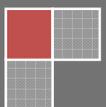


2009

AEROFLOT AIRLINES: Analysis & Crafting Strategies



Executive Summary

The following report aims to examine an international company's internal and external environment and suggest possible amendments in the strategies developed by this company.

Aeroflot Airlines is a Russian Airline Company which is subsidized by the Russian Government. It is part of the European Skyteam Alliance and it has developed to the point of being a market leader on the home market and in the list of leading ten European airlines.

The External Analysis carried out and presented further below outline several main factors that have to be considered. These are the following:

- The economic environment is pressurized by the world crisis at the moment. This reflected into:
- Very unfavorable foreign investment market;
- Increase in taxations;
- Intense restructuring of the competitors positions.

The internal analysis of the company outlines the ways Aeroflot chose to adapt to the constantly changing economic environment. As a market leader, the company has developed a high quality of services towards its most well known consumers-the business class. However, the analysis reveal that quality is lacking in the market niche of the economy class which later on in the report is examined and proved to be the key point in sustaining the company during the times of crisis.

The report continues outlining the strategies that are suggested to Aeroflot. As already mentioned above they focus on the rapidly increasing market niche of the economy class. The strategy chosen is focused differentiation strategy and it emphasizes on improvements in the value chain of Aeroflot.

The main strategy and the supporting approaches are decided based on objectives and criteria driven out from the conclusions of the analysis carried out. The criteria are:

- Improve company's safety;
- Customer satisfaction;
- Keep up good financial performance.

Suggestions were made for alternative strategy in case of further intensifying of the economic crisis within the country.

The last part of the report provides a more detailed view of how strategies are going to be implemented for the company. Financial forecasts are provided in order to measure the effect of the suggested strategies over the financial performance of Aeroflot.

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Introduction

The report is carried out by fourth year students from the International Business Management and Human Resource Management streams at Arnhem Business School.

The aim of the report is to examine in details the performance of an international class company and suggesting improvements on strategic level by using the knowledge gained during the studies.

Chapter I • Company Background

I. Profile

- **Mission Statement**

We help your dreams and plans come true – use your business trips effectively, relax during your holiday, meet friends and relatives and discover new cities and countries. We do our best to make sure you feel right at home on board – secure and comfortable.”

- **Strategic Goals**

The main strategic goal is to develop an international class company based on the best traditions of the civil aviation of Russia.

To achieve this goal Aeroflot strives:

- To strengthen its leading position in the civil aviation of Russia
- To provide transportation of passengers to most large cities of the world. For this purpose Aeroflot intends to establish its own system of routes convenient for passengers and cost efficient and cooperates with airline partner-companies as well,
- To provide passengers with a stable service quality on the level of the competitors or even higher
- To achieve the level of production and economic indicators of the airline companies members of the Association of European Airline Companies
- To establish an effective system of relations in the company.

All of Aeroflot’s employees very much value the good traditions of Russian hospitality. Their standards of service are based on sincerity and friendliness as natural components of the Russian soul. Reliability and high quality ensure unforgettable travel experiences for their passengers. Aeroflot will always lend a sympathetic ear to their passengers, thanks to their suggestions the company is able to constantly improve the services provided.

II. Past Performance

- **Corporate Values**

- *Team spirit*

Team Spirit is highly valued in Aeroflot, it happened that the company encounter tough challenges during its post soviet times. However with improvements internal co-operationtogether between Company's airline subsidiaries, Aeroflot-Nord and Aeroflot-Don it was possible for Aeroflot to increase passengers' turnover.

- *Integrity*

In 2005 Aeroflot was committed in conducting operations for restructuring and expansion of the Company's aircraft fleets, whereby acquisition on leasing terms of modern fuel efficient aircraft were negotiated with manufactures and aviation leasing companies. Meanwhile Aeroflot successfully underwent the IATA Operational Safety Audit (IOSA), becoming the first Russian company to receive the IOSA¹ stamp of approval, and after that immediately construction began for a new Terminal located at Sheremetyevo. The company promised to deliver the highest standard in air travel business and has succeeded to be trust worthy.

- *Innovation*

Aeroflot has carried out a full automated system for electronic ticket services and improving business efficiency, on revenues management and performance management for high quality of services. Business costs had been decreased and revenues had increased at the same time, all service has underwent an optimization process. The benefits were in brand globalization, unification of customer loyalty, and creation of synergies in procurement, and technical and ground service.

- **Strategic Goal in 2005**

Aeroflot development strategy in 2005 consisted in expanding between the rivals by securing their competitiveness overall.

- *Strengthening the positions on the domestic market through increasing the volumes of transportation and optimization of the network of routes.*
- *Finding a company strategic partner.*
- *Improve company's image in the country.*

¹ <http://www.iata.org/ps/certification/iosa/>

Aeroflot has made significant progress over the past five years, enabling the airline to meet the levels of service and safety of the most effective airline companies of the world². In 2005, the airline received an award for Onboard Service Improvement Excellence from Skytrax, a leading research and consultancy firm for the airline and air transport industry.

A partnership with SkyTeam in 2006 had increase Aeroflot's growth and enhance its operational efficiency, thereby improving service offerings to highly valued customers. The company looks forward to better serving the customers by linking them to the extensive SkyTeam network and providing them with more convenient connections, as well as the opportunity to earn more frequent flyer miles as they travel throughout the world.

As part of its membership, Aeroflot passengers will be able to accrue and redeem frequent flyer miles interchangeably on any of the nine other SkyTeam member airlines. In turn, SkyTeam passengers on flights operated by Aeroflot can earn miles in their preferred frequent flyer program. Aeroflot, which has seen steady growth in passenger volume and profit over the past several years, has strengthen his position in the domestic market by remodel the company's logo and slogan regardless the influence of soviet communism on foreigners, and partnering with SkyTeam, the second world's leading airline alliances, has boosted service quality for customers throughout its network, including in-flight service, and harmonized its flight system with SkyTeam.

By entering into bilateral agreements with all nine existing SkyTeam members, which have been tough to meet entry requirements, Aeroflot significantly improved its standards of operations and was able to operate 18 new medium-haul Airbus and had receive 12 additional aircraft in 2006 and 2007, it received strong support from both the aviation and the investment communities for this key improvement.

- **Policy**

Aeroflot has renewed insurance policy of aviation risks with a discount of 19,6% in comparison with previous policy period In 2006 the discount was 12%. The renewed flight insurance policies of Aeroflot meet all the requirements of the aviation authorities of the countries, engaged into the airline company's routes, and correspond to Montreal convention requirements as regards to insurance of air carrier's liability for its passengers. Aeroflot current liability limits also meet the requirements of the Sky Team international alliance, partnering the airline, as well as the requirements of the alliance's current members under the code sharing agreements.

¹<http://en.wikipedia.org/wiki/Aeroflot>

Chapter II • External Analysis

I. Industry Definition

To identify the industry where Aeroflot belongs to, first we need to key out who are their target groups. Secondly, we need to understand what are the demands for the consumers within the industry: the consumer needs and last but not least we need to focus in how Aeroflot serve these consumers.

- **Target groups**

- *Commercial flights*

For the commercial flights Aeroflot target two different groups. The business consumers, in approximately the age of 25 to 55, these usually have a hasty life in business, they seek for privacy and quality service. This target group can afford to pay off sufficient amount of money to feel comfortable during their business flights. The economic consumer is everybody in the age between 2 to 80, who is looking for a cheap ticket and a way to travel from one point to another at the most comfortable and affordable manner. Both groups are tangible and hold up to their needs to their needs, as the business consumers, they need to feel comfortable during the flight, nevertheless the fee. On the opposite, the economic consumers mostly like to satisfy their needs against a low payment.

- *How Aeroflot is satisfying the target groups.*

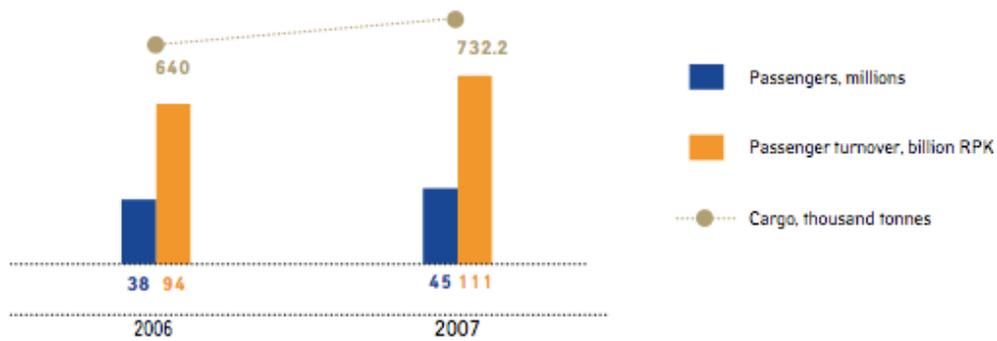
Each group has been satisfied in different manner, tickets for a flight could be purchased online or by representative office regionally, businesses flights have additional service as, business class checking registration and onboard entertainment program video on request for business class passengers and other features. The repertoire of digeplayers is constantly updated, so passengers can enjoy the latest international and Russian premiers. Economy flights are adapted with particular needs for the consumers, they enjoy additional services including, improved catering service with extended product offerings including alcoholic beverages, as well as additional comfort products, etc. Freights flights are important indicators of national and global economic development, and they also depend to a large extent on the state of the economy. In order to structure and improve efficiency of its cargo business, Aeroflot decided in October 2005 to set up a new subsidiary, Aeroflot-Cargo. Now, domestic & international costumers can be satisfied in order to make use of Aeroflot-Cargo services in sending or receiving mail and cargo for a reasonable price. Aeroflot make use of SITA Super Cargo (SSC) automated cargo handling system, who guarantee possible track and fast progress of cargoes through the delivery system in real time. Regardless of the efficiency of the system and the low price arrangements, Aeroflot would like to set off a satisfactory experience for the business to business groups, by setting up a web site for the Company's cargo department, including technologies that allow booking of cargo services and input by customers of essential information directly into the SSC. Shareholders and investors have been satisfied by the attention Aeroflot is giving them in the form of providing accurate information about

sales figure, market condition and current status of company's position. All this information can be seen in their annual report and their website, information over business and latest problems of airline & cargo business is given on their website. Additionally Aeroflot creates events as press conference, workshop and trainings, where investors are invited to be present for a learning experience based on the company strategy and the future interest of company's benefits. Aeroflot is doing business in the market of Russian Civil Aviation and Money Industry.

II. Industry Trends

The Russian airline industry has been showing strong growth since 2000; driven mainly by growth of the Russian economy, rise of business activity, rise of personal incomes and mobility, as well as development of air transport infrastructure and renewal of aircraft fleets.

Growth of the Russian air traffic market



Russian airlines carried 45 million passengers on domestic and international routes in 2007, representing an increase of 18.6% from 2006. These figures are still considerably lower than levels of passenger carrying before break-up of the USSR (88 million passengers were carried inside Russia in 1991), but they represent a steady growth dynamic. Passenger turnover grew by 18.2% to 111 billion RPK; growth rates in 2007 were more than twice higher than in 2006 and set a record for the period from 2000 to 2007. Growth rates of passenger traffic differed significantly between geographical areas in 2007. The largest growth of passenger numbers by 22.4% was on long-haul international routes to destinations outside Russia and the CIS (the so-called "far abroad"). Growth on routes inside Russia was 16.7% and passenger carrying on CIS routes expanded by 12.8%.

The 15 biggest airlines carried 70% of all passengers on Russian domestic routes, and the average growth rate in this category was 20.6%, which is 3.9 percentage points more than the average level on all domestic routes (16.7%) so the gap between largest airlines and smaller operators continues to widen.

The Russian market is now one of the most promising in the world, together with the Chinese, Indian and Middle East markets. Current forecasts for development of the economy and the market situation suggest that the trend of growing demand has a long-term character industry analysts estimate that nominal wages in Russia, which are used to calculate an affordability index, rose by more than six times in 2000–2007, while average annual ticket prices on domestic routes rose by just over two times. However, air transport mobility of the Russian population remains considerably lower than in developed countries.

