Analysis of British Airway's Hedging Strategies

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ABSTRACT

From January 2020 onwards, major air crashes have occurred in the international community. Nearly 200 people were killed in the passenger plane accident from Iran's capital airport to Ukraine's international airport alone, which shows the seriousness of the problem. How to hedge the risk for the airline company is crucial. The purpose of this article is to explore the impact of hedging strategies on British Airways in the past few years and analyze the solutions to reduce losses. We start with a description of BA, followed by a discussion about the current hedging strategies. The method of SWOT is used to investigate BA in more depth. The conclusion reached is that BA should hedge less in such a speculative environment and collaborate with other related companies.

Keywords: *British Airways, hedging strategies, SWOT, speculative environment*

1. INTRODUCTION

The Studies over the past decades have provided important information on the influence of hedging on an airline company. Styles British Airways PLC was established in April 1974 when British European Airways (BEA), the British Overseas Airways Corporation (BOAC), and their subsidiary firms merged to become British Airways PLC. Its head offices are at Harmondsworth, in London [1], [2], [3].

British Airways was brought to market by the British government in early 1987. The US Justice Department penalized British Airways $300 million in 2007 for price-fixing. In the years after that, the firm has pursued partnerships with other airline companies, the most notable of which is Iberia. It formally partnered with the Spanish airline in 2011 to establish the International Airlines Group holding company. However, every airline continued to function by its name[4].

The firm's fiscal situation in 2020 was £1.3 billion in earnings, liquid assets, and other interest-bearing resources[5]. At the close of 2020, the budget deficit of British Airways was £7.5 billion. Long-term obligations, both continuous and non-continuous, are deducted from assets, cash equivalents, and current interest-bearing assets to get at outstanding debt.[6]

Passengers are crucial to BA's business, and involving customers allows the company to understand better and create service and product ideas that will benefit customers the most. Suppose the airline is unable to satisfy customers' requirements and does not interact properly to maintain their emotional connection to the brand. In that case, its reputation will decline, and sales growth will be undermined. Customers can join British Airways' loyalty program by purchasing Avios Group (AGL) Limited points provided to Executive Group members as part of their ticket[7]. Clients value safety, dependability, value for money, and user experience from reservation until arrival at their destination. Moral and environmental concerns are increasingly influencing consumer decisions. It is important to conduct research to decrease the potential risk for the airline company.

This paper will use the definition of the hedge as a risk management strategy used to offset losses in investments by taking an opposing position in a related asset. With the impact of covid 19, the number of flights reduced suddenly, which caused a huge loss in British Airway's derivatives, and the focus on hedging has strengthened. More people now pay attention to the methods which could reduce derivatives losses. This paper, therefore, tries to start from the description of a representative firm in the airline industry, British Airways, followed by the analysis of hedging strategies BA uses and the SWOT method to investigate this company and discuss reasonable solutions.

The remainder of the article was organized as follows. Section 2 describes the hedging strategy of this company during the Covid 19. In Section 3, the article conducts a SWOT analysis of the existing situation of British

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Airways. Finally, we conclude the article in the last Section.

2. HEDGING STRATEGYATH

During the Covid 19 outbreak, firms were affected by derivatives losses. Upon losing tens of billions in derivatives trading in 2020, some of the world's largest airline companies, such as British Airways, are scaling back their massive fuel-hedging operations. IAG SA, the parent company of British Airways, suggested reducing its year-ahead fuel hedging to around 70percent of its demand. Conversely, Deutsche Lufthansa AG reduced its hedging operations by roughly 25%. When global oil prices fell in 2020, British airlines suffered a loss.

Because it is obvious that during the entire epidemic period, almost all international flights were suspended without any frequent contact, which led to a large number of airlines facing economic collapse for a time.

In response to all aspects of airlines, Dutch aviation consultancy To70 has made a new survey in particular. The survey results show that the total number of flights throughout 2020 has always been in a stage of continuous decline, but the overall death toll of global commercial airliners is much higher than the usual period, which is also sighing. The BBC has repeatedly emphasized that throughout 2020, a total of 299 people died due to the crashes of commercial airliners, a significant improvement compared to the same period. The number of flights is decreasing, but the number of fatalities in air crashes continues to increase, which illustrates a rather serious situation. This causes a huge decrease in airlines companies' stock prices.

