centric strategy is critical in terms of trust and preference.

Porter's Five Forces

Bargaining Power of Suppliers: High

When it comes to aircraft suppliers, two companies dominate the market: Boeing and Airbus, creating a form of duopoly. Airlines either buy or lease planes, and the contracts are frequently long-term, making it difficult to foresee the company's needs. On the other hand, the price of fuel can fluctuate significantly, and contracts are also established on a long-term basis, making it highly unpredictable. Both products are in high demand since airplanes must be constantly renewed and airlines do everything possible to keep them flying. IAG mitigates supplier power by centralizing its negotiating power in a single entity that represents the entire group.

Bargaining Power of Buyers: Moderate

Customers have gained more independence in the process of buying a ticket when distribution systems transitioned to online models. Fare discrimination caused price wars between travel agencies and airlines, which were intensified by LCCs. As a result, the industry is now highly price-sensitive, with customers seeking the lowest fares. When purchasing a travel ticket, buyers do not have the power to negotiate with airlines, but they will compare rates across available distributors and choose the least expensive alternative.

Threat of New Entrants: Low

Entering the market requires significant capital investment and expertise, and incumbents already have a competitive advantage in terms of economies of scale and scope, airport slots, brand reputation, and so on. The combination of legislation and the preceding factors creates high entry barriers. Furthermore, the market is consolidating rather than fragmenting, particularly in Europe.

Threat of Substitutes: Moderate

It is important to set boundaries when it comes to substitutes. In this situation, substitutes can be any form of transportation, including other airlines, trains, buses, and so on. However, internet and online meetings, notably for business travelers, can be seen as alternatives. Due to last-minute cancellations and constant legislation alterations, business travelers have decided to hold online meetings or use private aviation services as the virus progresses. Therefore, this threat is considerably higher in this segment. Leisure travelers are prone to keep using airline services for their travels and do not necessarily spend the time to take another means of transportation as it is time-consuming. Nonetheless, with companies expanding their network, buses, trains, and car-sharing are viable options for short-distance travel and are sometimes less expensive and considered more sustainable.

Industry Rivalry: High

This highly competitive industry is characterized by a large number of competitors, none of which is clearly a market leader. Airlines compete fiercely for customers through differentiation and pricing strategies. Price transparency and service features such as perishability, intangibility, and inseparability, among others, encourage firms to sell today what they will be unable to sell tomorrow, increasing competitiveness. The industry is highly regulated from the supply side, and airlines need to be flexible and resourceful to set up a service that attracts customers. This can also be achieved through collaboration with stakeholders, including other airlines, in order to build cooperative partnerships and maximize passenger volumes. Because airlines have high fixed costs, occupancy rates are important to be maximized to cover expenses, causing high competitiveness levels.

IAG attempts to reduce suppliers' bargaining power by using its integrated platform and placing large orders to obtain better deals. Its portfolio enables it to engage with many customer segments and enhance loyalty among the Group’s airlines. In terms of industry rivalry, it is attempting to consolidate the market through M&A and alliances. By eliminating existing competitors and developing partnerships with others, IAG ensures that it is well positioned and gains control over the industry. This strategy also results in higher entry barriers due to consolidation and economies of scale.

2. *How does IAG use its dynamic capabilities to respond to the crisis? Perform an assessment of strategic adjustments.*

In this specific crisis, there are aspects the Group addressed better than others due to several factors, such as unpredictability and constant external changes. Students should analyze what industry changes were more relevant and how did IAG adapted its resources to respond accordingly. It is recommended to assess which resources are crucial to developing a competitive advantage for the organization and how it responded on a problem-solving basis using its dynamic capabilities.

Dynamic capabilities refer to a company's ability to modify its resources and apply them to problem-solving circumstances. When dealing with pandemic-related challenges, resource base adjustments are critical, and IAG needed to adapt and take the necessary measures to stay competitive. Most senior executives and board members are used to dealing with crises, and the industry itself is a perpetual problem-solving activity. Because aviation is one of the least profitable industries, decision-makers must be up to date and flexible, traits that came in handy during the crisis.

IAG acted quickly to remodel the aircraft to comply with safety regulations, assuring customers that it was safe to fly. Its booking policies were altered in order to safeguard customers and strengthen loyalty, as evidenced by refunds and rescheduling flexibility. To comply with government policies and imposed lockdowns, network management and route scheduling were revised numerous times. The fleet restructuring was accelerated by permanently grounding less-efficient aircraft, some of which were turned into cargo freighters, while others were used for repatriation flights to meet the market's demand. The aforementioned resources are relatively quick to manage and depend mostly on the Group's decisions, whilst others require further agreements.