III. Size of Market

The Russian air transportation market is expected to grow in the near future. According to data released by the Russian Ministry of Transportation, in 2007, Russian airlines transported 35 million travelers, an increase of 3.9% compared to 2006. By 2010, it is expected to exceed 50 million travelers per year. Airbus experts say that for the next 20 years, the volume of passenger transportation in Russia is expected to grow faster than globally. The Russian market will grow 6% on the average annually, whereas the rest of the world will have only 5.3% annual growth.

To accommodate this growing demand, airlines will require 200 long haul aircraft and 300 regional aircraft. Other statistics from the Ministry of Industry and Energy indicate that the need for regional aircraft will amount to 320-350 units up to year 2022, which is approximately \$6 billion. According to Airbus estimates, the Russian industry will require more that 600 aircraft at the total cost of \$45 billion. Another 80 freight aircraft will be needed to meet the growing cargo transportation needs. The above statistics makes the Russian market one of the most attractive national markets for manufacturers and suppliers of aircraft and related aviation equipment.

Smaller regional aircraft (both for chartered VIP flights and for public flights) is another important market segment of the industry. According to reports from the Ministry of Economic Development and Trade, air transport will remain the single way of transportation in the Eastern regions of Russia. The average distances among inhabited areas in Siberia and the Russian Far East are about 600-700 kilometers. Roads are in poor condition and ground transportation can take several days. The number of inhabitants in Siberian towns and settlements is fairly small and planes with 15-20 seats would work best to meet their needs. No information is available about the exact size of this market.

IV. Economic Environment

Russia ended 2008 with its tenth straight year of growth, averaging 7% annually since the financial crisis of 1998. Although the Russian Government has laid out plans to diversify the economy, energy and other raw materials still dominate Russian exports. Over the last six years, fixed capital investment growth and personal income growth have averaged above 10%, but both grew at slower rates in 2008. During the past decade, poverty has declined steadily and the middle class has continued to expand. Russia has also improved its international financial position, running surpluses since 2000. The government saved these surpluses in two sovereign wealth funds, together valued at over \$200 billion: a reserve fund to support budgetary expenditures in case of a fall in the price of oil and a national welfare fund to help fund pensions and infrastructure development. Foreign debt is approximately one-third of GDP. The state component of foreign debt has declined, but commercial debt to foreigners has risen strongly. In 2008, Russia's GDP grew an estimated 6.0%, led by non-tradable services and goods for the domestic market, as opposed to oil or mineral extraction and exports. The economy slowed significantly in the second half of the year due to the global financial crisis and a steep fall in the price of oil. Investor concerns over the Russia-Georgia conflict, corporate governance issues, and the global financial crisis caused the Russian stock market to fall by roughly 70%. The global crisis also affected Russia's banking system, which faced liquidity problems against short-term external repayment obligations. In response to these issues, Moscow initiated a larger than \$200 billion rescue plan designed to increase liquidity in the financial sector, to help firms refinance foreign debt, and to support the stock market. The government also unveiled a \$20 billion tax cut plan and other fiscal supports for society and industry. In the first year of his term, President MEDVEDEV outlined a number of economic priorities for Russia including improving infrastructure, innovation, investment, and institutions; reducing the state's role in the economy; reforming the tax system and banking sector; developing one of the biggest financial centers in the world, combating corruption, and improving the judiciary. Russia's infrastructure requires large investments and must be replaced or modernized if the country is to achieve broad-based economic growth.

Table1.1 economic indicators

<i>GDP – per capita (2008 est.)</i>	<i>GDP-composition by sector (2007est.)</i>	<i>Inflation-rate consumer prices (2008 est.)</i>
\$15,800	<i>agriculture: 4.1%</i> <i>Industry:41.1%</i> <i>services: 54.8%</i>	13.9%

V. Investment Environment

In Russia, there is often little or no distinction between commercial and political interests. The Kremlin and associated political elites involve themselves actively in commercial dealings, especially in strategic sectors such as oil and gas, minerals, defense and aerospace. There have been numerous cases in which the government has intervened in sectors deemed to be strategic to Russia's foreign & security or commercial policies, such as the "YUKOS Affair" in which the government targeted the Russian oil giant YUKOS eventually resulting in the prolonged imprisonment of its CEO Mikhail Khodorkovsky.

Under Mr. Putin the state passed extensive new legislation and took other measures that increased state involvement in the economy, notably in the oil and gas sector under the state-owned champions Gazprom and Rosneft. There is now greater clarity as to the role of the state in the economy. The global financial crisis in the second half of 2008 hit Russian oligarchs particularly hard. The Russian state is taking on increased stakes in key companies formerly oligarch jewels, such as Norilsk Nickel. The financial crisis has provided increased opportunity for the state to assert its role in the economy, but short of outright nationalization of industrial sectors.

In terms of foreign investors, changes to the natural resources investment laws have effectively limited foreigners from owning majority stakes in strategic sectors. On 7 May 2008, a new Strategic Sectors Law came into effect defining foreign investment limits in 42 sectors. Foreign firms will only be allowed to invest in these areas beyond a certain percentage with government approval. Foreign government-invested interests will be prohibited from gaining control over any Russian company in these sectors.

VI. Social Analysis

The country ended 2007 with its ninth straight year of growth, averaging 7% annually since the financial crisis of 1998. In 2007, Russia's GDP was 1.59 trillion Euros, the 6th largest in the world, with GDP growing 8.1% from the previous year. Growth was primarily driven by non-traded services and goods for the domestic market, as opposed to oil or mineral extraction and exports. The average salary in Russia was 500 per month in early 2008. Approximately 14% of Russians lived below the national poverty line in 2007, significantly down from 40% in 1998 at the worst of the post-Soviet collapse. Unemployment in Russia was at 6% in 2007, down from about 12.4% in 1999.

As of 2007, the average life expectancy in Russia is 61.5 years for males and 73.9 years for females. The average Russian life expectancy of 67.7 years at birth is 10.8 years shorter than the overall figure in the European Union. The biggest factor contributing to this relatively low life expectancy for males is a high mortality rate among working-age males from preventable causes (e.g., alcohol poisoning, stress, smoking, traffic accidents,

and violent crimes). Mortality among Russian men rose by 60% since 1991, four to five times higher than in Europe.

In 2006, Mercer Management Consulting named Moscow the world's most expensive city for expatriate employees, ahead of perennial winner Tokyo, due to the stable Russian ruble as well as increasing housing prices within the city. Moscow now has 74 billionaires with average wealth of 4.5 billion Euros, placing it above New York.

VII. Five Forces Analysis

Fig 1.1



- **Threat of new entrants**

The threat of new entrants in the market of Russian civil aviation is low. The main reasons for that are huge amount of money that is needed to start airline business, and hardly any airlines company in coming years can offer as many destinations worldwide as Aeroflot has. That is why Aeroflot should not be afraid of possibility of new entrants.

- **Bargaining power of suppliers**

Aeroflot's fleet, which is among Europe's most modern, youngest and fastest growing, consists of 90 aircraft

(Airbus, Boeing, Tupolev and Ilyushin planes), confirming the airline's commitment to the highest economic, safety, ecological and noise standards. In 2009 the company is planning to receive the total of 24 brand-new modern planes. In 2007, Aeroflot signed multi-billion US dollar deals to buy 22 Airbus A350 jets and 22 Boeing B787 Dreamliners, with deliveries in both cases to start since 2016. In 2008, Aeroflot started receiving Airbus A330 aircraft which will dramatically expand the airline's long-haul capabilities and standard of service. So we can conclude that Aeroflot has long-term relationships with its suppliers.

- **Threat of substitute products**

The threat of substitute products is low, because of the size of Russian Federation. If you go for a long distance by train you will spend much more time on the trip than if you fly by plane. Also Russia is not a member of European Union and people prefer to go to Europe by plane than to spend a lot of time waiting on borders.

- **Bargaining power of buyers**

Bargaining power of buyers is a threat for Aeroflot. Aeroflot mainly aims to business customers, who are willing to pay more for better quality of services. Nowadays, in the time of financial crisis many people would prefer to spend less on tickets and fly by budget airlines.

- **Competitive rivalry**

Competitive intensity on the market of Russian civil aviation is not high. Aeroflot is the only one airline in Russia that aims at business customers. Aeroflot is a part of Sky Team alliance and that sufficiently increases the number of destinations available to its customers. So Aeroflot's rivals can hardly compete with it in number of routes available. There are three main competitors for Aeroflot:

- *Transaero*
- *S7*
- *Rossiya*

VIII. Competitor Analysis

As Russia's largest airline, Aeroflot has felt the full benefit of increasing demand for air transport. Company operations are completely focused on regular flights, reflecting Aeroflot's positioning as a global network carrier. Business development in 2007 enabled Aeroflot to strengthen its positions on the regular domestic flight market, significantly enhancing attractiveness of the company's route network and supporting development of cooperation with other airlines as part of the skyTeam global alliance.

Aeroflot's results in 2007:

- The company carried 8.2 million passengers in 2007, or 12% more than in 2006.
- Addition of traffic by Aeroflot subsidiaries gives a total figure of 10.2 million passengers, which is 16.6% more than in 2006.
- The occupancy rate over 2006 increased by 0,2% up to 70.3%,
- Revenues passenger kilometers (RPK) increased to 27,879.3 mln, a 14.6% growths in comparison with 2006 (24,324.8mln)
- Total Revenue was 95 bn RUR (2,71 bn euro), a 27.2% growth in comparison with year 2006 (74,75 bn RUR-2,13 bn euro)

Fig 2.1

Russian market structure by overall passenger turnover (domestic and international traffic), %

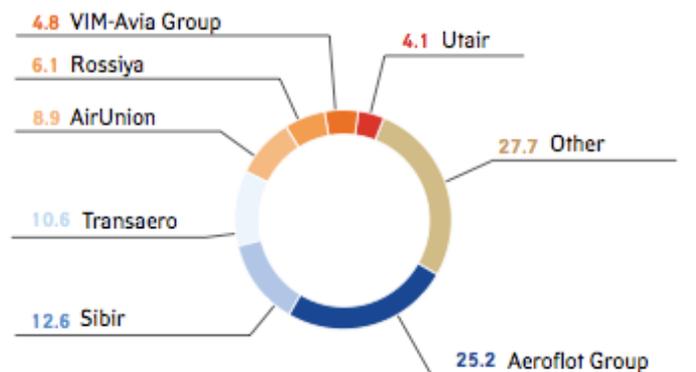


Fig 2.2

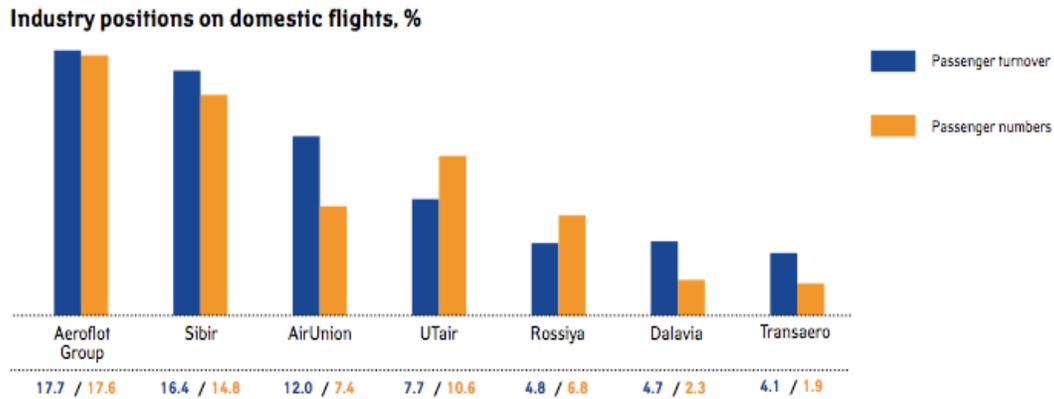
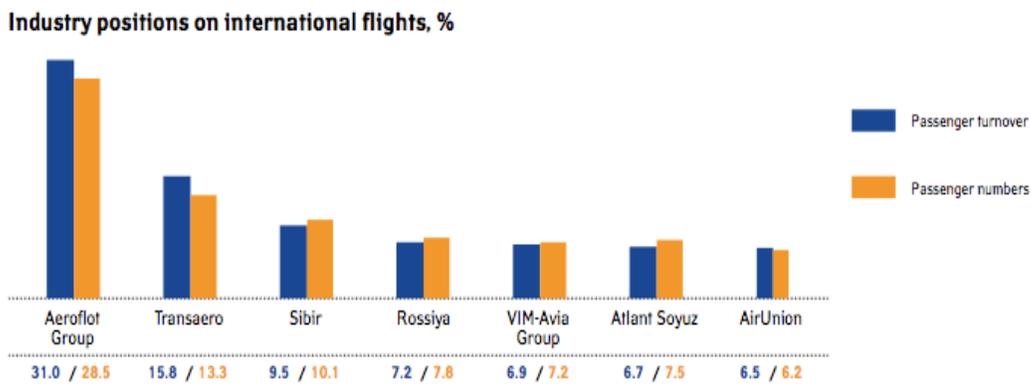


Fig 2.3



Aeroflot kept its leadership on the regular international airline market, achieving a total number of 5.4 million passengers or 45.4% of the overall market, while Transaero took second place with 13.8% market share.