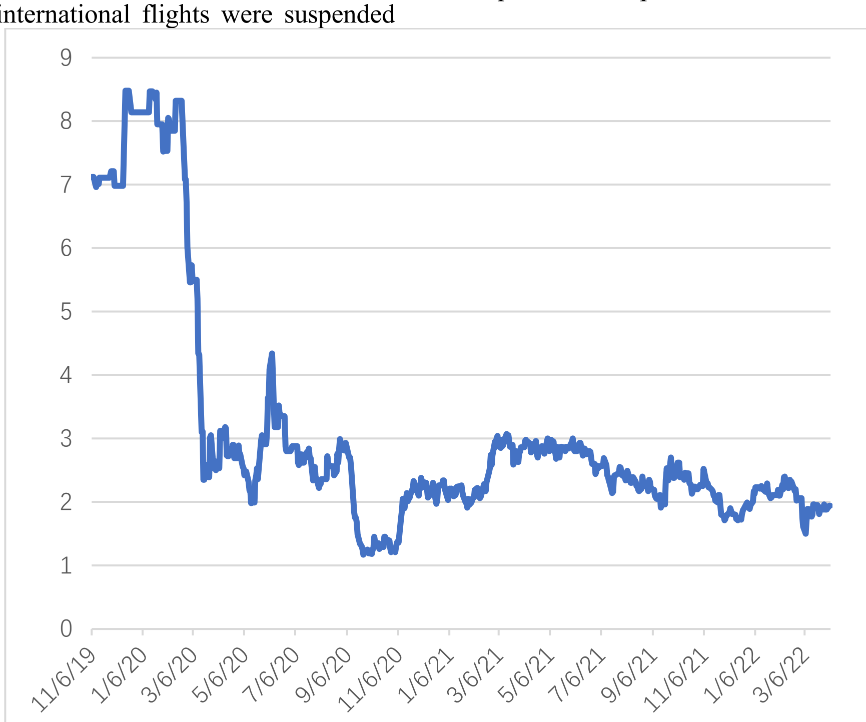

Figure 1. The stock price of Airlines

Figure 1 shows the stock price of International Consolidated Airlines Group S.A. We could see that due to the happening of Covid-19, the stock price plummet. After that, because of lots of crashes of commercial airliners, the stock price also decreased.

Airlines were severely affected by oil derivatives they bought when the virus started, prompting the move[6], [8].

While they typically purchased derivatives to limit their costs, BA frequently reduced the price by concurrently releasing agreements that would take a loss if prices fell. Usually, reduced physical fuel costs offset this, but with so few flights operating in 2020, the corporation was forced to deal with significant losses on that part of their business. While some airline companies hedged minor volumes, their position in the oil sector is still limited due to poor capacity predictions. Even if travel levels rebound, this is anticipated to remain. British Airways is also thinking a little farther ahead and lowering the quantity of fuel they will hedge.

Forward exchange contracts lock in an exchange rate for buying or selling one currency for another or fulfillment at a specified date. By analyzing how predicted earnings are secured to counteract future currency bets that terminate on the period of the cash flows, future contracts help British Airways hedge from currency risk. Money market strategies aid in evaluating suitable interest rate hedges for potential long-term loans or obligations, such as airplane leases.

Due to reduced capacity, emissions, oil, and fuel expenses declined, mean product fuel prices dropped. As a result, actual gasoline prices were higher than in 2019, with the fuel hedging policy compensating for the reduced selling prices entirely. British Airways also received new airplanes. These are next-generation airplanes that are more fuel-efficient and emit fewer pollutants. The reduction in staff costs was due to a loan connected to funds received from the American government under the COVID 19 Job Replacement Initiative in 2020. Restructuring and substitution efforts have resulted in additional cost savings for preparation staff and volume benefits resulting from reduced flying hours.

Volume-based price reductions account for most of the improvement in the residual benchmark cost of operations. Housekeeping, culinary, and other operational costs decreased in 2020, owing to cost-cutting measures such as the closure of multiple cafés and other restaurant work and supply-chain efficiencies. Russia's takeover of Ukraine already changed natural gas and oil prices. This increase is mainly due to fears of Russian effects on monetary transactions involving Russian natural gas and oil. Russia is the foremost oil producer in the world[9], [10].

Russia is Europe's largest energy supplier. Due to certain natural circumstances and previous Russian production restrictions, Europe is now struggling with highly high oil and gas prices. Gas prices in Europe increased even more following the invasion. Gas price volatility soared in the Dutch market, a crucial natural gas trading center for mainland Europe. With high oil prices and substantial financial reserves, Russia can export less gas. Its reputation as a dependable energy provider is already shattered. This decision would have disastrous consequences for Russia's energy future.