Negotiations with trade unions were a challenge due to collective bargaining and IAG's multinational character. A consensus was achieved that comprises both cutting the number of positions and saving others through furloughs and layoffs. This response reflects that IAG is unable to respond rapidly in terms of human resource restructuring to a crisis like this since it is dependent on other entities to make decisions. In terms of liquidity, IAG was able to raise funds to finance its activity from the United Kingdom, Spain, and Ireland governments and entities. These decisions may have an additional impact on running airlines as governments' bargaining power has increased, potentially delaying future decision-making procedures.

IAG is attempting to capitalize on the crisis in order to increase its portfolio while sticking to its strategic priorities. The Air Europa proposal acquisition has been renegotiated to a transaction value of €500 million instead of €1 billion. This strategic decision demonstrates IAG's ability to identify opportunities from the crisis and adapt its resources in order to sustain a competitive advantage, particularly in one of its most important hubs.

3. *How do you frame the concept of horizontal integration in IAG's crisis-management strategy?*

This question aims to further understand growth strategies and how they can be explored to seek opportunities in a crisis context. Students should discuss the concept of horizontal integration and how it can be used to set a strategic direction. The Ansoff Matrix provides an approach to this issue that can be studied and discussed in class.

Horizontal integration consists of the acquisition/merger of two companies from the same industry. When two companies at the same level of the value chain join through M&A, the market becomes more consolidated, posing a threat to competitors and potential new entrants. The merger of British Airways and Iberia was the very first step toward further strategic decisions. Portfolio expansion continues with the acquisition of Vueling, followed by Aer Lingus, bolstering the position in home markets while expanding into new ones has been achieved through both M&A and organic expansion. This consolidation provides IAG a competitive advantage in terms of negotiating power with suppliers and governments, as well as strengthening its position over competitors. These are particularly significant features in the context of crisis management since it needs fast decisions to respond to changes in the environment, which will most likely result in a better outcome if bargaining power is high.

In this case, wet leases and aircraft delivery arrangements have been renegotiated with suppliers. Other services, such as fuel contracts, airport slots (increase route efficiency and cost reduction), trade unions regarding human capital, and governments to expedite and exert pressure on restriction relief, were also negotiated. Rather than negotiating individually for each airline, the Group’s integrated platform confers collective bargaining power, allowing for better solutions when negotiating with suppliers.

The Group frequently uses this strategy to expand the business in two directions: market development or market penetration. It is a quick way to gain assets and market share, both of which provide resources and market power. A resourceful organization with many executives from various operating companies provides a competitive advantage in navigating the crisis, from a solution-oriented and resource-based perspective. The intention to acquire Air Europa is a prime illustration of this; by leveraging from its financial structure, the Group was able to renegotiate the acquisition value to half of its original amount, taking advantage of the crisis.

4. *Comment on the future of the industry and IAG's. Provide recommendations and implications as a result of your assessment.*

The Group's strategy must be aligned for it to respond to external environmental changes in a way that has never been done before. The crisis has evidenced that businesses must constantly adapt not only to the competitive structure of their industry, but also to pandemic-related emerging threats. As a result, setting specific strategic goals has become more complicated, as customer behavior, regulatory changes, and economic/market conditions are more difficult to predict. IAG is committed to achieving its long-term general strategic objectives of strengthening a portfolio of world-class brands, expanding its global leadership position, and improving a common integrated platform.

The future of aviation is uncertain, but some scenarios are gaining consensus amongst industry experts. Travel is more likely to recover between countries with more sustainable pandemic management, meaning vaccine access, greater caseload control, and compliance with safety measures. This may prevent death and hospitalization rates to increase, giving governments the confidence to keep borders open. If we consider what happened in previous crises, leisure trips are expected to lead the recovery. Remote working options and other flexible measures that were implemented in response to the pandemic are likely to persist, which will be detrimental to carriers that rely heavily on their business classes. These are especially important on long-haul flights because they are responsible for generating most of the profits, even though economy travelers fill up a large majority of the plane seats. This could mean a reevaluation of IAG's long-haul operations, including new pricing models, network, and aircraft reconfiguration, in order to meet the growing demand for leisure travelers as opposed to business travelers. The increased debt levels are also a factor that will likely lead to ticket prices raise.

Government intervention in the industry has increased once again as a result of state-aid credits. This can be considered as an opportunity for IAG to collaborate closely with governments and exert some influence over air travel regulation, potentially reducing the impact of constant policy changes.

A straightforward approach to the pandemic was to reduce capacity and rethink cost-based structures to become more flexible, increasing variable costs' share compared to fixed costs to secure liquidity. Despite efforts to adapt to demand levels, it is presumed that air travel is still oversupplied, as evidenced by a drop in the price of aircraft leases and purchase deals. This represents an opportunity for financially stable companies, such as IAG, to consider placing long-term orders with aircraft and fuel suppliers and renegotiate contracts.