The company substantially expanded its operations on regular domestic routes, carrying 2.8 million passengers (19.7% more than in 2006, and 16.7% more than the average level for Russian airlines). Including subsidiaries Aeroflot-don and Aeroflot-Nord, Aeroflot group accounted for 17.7% of domestic volumes measured by passenger turnover and 17.6% by passenger numbers (4.3 million people). The respective figures for second-placed Sibir were 16.4% and 14.8%.

Competitors:▪ **Transaero**

Transaero is the second largest Russian airline serving international routes. Transaero won Wings of Russian 2007 award in Airline of the Year –the Best Airline Serving International Routes. Transaero is the leader of the industry in terms of long-term stable development. The airline's passenger flow grew by almost 12 times in the recent five years. Transaero has the largest long-haul fleet in the Russian Federation, which includes 38 aircraft. Transaero serves routes connecting Moscow with 85 destinations and it is the only Russian airline to operate scheduled flights to five continents. International flights account for approximately 85% of the entire passenger turnover of the airline.

Transaero has shown impressive growth in 2007:

- *Revenue passenger kilometers (RPK) grew by 3,966 million to 11,759 million, a 50.9% increase from 2006;*
- *Passenger number grew by 1.105 million passengers to 3.242 million, 51.7% more than in 2006;*
- *Load factor increased up to 79.43%.*
- *Revenue (excluding VAT, excises another obligatory payments) was RUR20,5bn (580 mln euro), which is by 50.5% more as compared to 2006.*

▪ **Sibir S7**

S7 Airlines is Russia's largest domestic airline and one of the world's top 50 airlines in this segment. In 2007 the company received an official notification from the IATA about the inclusion of the airline in the registry of operators of the IOSA (IATA Operational Safety Audit) and became Russia's second airline to successfully pass the full procedure of the international audit for conformity to operating safety standards.

Results of year 2007:

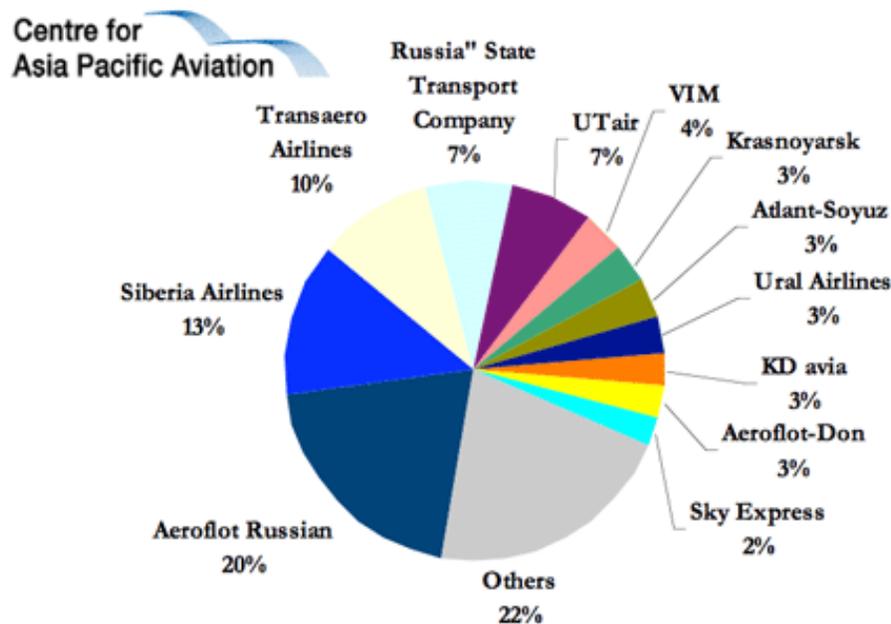
- *S7 Airlines completed more than 47,500 flights in 2007, an increase of 19% over 2006*
- *S7 transported 5,698,109 passengers, a 16% increase over 2006.*
- *The number of passengers transported increased by 22% on domestic routes and 8% on international routes.*
- *The occupancy rate over 2006 increased by 3 percentage points to 80.9%, while the commercial occupancy rate increased by 5.2 percentage points to 75.3%.*
- *Passenger traffic exceeded 13.9 bn passenger-km in 2007, up 11% from 2006.*
- *Airlines' revenue during the reporting period increased from the previous year by 24% to more than 30 bn rubles-857 mln euro (not counting VAT).*

- **Rossiya**

Federal State Unitary Enterprise State Transport Company Rossiya is Russia's largest state-owned air company, and the leading air carrier in the North-Western Region of the RF. In 2007 Rossiya carried a total of 3,244,585 passengers in its own aircraft fleet. Today, the company offers flights to over 100 cities of the world and has 50 offices in RF and countries in and outside of the former Soviet Union.

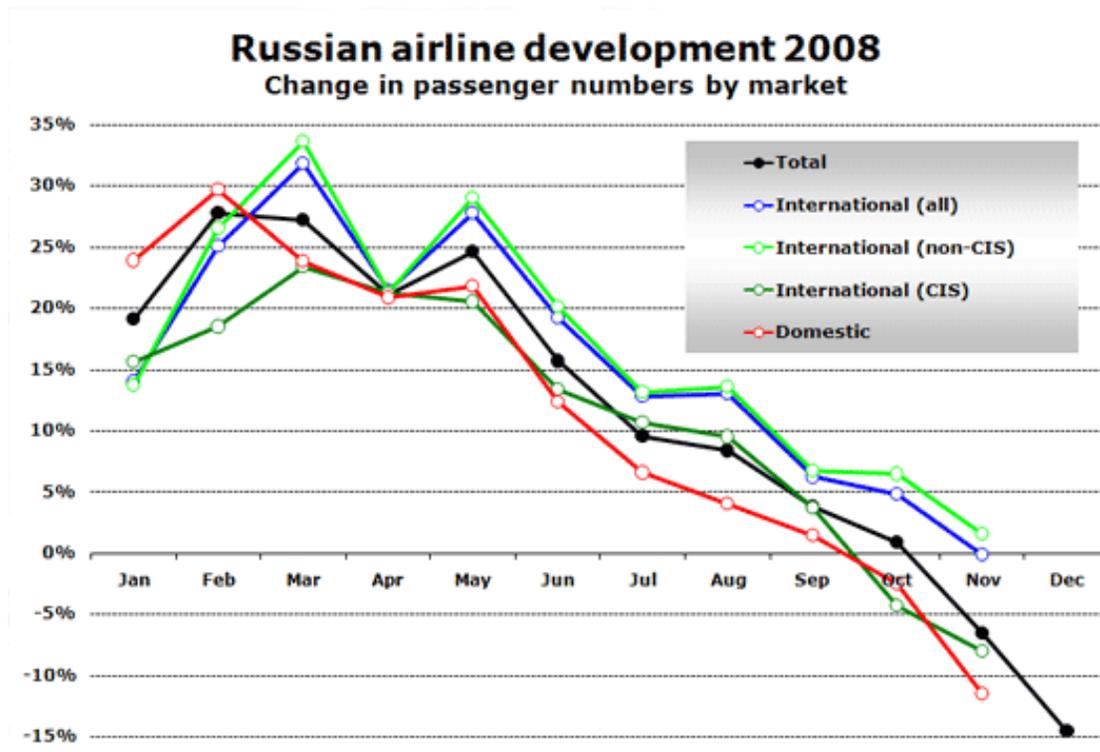
IX. Strategic Positioning

The airline industry market can be divided on a few big companies carrying flights for about of 57% of air passengers and a couple of smaller ones operating on the market with an overall market share of 43%. The key players competing on the Russian airline market are our company Aeroflot which is currently carrying out 20% of the air traffic in Russia. Siberia Airlines carrying out 13% of the Russian flights followed by Transaero holding approximately 10% of the market and Rossiya and Utair equally carrying 7% of the flights. The rest of the market is dominated by much smaller airline companies (VIM, Adant, Soyuz,Ural Airline, KD avia, Aeroflot-Don, Sky Express and others).



Aeroflot kept its leadership on the regular international airline market, achieving a total number of 5.4 million passengers or 45.4% of the overall market, while Transaero took second place with 13.8% market share.

Russia's rapidly developing air transport industry grew by around 20% in 2007 and in the first five months of 2008 Aeroflot Russian airlines continued to report growth at that level. However since then growth has slowed rapidly falling to under 1% in October. In November passenger numbers on Russian airlines fell by 6.5% and in December by 14.5%



Demand suffered as a result of the collapse of several medium-sized airlines including KrasAir (with a fleet of over 30 aircraft) which ceased flying at the end of October. Domodedovo Airlines which operated a fleet of 13 Russian-built aircraft ceased operating at the end of September. These failures were triggered by the unprecedented price of fuel. Domestic traffic has suffered most while international traffic (at least until November) was still showing signs of growth.

However although the severe economic crisis and the decrease in air flights Aeroflot has won a lead in domestic airline market in November 2008 where S7 (Siberian Airways) lost its lead. On international routes Aeroflot remains the leading industry player ahead of Transaero, Rossiya, S7 and VIM. In 2008, Aeroflot flew about 12 million passengers, 14% more than in 2007. This in fact accounts for a quarter of the entire industry performance. On domestic lines, Aeroflot carried over 5 million passengers, 19% more than in 2007. According to the estimates, the Group's share in the industry's total passenger flow grew by 3% as compared to 2007 and amounted to 20% of all passengers carried in Russia. On domestic lines, JSC Aeroflot flew 3.6 million passengers

(27% more than in 2007); JSC Aeroflot-Don flew 567,000 passengers; JSC Aeroflot-Nord carried 922,000 passengers.

On international lines, Aeroflot Group carried over 6.5 million passengers – 10% more than in 2007. The Group's share in the industry's total passenger flow grew by 1% as compared to 2007 and amounted to 29%. On international lines, JSC Aeroflot flew 5.7 million passengers (6.5% more than in 2007); JSC Aeroflot-Don flew 750,000 passengers; JSC Aeroflot-Nord carried 100,000 passengers.

In January 28 2009, the Board of Directors of JSC Aeroflot – Russian Airlines at its regular meeting revised the results in the Flight Safety (FS) sphere in 2008. The presented documents show that the implementation of the flight safety management strategy has driven the FS absolute and qualitative indicators up to satisfy the world's highest standards. In particular, Aeroflot's safety management now fully meets the requirements of European Civil Aviation Conference (ECAC), the SAFA program. In 2008, the flight safety index amounted 99.955%, which corresponds to the 'high' level in the international classification and to the levels of the world's leading carriers.

X. Driving Forces

- **Industry growth rate**

After almost a decade of stagnation that marked the 1990s, Russian airlines have demonstrated an impressive passenger growth rate of about 9% a year. Although fuel-cost increases in 2004-05 reduced traffic development, most carriers have adapted to the new conditions by cutting operating costs, increasing fares and modernizing fleets. Strong traffic is projected well into the next decade. Results this year signal how robust the market is: Passenger volume for the first six months was 16.2%, a level exceeding expectations.