The expense of the hedging tactics used by British Airways, particularly the short sell, which is leverage, is more significant than the advantages. As a result, British Airways should avoid hedging in such a speculative environment. Due to uncertainty, hedging risks will rise, and an unexpected pattern is not suited for hedging foreign reserves and gas. A more secure currency, such as the Chinese RMB, should be an interim safe refuge for foreign currencies.

In reaction to the impact of covid-19 in 2020, the risk management process was updated to improve the Group's risk assessment. The operation aided the BA Board of Directors and senior management in quickly responding to the new, rapidly changing threat landscape. It allowed for a good explanation and recognition of evolving dangers associated with the pandemic's implications and how the disease outbreak has impacted identified risks in the Group's risk evaluation.

3. DISCUSSION

As explained in the introduction, it is clear that the SWOT method should be used to further investigate British Airways PLC. The strength such as a good reputation is as important as the weakness such as over-reliance on the UK market. Further, the discussion on opportunities and threats also plays an important role in developing the strategy for BA. A more detailed account of SWOT is given in the following section.

3.1 Strengths

British Airways flies to about 450 destinations worldwide, and its parent company, International Airline Group, also owns Aer Lingus, Vueling, and Iberia [9] (Peeters, P. et al., 2019, 164). Due to its broad range of facilities, the company could make money from improved productivity. This profit improves the airline's comparative advantage by investing in innovative, modernized airplanes and ensuring more personalized service.

Its reputation is well known. British Airways has garnered both the Customers and Businesses Superbrands awards for many years. The Sunday Times and National Geographic named British Airways the best long-haul and short-haul airline in 2015. It is labeled as the best European airliner, and Business Traveller named the airline the best short-haul operator with the most flights and lounge access.

Therefore, British Airways obviously has a good reputation. British Airways has the most return flights between Scotland and Heathrow, London City, and Gatwick airports, up to 60 each day. It is still the only company that serves New York from all the London's major airports: Gatwick, London City, and Heathrow. Regarding the magnitude and importance of the UK aviation industry, the company's current dominant position in the competitive market is significant.

3.2 Weaknesses

British Airways' executives must reduce the company's over-reliance on the UK market. The UK accounts for about half of all airline revenues, while the UK and the US account for 79 percent of all sales. In the United Kingdom, its current stance puts it at threat of a market shrink and competitive challenges. In 2019, British Airways' operating income was 11percent, which was lower than the average industry profitability ratio of 13percent. Therefore, British Airways' low-profit margin exposes the company to industry shrink.

3.3 Opportunities

BA should form strategic partnerships with other companies in the airline and catering industries. Star

Alliance, SkyTeam, and Oneworld are the three examples. These worldwide partnerships contribute 65% of total revenue and guarantee a lot of benefits, including improved connection, cost savings, and a more consistent support standard for customers.

Brand extension on a global scale is also an opportunity. British Airlines should develop an excellent development strategy that includes foundations of operations in international locations, including customer aircraft operation, maintenance, and airport facility activities. Recruitment and termination of employees, talent development, and financial analysis in existing currencies are all aspects of international integration that must be solved.

BA should also work to improve its relationship with labor unions. They should establish a labor-management partnership as a competitive advantage. They can develop mutual goals and build a profitable business that benefits both sides.

3.4 Threats

The continued competition between rivals, terrorist attacks, system failures due to the staff strikes, and the dispute with the UK government are significant threats to British Airways.

On this basis, British Airways should keep its reputation and broaden the scope of business including developing new markets in order to raise the low-profit margin. In addition, BA should also engage in strategic partnerships with other companies and focus on gaining a competitive advantage to survive in the continued competition.

4. CONCLUSION

In conclusion, the paper has analyzed the impact of hedging strategies on the British Airways in the past few years. Drawing on the SWOT analysis, the study has shown that BA should focus on developing new markets, reducing hedging, and maintaining its reputation. Therefore, more investment in the risk management process will eventually benefit the organization.

The article also exists some limitations. For instance, the article does not conduct lots of data analysis and utilizes a quantitative method to solve the hedging strategy. Thus, system failures and increased levels of competition are still vital threats and should be focused more on further research. In the future, we will use the BLACK-SCHOLES option pricing model to analyze stock data to help companies hedge risks.

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