The leading airline groups are expected to seize consolidation opportunities in the fragmented European market. IAG is already negotiating the acquisition of Air Europa, which would increase its market share and bargaining power. The acquisition will help IAG to mitigate direct competition on routes, as well as indirect charter services.

The Group's operating companies are well-positioned in their markets, and it is important to maintain service standards to assure brands' reputation. A customer-centric approach must be developed and downgrading customers' experience to save costs is a risk for future engagement and loyalty. IAG should invest in digital operations as travelers need more assistance and available solutions through the tip of their fingers (smartphones, laptops, etc). Additionally, by implementing digital solutions, the company will be able to collect data that will help in making faster and more accurate decisions as customer behavior and trends have changed. Stakeholder engagement must be enhanced through its integrated platform to guarantee a good relationship and facilitate negotiations.

The Covid-19 crisis has evidenced the need for airlines to rethink their operations. Another example of industry shifts caused by the pandemic is the growth of air freight due to e-commerce sales. By converting some of its fleet into hybrid cargo/passenger aircraft, IAG would be able to expand its freight operations flexibly. In this way, the Group avoids the risk of having a large cargo-only fleet while also meeting market demand.

Sustainability is a constant concern in IAG's strategy and should not be sidelined because of the crisis. The aforestated measures and recommendations also have implications for minimizing the Group's environmental impact.

IV. CONCLUSION/LIMITATIONS

The present dissertation applies theoretical frameworks to a real-world scenario. The analysis underlies on the strategic aspects of a major European player in the air travel industry to face the Covid-19 crisis. Students have a perspective on how a large corporation has adapted to an ever-changing external environment and used its resources and capabilities to remain competitive. It illustrates how environmental changes can affect the industry and consequently the structure of companies, namely IAG. The operations were completely remodeled, and route management needed to be adjusted according to government policies and customer behavior. Human resources management had to become more flexible to decrease fixed costs and preserve liquidity. To meet demand and optimize operations, the fleet's retirement was accelerated, and some of the aircraft were used in repatriation and cargo flights. A customer-centric approach was employed to restore consumers' willingness to travel and assure clients' safety, namely through the implementation of refunds and flexible booking options. These and other measures mentioned in the case provide students numerous examples of how to practically employ dynamic capabilities. On the other side, the acquisition of Air Europa is an excellent example of how to capitalize on opportunities that arise from a crisis.

The Covid-19 crisis is still a very recent topic, and it has proven to be unpredictable. This is one limitation of the case study, and students/lecturers should examine additional alterations so that they can reach more accurate conclusions. The lack of literature regarding the pandemic made it difficult to have a clear perspective of future developments, which is also a main challenge for airlines themselves.

The information was mainly obtained from internal document sources, namely reports, which can lead to a unilateral analysis. As an industry enthusiast, I may also have an optimistic approach on the case, despite my efforts to preserve an unbiased position and rely on facts.