The Russian State Research Institute of Civil Aviation forecasts annual passenger growth of 7.5-9.5% through the end of the decade, with a gradual slowdown to 5.1-7.8% through 2020.

Russian flag carrier Aeroflot handles roughly 10% of total volume on domestic routes and dominates more than 25% of international traffic. In the first half of 2007, the airline served 3.773 million passengers, with an impressive 17.9% growth, compared with the same period in 2006. Aeroflot was also the first Russian airline to become a member of a global alliance—the Air France-KLM-dominated SkyTeam. To meet entry requirements, Aeroflot significantly improved its standards of operations, service and safety. It also leads the list of Russian carriers successfully passing the International Air Transport Assn.'s Operational Safety Audit (IOSA).

By year-end, Aeroflot plans to inaugurate its own terminal at Moscow Sheremetyevo Airport, which will ease connections between domestic and international flights that are now spread over different terminals.

- **Innovations**

Aeroflot Cargo summed up preliminary work results of its business activity in 2008: the total transportation volume made up 150,305 tons of cargo and mail that is 10.7% more than in 2007. At the same time 86,395 tons of cargo and mail were transported in cargo holds of passenger flights – positive dynamics of 1.1%. Also 63,910 tons were transported using air freighters with the positive dynamics of 27.2%.

Beginning from March 1, 2009 Customer Service of CJSC “Aeroflot Cargo” will be available on a round-the-clock basis. Customers of the company will be answered their questions 24 hours a day; this will facilitate their market activities and enhance the level of services rendered by the carrier. Organizing its business at the international standards level, Aeroflot-Cargo is continuously improving its services.

"Aeroflot Cargo" Airline on 3.12 2008 announced a 5 year deal with CHAMP Cargosystems which will see the airline migrate to the new generation Cargospot system. The new technology will deliver complete end-to-end control over the sale and management of cargo by integrating the processes of all the airline's cargo-related business activities.

- **Technological Change**

Few established legacy airlines have witnessed so much change in the last 20 years. For Aeroflot, change is intrinsic to its strategy as it seeks to augment market share and modernize its fleet and operations. He fleet comprises: 11 A319s, 14 A320s with 14 on order, 10 A321s with 4 on orders, 11 767s, 28 Tu-154Ms and six IL96-300s with six on order. Also on order are 10 A330s, 22 A350s, 22 787-8/-9s and 30 Sukhoi Superjet 100s with 15 on option. This is an airline that is taking operational modernization very seriously.

For the benefit of passengers, about a year and a half ago the company installed self check-in kiosks in Terminal 1 (two kiosks) for domestic flights and in Terminal 2 (four kiosks) for international flights. Aeroflot is in the final stage of the construction of its new Terminal 3, where they plan to put into operation 24 kiosks (16 in the international section and eight in the domestic section). Online check-in is a very attractive procedure for the customers. The company considers it as an important element of the facilitation of passenger service. Aeroflot plans to improve the situation in its new Terminal 3.

- **Entry of a new competitor**

Russia is creating a new state giant, Russian Airlines, to absorb carriers crippled by the financial crisis, but experts warn it will sideline Aeroflot and reverse years of progress toward a vibrant airline industry. Aeroflot, Russia's flagship carrier will now have a competitor with strong lobbying power and a direct line to state cash. And its expansion plans into eastern Russia may be frustrated by the state's takeover of nearly half the sector.

- **Costs and efficiency**

As the leader in Russian civil aviation and one of the longest-standing airlines in the world, the company takes the responsibility towards the environment very seriously. Whilst maintaining the highest standards in every area of our work, everyone at Aeroflot, from check-in staff to senior executives, realizes the importance of their environmental actions and is continually looking for ways of improving its green focus.

Much more than just complying with the environmental strategy of the International Air Transport Association (IATA), Aeroflot has recently set up a corporate policy for energy saving and improving our environmental effectiveness by 2020. To improve fuel efficiency and reduce negative environmental impacts, the company has set the target of saving up to 1.5 million tons of aviation fuel per year and to reduce overall fuel consumption by 43.6 per cent. To achieve this goal, Aeroflot increase aviation fuel consumption efficiency, limit the amount of overall waste disposal, and make sure that plans and measures for environmental protection are understood by everyone that works for them.

To satisfy the customer needs, the company supplies an efficient flight service, as well as dedicating the time and effort to continually purchasing environmentally friendlier aircraft. The target for 2020 is to acquire 122 new fuel-efficient aircraft. Over recent years, Aeroflot already strategically purchased a large number of new aero planes, proudly making the fleet one of the youngest in Europe to date.

Throughout 2009, the company will maintain strict levels of monitoring and compliance towards environmental protection. Additionally, Aeroflot will constantly be working on ways to improve all areas of environmental focus with the target of becoming one of the world's most environmentally-aware and green airlines.

XI. Critical Success Factors

In the Air Transport industry one of the most important roles plays human factor. There are lots of people involved in one flight. For example: Technicians, stewards, pilots, dispatchers and lots of others. And that is why corporate culture is one of critical success factors for Aeroflot Company. Strong Corporate culture provides company with better performance, it cause less job rotation for employees. By these means Aeroflot expects to increase employee retention rate by 7%.

Another critical success factor for Aeroflot is Employee Alignment. It is extremely important that all employees know the company's strategy and work for the same goal. Aeroflot intends to reach 100% level of personnel that knows company's goals in 2 years.

Employee training is also one of the keys to success for Aeroflot. More money spent on it will immediately result in better technical performance of planes and in better quality of service provided to passengers.

In the internal business processes one of the critical success factors is Introduction of new services. Aeroflot aims to widen the number of services provided to passengers during and after flights and building of new terminal Sheremetyevo-3 is a good opportunity for it.

Speaking about technical side, one of the keys to success is enhanced baggage delivery system. Although the percentage of misdelivered baggage is relatively small in the industry, Aeroflot aims at business customers and it can cost company a lot of money. That is why Aeroflot is going to make improvements in baggage delivery system and shorten number of cases of misdelivered baggage to 0 within next 3 years. (Nowadays on average 18 out of every 1000 checked bags don't arrive in the right place at the right time)³.

Due to that fact that the target audience for Aeroflot is business customers, the percentage of on-time flights is extremely important. For business people the delay of flights can cost lots of money and that's why it is one of the keys to customer loyalty. Aeroflot aims to reach 85% level of on-time flights within next 2 years. (The industry's average level of on-time flights nowadays is approximately 75%)⁴.

Speaking about cost side, Aeroflot is going to introduce fuel-efficient planes. The fuel prices were rising dramatically over last years and decreasing fuel costs is a wise step in airline industry.

³ <http://www.popularmechanics.com/technology/transportation/4237628.html?page=1>

⁴ <http://www.transtats.bts.gov/HomeDrillChart.asp>

Operational excellence is also a critical success factor for Aeroflot. More important improvements in that field cause also reduce in costs. The Company aims at 80% rate of planes operating properly in domestic market and 90% in international.

From the customer perspective, one of critical success factors is enhanced services. This factor is extremely important for business passengers because they pay money not only for the transportation but also for the quality of services provided by airline. This critical success factor will result in customer retention and satisfaction. The Company expects increase in customer satisfaction by 10% by the year 2011.

An additional route is another important critical success factor for Aeroflot Company from customer's perspective. Aeroflot is going to increase the number of routes available to its passengers on both domestic and international market by 15% by year 2010. That would result in increasing market share.

From financial perspective, sales growth is a critical success factor from revenue growth strategy. Aeroflot expects to monitor positive dynamics in this factor due to implementation of technical and other improvement that will bring new customers. The company expects 15% in this indicator.

Costs decrease is critical success factor in the productivity strategy of the company. Aeroflot aims to decrease it costs by 12% by year 2014.

Chapter III • Internal Analysis

I. SWOT Analysis

- **Strengths**
 - *Aeroflot is one of the longest-established airlines in the world and one of the best-known brands in the business industry*
 - *Aeroflot is a member of the SkyTeam global alliance.*
 - *In 2007 Aeroflot successfully obtained renewal of its IOSA (IATA Operational Safety Audit) certification, confirming its compliance with new tougher IOSA rules.*
 - *Aeroflot showed strong operational and financial results in 2007.*
 - *Aeroflot's reputation for reliability also played an important role : the Company's quality management system and flight safety match the highest international standards.*
 - *Aeroflot is leader on the Russian air transport industry.*
 - *Aeroflot agrees fixed price formula for jet fuel with Russian oil companies.*
 - *Aeroflot has unique product which competes successfully with its European competitors- Aeroflot Bonus*

- **Weaknesses**
 - *Lack of pilot training and technical services in the subsidiaries of Aeroflot*
 - *Aeroflot isn't active at small regional airports.*
 - *The lack of systems providing customers' feedback does not allow the company to focus completely on the changing demand.*

- **Opportunities**
 - *Opportunities for steady growth of 4.7% on the domestic market and to obtain larger share of the domestic market:*

 - *Potential to constructs new terminal for the VIP aviation in Pulkovo St Petersburg. The project is estimated to cost \$100 million.*
 - *Aeroflot intends to bid in a tender for privatizing Czech Airlines⁵.*

- **Threats**
 - *Increasing prices of fuel costs*
 - *Aeroflot customer trust might decrease as a consequence of the recent flight incident (an airplane crash) in 2008.*
 - *New regulatory restrictions in the industry introduced aiming to be beneficial for the new state-owned airline created by Rostekhnologii.*

- *The Russian government has cancelled import duties on civil aircraft seating up to 50 for nine months.*

- **Conclusions**

Aeroflot mainly aims at business passengers and it is essential for them to keep the quality of services high in order to keep its customers loyal to the brand.

Brand Image. Aeroflot is the oldest airline company in Russia. Most people when speak about Russian civil aviation mean Aeroflot. More than that, Russian government holds 51% of company's shares and that fact also adds value to the Aeroflot's Brand Image by making the people who trust in the government more committed to the brand.

Sky Team alliance. Aeroflot has entered Sky Team Alliance in 2006. That helps company to widen its routes network, providing passengers with 841 Destinations in 162 countries.

Good financial performance. Having a look at financial indicators of Aeroflot over the last years we can conclude that company brings good profit to its shareholders and profit growths every year (21.4% over 2007⁶ and 36% over 2006⁷).

⁶ http://old.aeroflot.ru/eng/attach.asp?a_no=2367

⁷ http://old.aeroflot.ru/eng/attach.asp?a_no=2058

II. The 7S Model

▪ Strategy

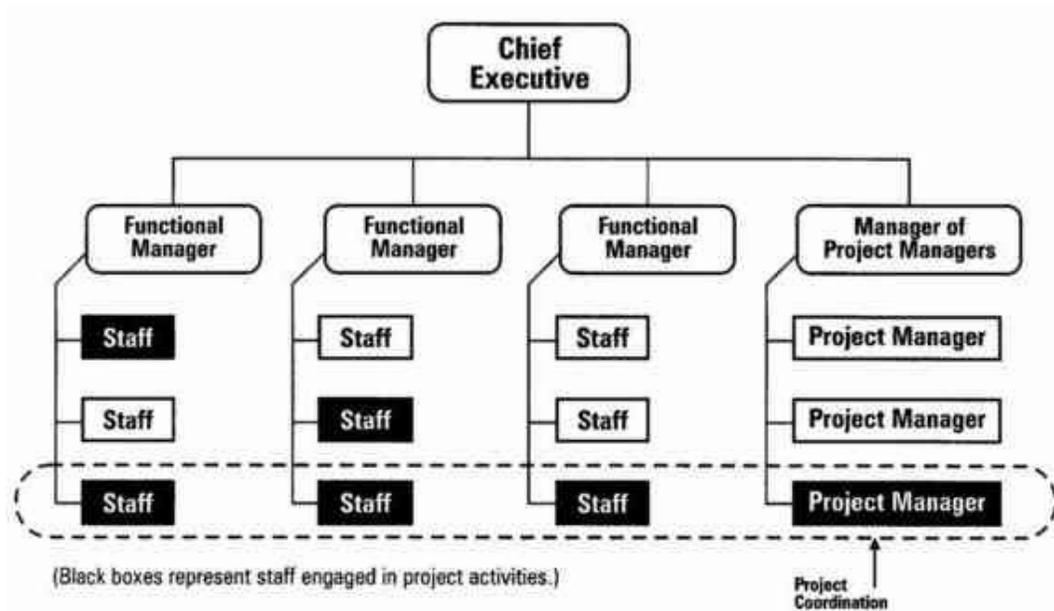
The main strategy of Aeroflot Airlines is to develop an international class company based on the best traditions of Russia's aviation. The company strives to achieve this tactic by developing a number of strategic goals which are:

- *Providing passengers transportation to most large cities in the world by establishing its own system of routes both convenient for passengers and cost efficient as well as to co-operate with airline partner companies. This strategy is designed in order to overcome the competitive advantage of a number of European Airlines such as Air France and British Airways and strengthen its image and leading position in Russia and Eastern Europe.*
- *To provide passengers with stable service quality on the level of its competitors or even higher*
- *To reach the level of production and economic indicators of the members of the Association of European Airline Companies and to establish an effective system of relations and co operations inside Aeroflot and to international airlines and associations.*

These goals are set in order to increase the market share in the home market; to increase Aeroflot's relative market share in the high-class passenger transportation compared with foreign competitors; satisfying better the customers by developing a network which main principles are focusing on the most profitable segments of the market and the increase of comfortable transfer possibilities; to switch over to up-to-date fuel efficient and more comfortable airline.

▪ Structure

There are three types of organizational structure. Aeroflot Airlines is built on the basis of matrix structure. It is a combination between divisional structure and functional structure. It allows to use the strengths of both the structures, despite the dual authority. However, the organizational structure is very useful to multinational companies such as Aeroflot Airlines.



In the matrix organization, each manager reports directly to the general manager or board of management. However, each manager who reports has his authority and power when it comes to the projects to be implemented.

The basis for the matrix organization is to create synergism through shared responsibility between project and functional management.

➤ *Management:*

The management board consists of 22 officers and directors. The chairman since 1997 is Valery Okulov. The other members are directors of Strategic Program Realization, Finance and Planning, Deputy General Directors, transport Support, Management- Flight, Administration, etc.

▪ **Systems**

The management systems are modern tools of the corporate management. It aims at the implementation of the potentially possible improving of the products or services which are presented to the customers. The management systems currently implemented into Aeroflot's are as follows:

➤ *ISO 9001:2000*

The quality system set up by Aeroflot meets the standards of the international quality system ISO 9001:2000. The company's system is called JSC "Aeroflot" and it is a system directed to perfecting the overall performance of the organization, related with safe and regular passenger transportation with the high quality of the services.

➤ *The “Hidden Passenger” method*

Its purpose is to estimate the degree of the customers' satisfaction by using various market researches, passengers' inquiries, analysis of messages, etc.

➤ *Open Line*

It encourages the analysis of the feedback received from the customers and based on which strategies are aligned concerning customer satisfaction.

➤ *IATA*

It assesses the performance of the company by comparing it with the performance of the leading airlines in the world.

➤ *IOSA (International Operational Safety Audit)*

It is a harmonized standard of the world wide aircraft industry in the field of transportation and safety. The system constantly maintains, improves and assesses in accordance with the changing requirements of the aircraft branch and regulating instruments.

The other 4 Ss from the McKinsey model are less tangible and are more cultural oriented. These are:

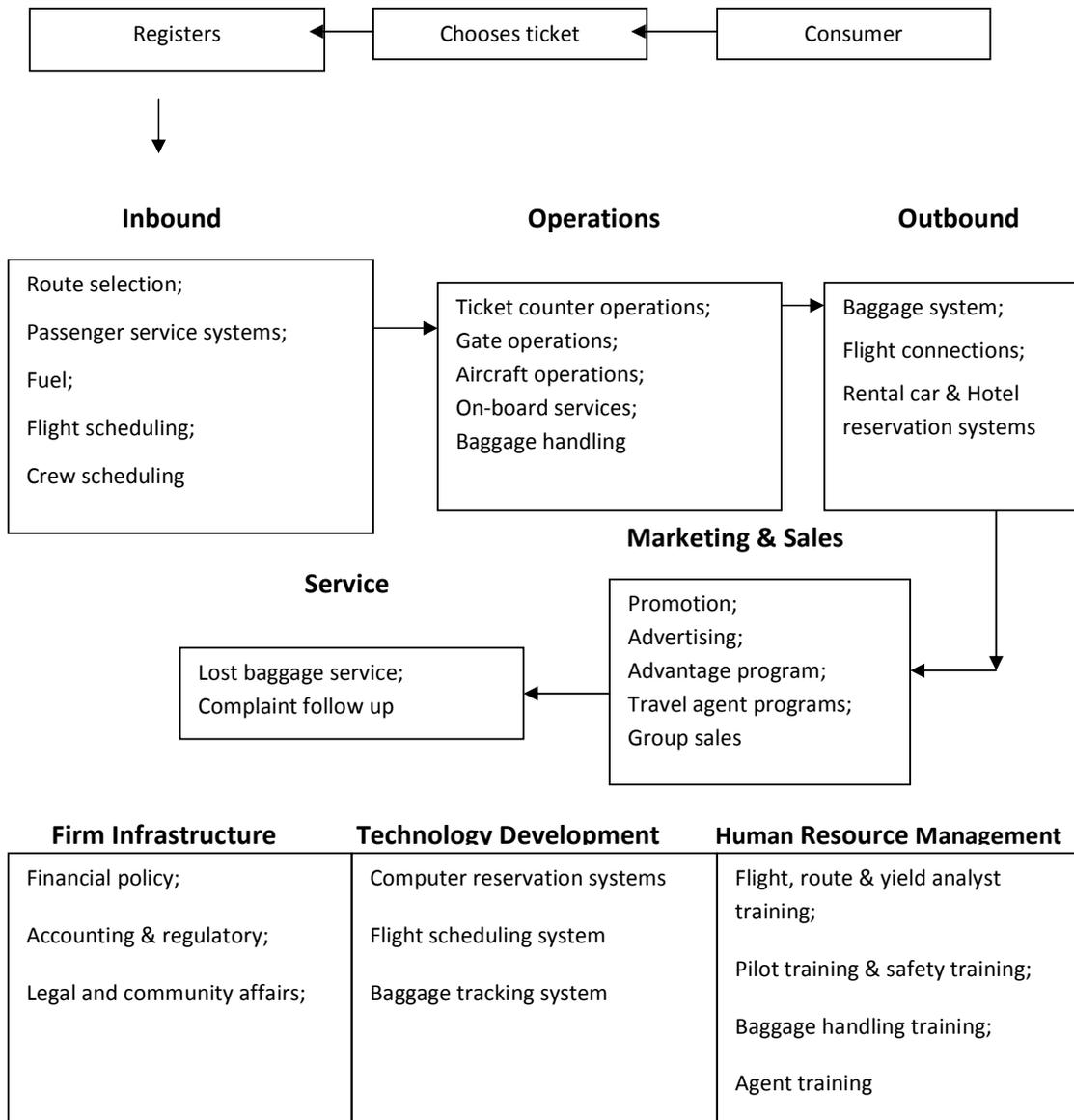
- Skills: the capabilities that exist within the company;
- Shared Values: all the values and beliefs of the organization;
- Staff: the company's personnel resources and how are they developed and motivated;
- Style: the leadership approach of the top management and the company's operating approach.

However, Aeroflot does not provide sufficient information based on which these could be analyzed.

III. The Value Chain

Inbound of Aeroflot is controlled in a very proper manner. Aeroflot deals with two major types of customers, business customers and economic ones. They of course consume food & beverages when the plane is in the air on the ground therefore Aeroflot has it's inventory.

In this case inventory are the regular preparation that are done before the plane is ready to take off. Thus Aeroflot's suppliers must be on time with delivering of inventory before schedule time to take off . Let's move on into the value chain of Aeroflot, then we can see how each department is interacting with each other and therefore is adding value into the chain.



- **Operation**

Operations consists of receiving the passengers at the entry of the airport, preparation at the gate to board aircraft and passport checking before entering aircraft. Aircraft control checks before departure like for instance examine the plain for defects or problems that could arise during the journey. The onboard services during the flight is operated by the crew members who serve the passengers. The baggage's is placed in the aircraft in order to fly to the destination.

- **Outbound**

Outbound of Aeroflot consists in operation that occur when the aircraft arrive on a destination, the baggage is disposed to the baggage lines where the passengers are waiting at the arriving hall to pick up their baggage's. Passengers who travel to various destination may have to take two or more aircraft daily to reach to their destination. Rental car & Hotel reservation system is taking care to distribute the passengers to their final destinations.

- **Marketing & Sales**

Aeroflot is the leader in development of modern sales methods and distribution channels on the Russian air transport market. The Company has strong working relationships with leading international booking and distribution systems, such as: Sabre Travel Network, Amadeus, Galileo, WorldSpan and the Sirena Travel automated booking system. Aeroflot was the first Company in Russia to introduce electronic tickets and is rapidly developing its Internet sales with every year. The sales system in Russia consists of several elements. This are the Company's own sales channels: representative offices and Aeroflot branches in various regions of the country; the Company's sales offices network in Moscow; a call center for information and bookings via phone as well as their online resources via ⁸. Agent sales channels include: a network of agencies in Moscow and in Russia region. The network of ticket agencies and of the Company's own offices in Russia and worldwide is very extensive and offers excellent geographical coverage.

- **Services**

Aeroflot offer service of lost & found baggage's, the passengers can complain at the department of lost & found desk for their missing baggage's and usually a report is issued accounting the lost baggage and immediately an investigation is handled by the department personnel. For complains about inappropriate services, there is an complains office body meant for customer on the airport or alternatively the passengers could be contacted online via office feedback service provided by the Aeroflot's website.

⁸ <http://www.aeroflot.ru>

- **Firm Infrastructure**

In order to cut cost and perform effectively, Aeroflot's decided to align the IT strategy with its overall business strategy, with a focus on Aeroflot's infrastructure and organization. Now, base on up-to-date information from the information system, the company is able to interconnect departments and obtain right information to process and analyse the cost behaviour. By doing this Aeroflot has been able to minimize and hedge the financial risk, using a variety of instruments, such as: fixing of variable interest rates on leasing agreements; calculation and setting of limits on operations with guarantees of bank customers and Aeroflot agents; calculation of personal limits of agents for ticket sales; bank options; price setting in contracts for fuel – pricing, hedging ,ect. Although, Aeroflot is spending time in analyze data and cutting cost , it negotiate new hull insurance on aircraft and airline legal liability insurance. The whole renewable insurance system is automated whereby each insurance has to be validate at different department before it is applying to an aircraft. Aeroflot maintain a safety infrastructure by coordinate all organization procedures under validation codes and ranking level , the business model allows Aeroflot to concentrate on the management decisions and strategy without having to worry too much about its financial performance.

- **Technology & Development**

Aeroflot new online booking service minimizes the cost by reducing paper expenses and focus on E-ticket sales. Base on this automated system, passengers could book tickets through the online reservation system. In the mean time in the reservation procedure Aeroflot's flight scheduling system offers flight choices on the possible flight destinations. This system interactivity makes Aeroflot flexible to manage growth in passenger volume as well as giving cost savings on behalf of customer service. Aeroflot has just recently introduced new baggage tracking system. That is the so called WorldTracer⁹ system, it is meant for baggage tracing and tracking, the system facilitates the search for missing baggage's and has proven to significantly reduce the amount of passenger complaints.

- **Human Resources & Management**

Base on routes and flight destination an analysis will be made if there is needed to arrange some trainings for new crew members base on their knowledge on aircraft or because of deficiency on personnel. Aeroflot Pilots are required to reinforce their qualification by training for the sake of better security and safety. Each new bought aircraft includes innovations therefore requiring constant improvements in pilot training programs and the company personnel motivation systems. Sales agents training is a vital item which reflects in sales increases and improvements in agencies infrastructure thus providing them with the latest news about the company services and technologies. By embarking the outlined above enablers, Aeroflot is able to deliver relevant information about passenger accommodation and safety on flights as well as improvements in the service quality and company profits.