V. Exhibits

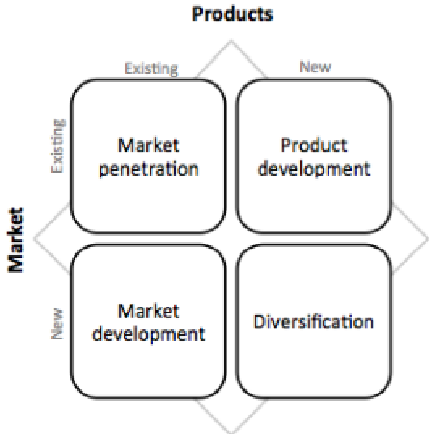

Exhibit 1 - Ansoff Matrix

Source: Lohmann & Spasojevic

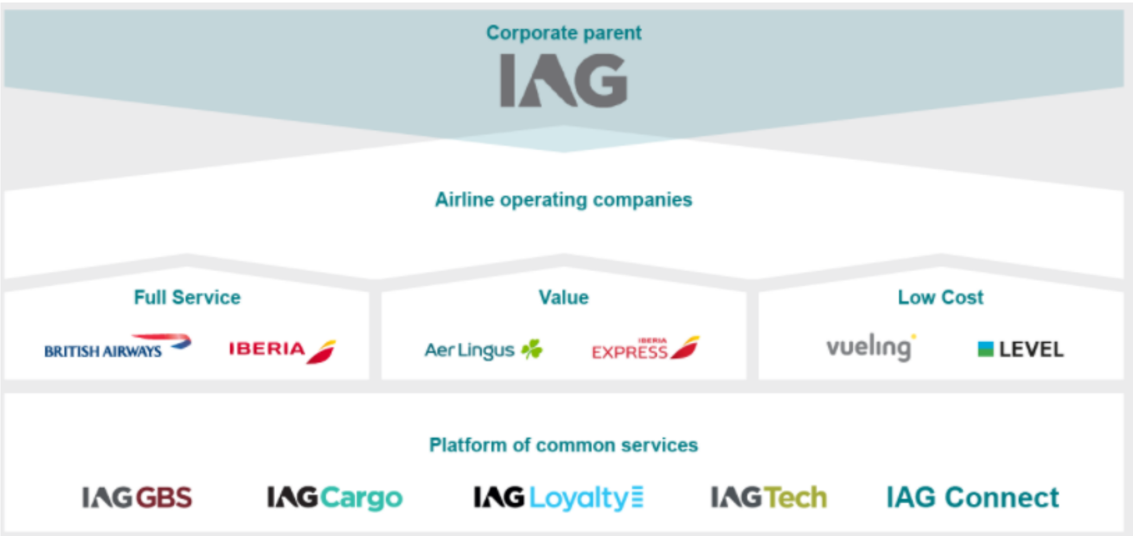

Exhibit 2 - IAG's strategic priorities

Source: IAG Annual Report and Accounts 2020

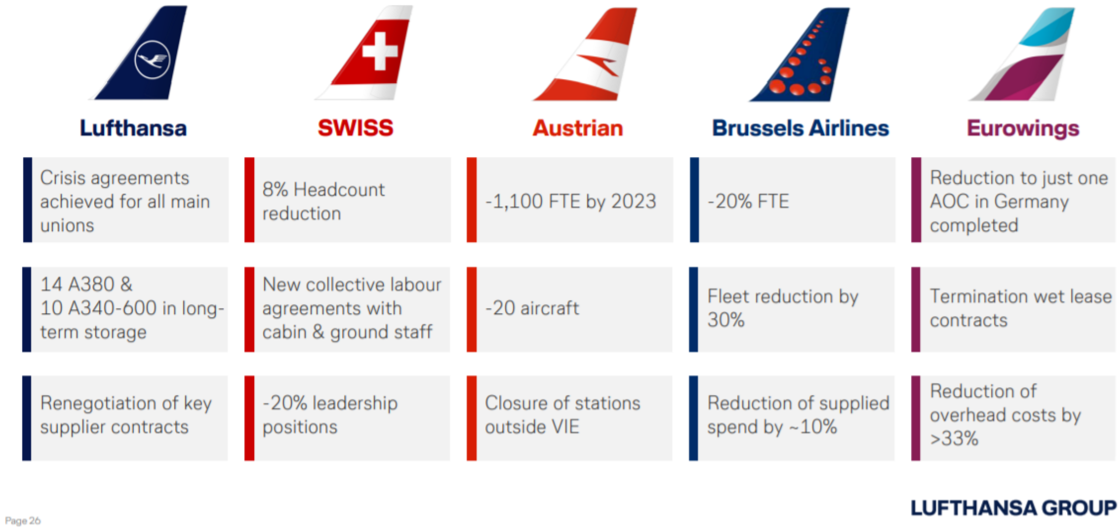

Exhibit 3 - Significant progress achieved in the restructuring of LHG

Source: Management Presentation on the Results 2021

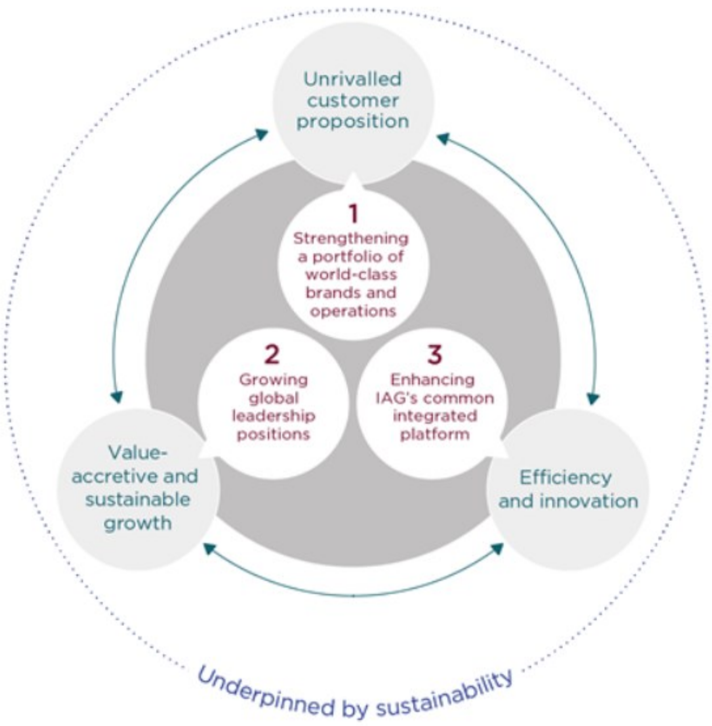

Exhibit 4 - IAG's strategic priorities

Source: IAG Annual Report and Accounts 2020

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