⁹ <http://www.evaint.com/article/16/159/Alliance-standards-at-Aeroflot.aspx>

IV. Quality of Service

Aeroflot provides its passengers with very high quality of service. Aeroflot mainly aims at business passengers and one of the main keys to brand loyalty is quality of service. It provides its passengers with tasty food and extended product offerings including alcoholic beverages, the distance between passenger seats is bigger than the competitors', whereby all seats are made from leather and especially in the business class is extremely comfortable. Aeroflot has brought a new online E-ticketing system aiming to improve the quality of service and to make its services more convenient for the company's customers.

However, the overall reported quality of service is good, but some customers have reported problems with some of the flights delivered by Aeroflot. Such of problems that have been reported are like follows:

Such of problems that have been reported are about some plane of Aeroflot are deteriorated in such manner; (the seats are too old and its furniture scratchy, the personnel to some of the flights seemed to be not enough helpful in other words uninterested to passengers needs.

Another serious problem outlined by some of the Aeroflot passengers is the lack of announcement in English during some flights, some of the flights which were also announced in English was announced with a really bad accent and were hardly understandable, this kind of problems are quite typical for flights served by Aeroflot on the domestic routes. In general it is reported by many that a lot of the Aeroflot personnel lacks proper English command. The grievances found to be most irritating for Aeroflot's international lines where a lot of International Business people fly on a regular basis. Another research also found out that some passengers report to have experienced problems with slowness with food services delivery during flight.

Besides all the negative reports, a lot of satisfied have been scored.

There are a lot of reports of international and domestic passengers who report that the services, food and check in of Aeroflot went quite well for them and Aeroflot's plains are really convenient, the flight seats are more than comfortable, the food is on a perfect quality level. In order to be more objective concerning Aeroflot's Quality of Service and to be able to determine Aeroflot on a quality scale we used Airline Quality (The world's largest database of Airline and Airport reviews for over 620 airlines and 645 airports. Flight reviews, lounge Reviews, seat review etc.). Airline Quality research has concluded the following about Aeroflot's quality performance.

Aeroflot Summary Quality Ranking¹⁰	
Combined Quality of Product / Staff service in airport and onboard environments	
Business Class	4 Star status
Economy Class	3 Star status
Airport Services	
Check-In service - Business Class	3 Star status
Check-In service - Economy Class	2 Star status
Transfer Services - Business Class	2 Star status
Transfer Services - Economy Class	2 Star status
Arrival Services	3 Star status
Business Class Lounge - product facilities	2 Star status
Business Class Lounge - staff service	3 Star status
Onboard Features	
Inflight entertainment may vary according to aircraft type	
Cabin Safety Procedures	4 Star status
Inflight Entertainment - Business class	4 Star status
Inflight Entertainment - Economy class	2 Star status
Amenities, Blankets, Pillows, Towels etc	3 Star status
Airline Magazine, Newspapers & other mags	4 Star status
Cabin Seat Comfort	
Seating may vary according to aircraft type	
Business Class - long haul	4 Star status

10

<http://www.airlinequality.com/Airlines/SU.htm>

Business Class - regional / short haul	4 Star status
Economy Class - long haul	3 Star status
Economy Class - regional / short haul	3 Star status
Onboard Catering	
Business Class meals - long haul	4 Star status
Business Class meals - short haul	4 Star status
Economy Class meals - long haul	4 Star status
Economy Class meals - short haul	3 Star rating
Cabin Staff Service	
Business Class - service efficiency	4 Star status
Business Class - staff attitude & friendliness	4 Star status
Economy Class - service efficiency	4 Star status
Economy Class - staff attitude & friendliness	3 Star status
Responding to Passenger requests	3 Star status
Cabin presence through flights	3 Star status
Assisting Parents with children	4 Star status
Staff Language Skills	3 Star status

Quality ranking used in airline rating summary below

5 Stars = Excellent

4 Stars = Good

3 Stars = Fair

2 Stars = Poor

1 Star = Very Poor

- **Aeroflot Strategy to reduce and resolve its current quality services problems**

Aeroflot is already aware of the grievances and complains about quality of air flight service. In a response to the problems Aeroflot has created a strategy targeting service quality improvements. These improvements consist in improvement of its business-class, introduction of new system of training the staff, significant changes into the menu and increase in number of entertaining programs and services during the flight and after it. As a result consequence of implementation of the strategy for company development, 10% growth in customer satisfaction is expected until the end of 2011.

In the near future Aeroflot is to significantly increase passenger service quality. The company plans to have two-class cabins provided with the improved business class. New service conceptions tested in many directions will be spread out to all the flights. Special trainings of stewards and other staff who deal with customers are to be conducted; significant changes are to be introduced into the menu and the range of on-board entertainment programs is to be enriched.

The company plans to resolve its grievances about ineffective flights services through developing its personnel skills and knowledge. Aeroflot's goal in the sphere of personnel management is to provide its employees with attractive opportunities of professional development and competitive wages, to provide social protection, to attract highly skilled people by the perspective of professional development. A crucial issue is to establish the system of efficiency rates that allows measuring the contribution to the achievement of the company's strategic goals of each department and person separately. This all have to be linked to the system of remuneration of labor and strategy realization that currently exist in the company.

V. Benchmarking

Group	Flight Safety	Financial resource	Customer service capabilities	Rank internal sustainability	Relative cost position	Quality service Performance	Technological skills	Rank Overall	weighted overall strength
Aeroflot	2	3	2	3	3	2	4	3	22
Transaero	2	2	1	1	2	4	4	2	17
S7	2	2	2	2	3	2	1	2	16
Rossiya	2	1	1	2	1	3	2	2	14

- **Flight safety:** *The assurance in being save on a flight.*
- **Financial resource:** *Places where the company can retrieve money.*
- **Customer service capabilities:** *Functionalities that a customer service can perform.*
- **Ranking internal sustainability:** *Identify & measure criteria for internal resources.*
- **Relative cost position:** *The position where the market price is greater than the cost in the value chain .*
- **Quality service Performance:** *A degree or grade where the overall service is acceptable during the process in the value chain.*
- **Technological skills:** *Based on abilities of company scientific and industrial process.*
- **Ranking overall:** *Having higher position in relation to others.*

Ranking table from 1 to 5

This table explain the comparison in several criteria's of how each company has been performing.

VI. Cost Competitiveness

Airline industry is an industry in which are involved a lot of costs. You can divide all costs into four main parts. They are:

- *Fuel costs*
- *Costs on personnel*
- *Costs of equipment*
- *Costs of repair of equipment*

- **Fuel costs**

Fuel prices were rising dramatically over past years and fuel is the major cost in airline business. In 2008 Aeroflot had agreed on a formula to establish fuel prices with the country's largest crude producers, led by GazpromNefte.¹¹ The parties agreed to switch to long-term contracts on fixed fuel prices. GazpromNefte is the oil arm of the national energy giant Gazprom.

The fuel price agreement is an efficient way of enabling the airline to be more flexible in planning its fuel expenses and would offer a certain amount of insurance against price fluctuations. This agreement will help Aeroflot sufficiently reduce fuel costs and spend on fuel much less than its competitors who are buying fuel on market price.

- **Costs on personnel**

Costs on personnel include wages and training expenses. Aeroflot aims at business customers and provides its passengers with high-quality service. That is why wages in Aeroflot are higher than wages of its competitors.

Speaking about training expenses, Aeroflot spends on it much less than other Russian airlines. Aeroflot has the biggest training centre for its personnel in Russia. That helps sufficiently cut costs on personnel training. Some other airlines also train their staff in this centre.

- **Costs of equipment**

In 2007, Aeroflot signed multi-billion US dollar deals to buy 22 Airbus A350 jets and 22 Boeing B787 Dreamliners. Such long-term relationship with producers of planes sufficiently cuts costs of equipment.

- **Costs of repair of equipment**

Aeroflot's fleet, which is among Europe's most modern and fastest growing, consists of 90 aircraft, confirming the airline's commitment to the highest economic, safety, ecological and noise standards. In 2009 the company

¹¹ www.mnweekly.ru/business/20081106/55355285

is planning to receive the total of 24 brand-new modern planes. Other Airlines in Russia are budget airlines and they mostly buy old planes, cutting costs of equipment, but increasing service costs, because old planes break more often than new ones.

- **Conclusion**

Comparing overall costs of Aeroflot and its competitors we can conclude that Aeroflot wins in this component. Aeroflot establishes long-term agreements with its suppliers and it helps sufficiently reduce costs over time.

VII. Scope of Sales

	Profit and loss statement (million USD)		
	1 st half 2008	1 st half 2007	Change
Revenues	2,138.40	1,665.30	473.1
Operating costs	2,001.60	1,408.50	593.1
Operating profit	136.8	256.8	120
Net profit	72.2	161.2	89

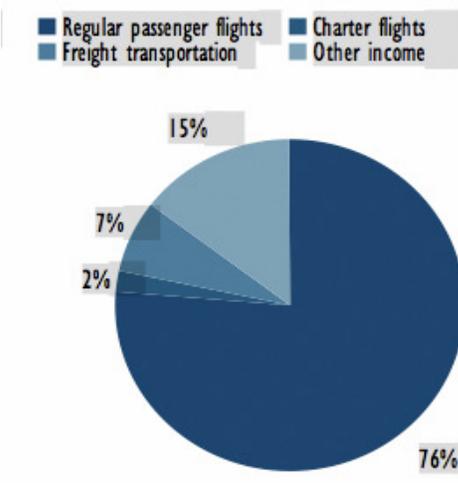
The 28.4% revenue growth in 1st half of 2008 was counterbalance by the 42.1% rise in costs and a high tax rate of 55.4%. Aeroflot benefited from solid growth in 1st half of 2008, with passenger turnover rising by 15.2%, and the company has yet to see any marked deceleration in 2nd half of 2008. In addition, pricing increases implemented during the summer season are expected to continue into autumn. This leads us to believe that the airline is on track to achieving revenue growth of 20% or more in 2008.

By looking at the information given to us for 1st half of 2008 and 1st half of 2007 we can see that the company is making about 50% less operating and net profit than in year 2007. The main reasons for that is the Economic crisis, the new competitors who is entering the Russian market, Russian Airline, to absorb carriers crippled by

the financial crisis and because of Aeroflot new strategies to augment the market share and modernize its fleet and operations. Until now the company bought about 100 new aircrafts and 20 more are on its way to be order. This is an airline that is taking operational innovation very acutely and it is looking for higher profit in long-term period.

¹² Fig1.1

Chart 2: Revenue breakdown, %



As it is shown in the figure above, we can see that the company is making 76% by Regular passenger flights, 2% by charter flights, 15% by Freight transportation and 7% by other earnings. The largest growth of passenger numbers — by 22.4% — was on long-haul international routes to destinations outside Russia and the CIS (the so-called “far abroad”). Growth on routes inside Russia was 16.7% and passenger carrying on CIS routes expanded by 12.8%. Aeroflot doesn’t provide services to the small markets, like the Siberian, where small planes are needed with 15 – 20 seats.

Source: Company data, Gazprombank estimates

¹²

https://rp1.tss.db.com/dbdr/publication/PressRel/138_OCT15200875420AM.pdf

Chapter IV • Crafting Strategies

The following chapter takes a closer look on the strategies that Aeroflot Airlines needs to develop and implement in order to overcome the obstacles outlined with the external and internal analysis. Several objectives have been designed based on the conclusions from the analyses included above.

I. Conclusions

- **Conclusions based on the external analysis for Aeroflot Airlines**
 - *There is a lack of proper aircraft infrastructure and high import taxes. However, there is still a great opportunity for the European manufacturing industry.*
 - *The entering in the Sky Team Alliance and the increased level of services and safety provided by the company has pushed Aeroflot to the leading position on the Russian market.*
 - *The company's strategies are oriented at increasing constantly the level of customer satisfaction. Therefore, they have introduced their cargo services and the future goal of Aeroflot is to adapt it to the huge market of the economy class, where customers can make a use of its services on an affordable price.*
 - *The Russian market is one of the most promising markets together with the Chinese and Indian one. The increase in the passenger transportation rates shows that the economic environment is favorable for the further development of the company.*
 - *The investment market in Russia is very unfavorable due to the laws set by the government which prohibit the foreign investments in all strategic sectors in the country. The aircraft industry is one of them.*
 - *Possible threat for Aeroflot is the lack of middle class customers. Since the company current services are more oriented to the business sectors, there is a huge uncovered market opportunity- economy class.*
 - *The government is taking over more than half of the aircraft industry. Aeroflot will meet a new competitor which will be completely subsidized by the Russian government;*

▪ **Conclusions based on the internal analysis of Aeroflot Airlines**

- *After careful analysis of internal environment of Aeroflot Company, we can conclude that company now is in a good position. Aeroflot is expanding-it widens the system of routes available for its passengers, Aeroflot entered Sky Team alliance, the Separate terminal Sheremetyevo-3 is being built for Aeroflot. The financial performance in the past years was also good, the profit of company grew every year (in 2008 there was a decrease in profit due to economic crisis).*
- *The company's current strategy does not suggest any serious changes to be done within the company and that also mean that company is in a good position. Aeroflot current strategy aims at continuous growth and improving the quality of services offered to its passengers. Aeroflot management and operations are based on several systems, which provide its passengers with both high quality of service and safety; and its managers with customer feedback.*
- *Aeroflot was the first who brought a new online E-ticketing system in the market of Russian civil aviation. The Aeroflot is the only airline company in Russia that has leather seats in both business and economy classes. But at the same time there are many unsatisfied customers with the personnel skills (bad knowledge of English by personnel, slow food services).*
- *Taking overall benchmarking of Aeroflot and its competitors in all aspects (quality of service, financial performance, customer feedback, technological level and etc.) we can conclude that Aeroflot is in better position than its competitors. In the cost competitiveness Aeroflot also leader among its competitors because of long-term agreements and relationships with its main suppliers of equipment and fuel.*
- *The sales forecast for the coming year is less than for previous years because of the economic crisis and therefore declined demand.*
- *Based on the internal analysis of Aeroflot we can conclude that the company performed well, but there are still fields that need to be improved. The main changes should be done in the field personnel training (there are many unhappy customers because of the low level of company staff skills). But also to be considered that economy class should be improved.*

II. Objectives and Criteria

Based on the conclusions mentioned above, the following objectives have been outlined:

- Maintaining high levels of flight safety;
- Renewal and expansion of the aircraft fleet;
- Preparation of the new Sheremetyevo-3 terminal for Commissioning, this is scheduled in 2009;
- Improvement of product quality at all stages of passenger Service;
- Intensive development of direct sales channels and Electronic tickets;
- Strengthening of cooperation with foreign partners in The SkyTeam alliance;
- Creation of the Company's own flying school to train Pilots for Aeroflot and for other airlines;
- Development of a brand management system;
- Implementation of a cost reduction program;
- Improvement of the training and motivation system for company personal ;
- Increase annual dividends per share to stockholders by 5% each year;
- Maintain a positive cash flow every year;
- Increase profits by 10% over the next 18 months

The Criteria designed based on the objectives and the SWOT analysis included further above in the report are the following:

- **Maintain High levels of flight safety→ Improve companies safety**
 - *In 2007 Aeroflot has renewed the (IOSA) IATA operational service and Audit, which is recognize as an international standard for Aviation industry for quality management system and flight safety. To support this policy, Aeroflot is using the company's school to practice and carry out better training on Aeroflot pilots and pilots of Skyteam partners. On behalf of the school, Aeroflot will pursue improvement for better trainings on staff, which customer's sometimes complaints about inappropriate service of Aeroflot. However, Aeroflot will improve in general the motivation system for personnel in order to increase overall knowledge and awareness of high level of security and flight safety.*
 - *Aeroflot second intention is to minimize complaints of passengers; most about misunderstanding from Aeroflot personnel in using English language and the insufficient way on serving meals. Aeroflot already has started to tackle this problem by giving appropriate training to the staff members.*
 - *An attribute for Aeroflot by giving training to pilots of foreign Skyteam partners is to strengthen cooperation with Skyteam partners. Aeroflot will offer partners opportunity for*

their personnel to attend training of safety and security matters, with result for partners to cut cost.

▪ **Renewal and expansion of the aircraft fleet→ customer satisfaction**

- *Aeroflot considered the steady growth market of Russian air passenger and the alliance with Skyteam an opportunities to provide proper services on safety flights. Aeroflot already has a focus on customer satisfaction but would like to perform better on services and increase satisfaction in all stages. Aeroflot insist in overall satisfaction, by means the company decided to purchased new aircraft, which will offers new features to all classes, but especially at the economic class, which currently is an unexplored market opportunity for as Aeroflot mainly focus on business class.*
- *In purchased new Aircraft and having in mind sustainable growth of passengers, Aeroflot started to build a new Terminal in Sheremetyevo-3 with the capacity of 12 million passengers per year. This Terminal will be dress up with all new technology and will have a unique design.*
- *In order for Aeroflot to measure customer satisfaction, Aeroflot should use better advantage from the technology in use; Aeroflot has scarcity in systems that provide customers feedback, this flaw doesn't allowed the company to focus completely on the fast changing demand. Aeroflot has intention to resolve this problem by reordering in its current structure on customer feedback; where in all stages will be improvement on feedback for customers.*

▪ **Intensive development of direct sales channels and Electronic tickets→ keep up good financial performance;**

- *Aeroflot is one of the airlines with longest history in the world and one of the best-known brands in the aviation industry, the company has good financial performance and is market leader in Russia. Having a good position in the industry, the company would like to develop a brand management system, which can communicate and expand the awareness of the company. By creating and implementing a brand managements system, the company would be able to support and increase in all of its sales channels. Which would lead to improvements of flight safety and customer satisfaction. Each sales channel will receive proper attention to increase revenues and profit.*
- *By intensifying sales via brand awareness, Aeroflot will receive sustainability on sales and will be able to increase profit over 10% for the next 18 months and by implementing a cost reduction program, Aeroflot would have opportunity to cut cost in the value chain and profit margin and still be able to sustain positive cash flow during the next 3 years.*

III. Crafting Strategies

- **Main Strategy: Focused Differentiation Strategy**

The analysis carried out on the basis of overall performance and market situation of Aeroflot Airlines prove that the company needs to take measures in keeping its competitive advantage and a position of a market leader in Russia. Therefore, a suggestion was made in order to keep these two criteria satisfied, A Focused Differentiation strategy should be developed and implemented.

The focused differentiation strategy is attractive to Aeroflot because the company has the resources and capabilities to effectively serve an attractive niche and there are only few rivals specializing in the niche. The main reason for choosing this strategy is that Aeroflot Airlines needs to build a better focus on its economy class due to the decreased customers' volume.

Why focused differentiation strategy?

- The target market niche is big enough to be profitable and offers growth potential;
- Aeroflot can compete effectively against its new big competitor based on the capabilities and the resources the company has at the moment to serve the niche and based on the goodwill it have built up;

Focus of the strategy

- **Target Audience**

A niche should be aligned and described first. In the case of Aeroflot the niche market is represented by the economy class customers. Even though the company is already operating on this niche, the strategies they used have not been sustained, which is a key element for the success of this kind of strategy. That is why Aeroflot will strengthen its position on the market by emphasizing on the following:

- **Production Emphasis**

In the case of Aeroflot Airlines, we may also say value chain emphasis. The company will focus on providing the most appealing services for its customers in every part of the value chain starting from the process of purchasing the ticket to the final stop.

- **Marketing Emphasis**

Aeroflot will also focus on communicating the services that best meet the niche customer expectations. The Aeroflot Bonus which was developed and implemented for these purposes will be relocated in order to meet the demand coming from that niche.

- **Financial Emphasis**

The main strategy emphasizes on increasing the quality of services and at the same time decreasing the prices on which these services are available. Even though, a lot of improvements are suggested, the company is in stable enough financial state and the size of the niche market and its potential will allow Aeroflot to sustain all the strategies suggested.

The size of the targeted market niche allows Aeroflot to sustain a positive level of its annual cash flow and balance sheet for the coming year, despite the heavy economic turbulence within the country. By sustaining the strategy for the coming years, the opportunity for market growth will provide further increase of the market share of Aeroflot Airlines and therefore increase the profits coming from this market niche-the economy class customers.

Sustainability

The key success factor and a key element to sustainability of this strategy is to have Aeroflot committed to serving the niche market better than its rivals. New services for the markets where the company operates currently will not be introduced. The strategy could be also perceived as a defensive one, since the main focus of it is to have Aeroflot strengthening its position on the market where it operates at the moment in order to keep high competitive advantage during crisis.

Alternative Strategy: Focused Low Cost Strategy

If Aeroflot fails in implementing its main strategy (focused differentiation strategy), it can apply focused low-cost strategy as an alternative strategy. This strategy suggests focusing on a narrow market niche and serving these customers at a lower cost and lower price than rival competitors. Aeroflot starts implementing this strategy, if the following events happen:

- *Financial crisis lasts more than one year (Russian premier-minister Vladimir Putin announced that Russia will recover from the world crisis in summer 2010);*
- *Aeroflot fails in implementing focused differentiation strategy;*
- *Sharp decline in demand for Aeroflot services.*

The target audience for this alternative strategy is an economy class, because aiming also at business customers in this case can totally ruin the reputation of Aeroflot as the business airlines. The main aim of this strategy for Aeroflot is to survive in the world crisis with the lowest possible losses.

Reaching economy of scale and providing customers with cheap services will attract more customers in the economy class, so we can predict the same effect at which Aeroflot aims in its main strategy-to increase the number of customers, and remain the positive profit margin.

Why will this strategy be successful for Aeroflot?

- Aeroflot has stable financial base, as its main investor is Russian government;
 - This strategy will attract new customers and as a result it will increase Aeroflot's market share at the time of crisis;
 - Aeroflot has well-established relationships with its suppliers;
 - Nowadays Aeroflot is the leader in costs competitiveness among market of Russian civil aviation;
 - Aeroflot gets strong competitive advantage, because it will provide its passengers with higher quality of services in economy class, than its competitors do, and at a lower price (because the main component of quality level for airline companies is the coziness of seats in the plains remain at the same level).
-
- **Shuriken Strategy**

Aeroflot is one of the best known brands in this industry and one of the best in providing excellent business class services. Also the company showed brilliant financial performance in the year 2008. Using these key components the company sees merit in launching a grand offensive strategy called Shuriken.

Shuriken focuses on economic class flights to achieve a local rather than industry wide competitive advantage. The strategy aims to obtain local cost advantage over competition and increase the company market share and customer satisfaction by involving multiple initiatives:

- *Improve inside view of the economy class flights (seats, food and beverage, customer services)*
- *Offer lower price with higher quality of services than its competitors*
- *Increase advertising and make the people aware of the additional performance features within the company.*

Shuriken Effect

Shuriken strategy uses the benefit of the economic crisis, where companies are using mostly defensive strategies to keep their competitive advantage. The strategy aims at commencing couple of offensive moves in order to force competitors into defensive actions to protect different sections of its customer base at once and alter competitors' interest. Basically Shuriken gives a reason for the Aeroflot rivals to stay constantly into defensive position and blocking their basis for creating competitive advantage. Meanwhile the strategy provides the needed time for Aeroflot to develop new models and styles for improving customer satisfaction and company development. Also the strategy protects the airline industry from new competitors as Russian Airlines to obtain higher market share and customer extent.

▪ **The Compliance Approach**

Aeroflot currently is using the compliance approach, companies that adopt this approach usually follows ethical codes. Through this approach Aeroflot has been able to manage in teaching and practice ethical and moral outstanding on daily business life. This approach has specific intention to force companies and their executives to behave better in their actions. It implied in having ethically upstanding reputation or imposes and enforces ethical rules and maintains high ethical standards. Aeroflot by default has its own codes¹³ of conduct where it visualize these codes by communicate these with employees, partners, shareholder, customers and third-parties. The benefit in using this approach is improvements to Aeroflot market performance, brand equity, and shareholder values.

In using focussed differentiation strategy or another strategy won't change the approach Aeroflot is using for ethical and moral outstanding. Otherwise in linking the compliance approach with a strategy will have a significant effect on an organization performance. The decision for Aeroflot to be ethical as a whole is because it is morally wrong to be unethical and reflects badly on the character of the company personnel involved and because having an ethical strategy is good business and it aims interest for shareholders.

Some ethical and moral standards that Aeroflot is intent to accomplish in using Compliance approach is:

❖ **Underlying Beliefs**

- *Being committed to ethical standards and Monitor Ethical performance.*
- *Unethical behavior must be prevented and must be punished if discovered.*
- *Maintain high ethical standards.*

❖ **Means of dealing with issues**

- *Establish a clear comprehensive code of ethic.*
- *Prevent unethical behavior.*
- *Provide ethical training for all personnel*
- *The company would like to obtain and maintain compliance office, chief ethics officer, and formal ethics compliance procedures.*

❖ **Challenge in trying to make approach**

- *The idea for organization members come to rely on the existing rules for formal guidance.*
- *Rules or guidelines proliferate.*
- *The locus of moral control resides in the code and in the ethics compliance system rather than in an individual own moral responsibility for ethical behavior.*

¹³ http://old.aeroflot.ru/eng/attach.asp?a_no=1715

❖ **Social responsibility**

Aeroflot commitment to social responsibility is linked to the company's strategy and operating practices on implementation of its social projects, meanwhile cutting out expenditure cost on non-productive activities.

Aeroflot has quite enough social projects and campaigns, which it's in interest of the company to keep on, pursue these activities, in order to carry out significant support on human rights and medical health. Hereby, Aeroflot intention is to create a bond with community by being responsible on company's actions and in responding and working toward a free community with a healthier future. Meanwhile Aeroflot believe that fulfilling these responsibilities in a sustainable manner, entails high ethical standards and cultivate culture that values honesty, integrity and transparency. Although it creates awareness on company's proficiency image, which Aeroflot use to sustain and strengthen corporate strategy and values. Looking on the long term, these activities are the best option to reach objectives and goals of the company and to encourage sustainability of profitability.

Chapter V • Implementing Strategies

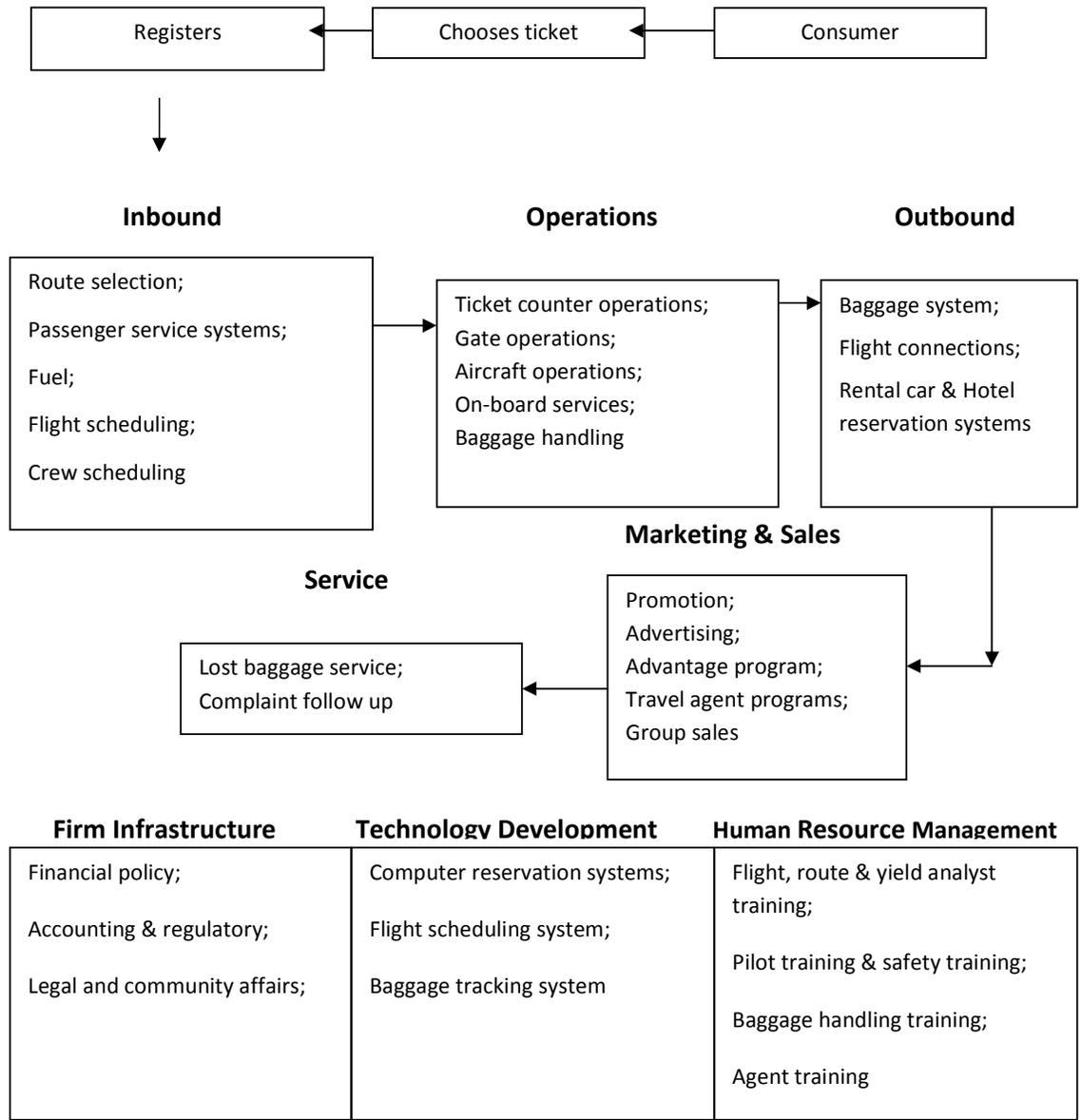
The strategies represented above are aligned according to the criteria built in order to achieve a more sustainable competitive advantage for Aeroflot Airlines in the times of economic crisis.

The following chapter provides an overview of the implementation of these strategies. Implementation has been developed in order to provide a more detailed view of how the strategies will affect the company and what is the possible outcome of the actions suggested.

1. Implementing Focused Differentiation Strategy

As already mentioned above, the main strategy focuses on the further development of the value chain of Aeroflot Airlines.

In order to have a more clear view of it, we would refer to the value chain structure of Aeroflot, which was examined further above in the report. The following graph will be the tool used to provide the scheme based on which the improvements will be suggested and performed.



The improvements take place after the consumer has purchased his/her ticket and has been registered in the data base of the airlines.

As it could be seen, the first part of the value chain is the Inbound, which consists of router selection, passenger services systems, flight scheduling. These three will be further developed in order to increase the competitive advantage of Aeroflot.

Since Aeroflot is part of the alliance, it has developed an enormous route of destinations internationally. However, the company will develop new routes within Russia and will extent the number of offices it has within the country, in order to attract more consumers from the targeted niche. The passenger services systems will also be further developed by introducing a twenty four hour emergency line and customer help.

Flight Scheduling will be available not only online, but coming schedules will be included in the weekly newspaper of the airlines. The Consumer will receive the updates in the schedules via emails, once he/she has purchased a ticket for a particular destination.

Furthermore, the operations as a part of the value chain will be a focus of a change. The strategy will emphasize on the ticket counter operations and the on-board services.

Tickets will be verified via self check in points. These will be introduced in a bigger number, not only at the VIP points but also for the targeted niche-the economy class. The on-board services will be improved by providing a higher quality of catering; a bigger variety of entertainment for flights longer than two hours.

The promotion emphasis of the focus differentiation strategy is to summarize the best the company could offer and provide to the consumers through the most effective communication channels. A more aggressive marketing campaign will be developed. The new services will be introduced with a promotion combined in attractive packages-starting from a certain route (famous destination) and ending with needed car/hotel reservation or transport to certain public buildings, such as train station, etc.

II. Implementing the Shuriken Strategy

In order to be able to execute the strategies in the right way, we have to answer a couple of questions.

What are the resources needed for the implementation and do we have them?

For the implementing of the focused Differentiation strategy the main resources needed are capital and team which to lead the execution of the strategies. Aeroflot has the highest market share in the Russian flight industry. Aeroflot showed strong operational and financial results in the year 2007 and 2008. Aeroflot is the oldest company providing flight services in Russia and the company is well – known brand worldwide. The people who keep Aeroflot staying on the top places in the Russian market are the same people which are needed for the implementation of the strategy. It is clear that the resources are existing in the company and have to be used in a precise way.

What strategic moves have to be taken and how they are communicated to the employees and the customers?

In order Aeroflot to increase its customer satisfaction in the economy class, the company will make some changes leading to more comfortable and friendly environment for the passengers. The first phase is changing the inside view of the planes. This change consists of:

1. New seats will be put similar to the business class providing more comfortable feeling during the flights.
2. Introducing Premium Sandwiches, Snacks & Beverages Program

This program will be introduced both in short and long distance flights. The program will consist in providing the customer with sandwiches and snacks for free and will be used as a tool to generate warmth in the customer. The sandwiches and snacks will be under the brand name of Aeroflot as it will be recognizable by the products packing. Flights two hours or longer have snacks and flights three hours or longer have Premium Sandwich and Chip Combo will contain some extra “secret” ingredients which make the taste quite differentiated in comparison to the normal “Aeroflot” sandwiches and snacks; this two will have size a little bit bigger the normal sandwiches and snacks. This program will be targeting mainly the economic class Aeroflot customers.

A free non-alcoholic beverage is to be introduces among both the economy and the business class travelers. Pillows, blankets, and headsets are also provided free of charge all having the Aeroflot logo on them. The purpose of this will be mostly leaded by the desire of the company to strengthen its brand name and extend its recognition and the company appearance in the mind of the customer.

3. Training for the employees who have interaction with the customers in their everyday duties. The training will consist of:

- Active listening skills
- Telephone Etiquette
- Managing customer expectations
- Conflict management

In the company website will be created a section called “Online grievances procedures” where customers will be able to give feedback, complain and explain how they experience the changes. And from there on the company will be able to measure the quality of the changes based on the customer’s perception and to see what the effect from the transformations on the customers is.

The second phase is to bring the ticket prices of the economy class to the same or even lower level than its competitors and to provide something extra¹⁴ to the customers’ expectations in order to create the feeling of getting something more for the same price in the client’s mindset.

The third phase is communicating the changes and the value of the changes to the customers. This will be done by making 30 seconds advertisement on the national Russian television for one month which explains accurately the different view of the economy class and how this view will has positive impact on the customers. The other tool that is going to be used for increasing the customer awareness is making 2-3 minutes movie with more details about the metamorphoses that happened in Aeroflot and publish it at the company website.

The employees of the company also have to be conscious of the changes in the company and even more important for them is to understand why these changes are made. The team responsible for the

¹⁴ Something extra – look at the phase one of the implementation.

implementation, with the help of the supervisors, will have to explain clear to the employees what the strategy aims for, in order to involve them in the process and to make them responsible for these changes of the company.

III. Implementing the Compliance Approach

Aeroflot is divided in 3 level, top, middle management and operational level, Aeroflot will link the compliance approach within the new strategy by implement guidelines at each level in how and why using the codes of conducts.

The codes of conduct has to be visible for all audience ; such codes are display on the intranet, extranet and corporation websites; the company brochures will have always topics about Aeroflot main responsibilities and brief description of the main ideas in using moral & ethics to guide the company. The brochures are useful to announce awareness of the codes and to disciplinant employee for an infraction of the rules.

Superiors & Subordinators

Ethical behavior is based on the relationship of superior and subordinate worker relationships. If a subordinate observes an indiscretion by his superior, in all likelihood it will be emulated by the subordinate. This phenomenon occurs top-down in the whole corporate chain of command. If it breaks down anywhere in the corporate hierarchy, it will become visible to the subordinate layers and potentially create a "trickle-down" effect. This means the boss has to be a role model for ethical behavior; they must "walk-the-walk" as well as "talk-the-talk."

For managers to behave ethical on their position and be able to maintain this ideology, Aeroflot has implemented a strategic monitor program, where managers are able to evaluate performance in departments and self performance. This program consist about top managers are meeting each other to deliberate about ethical situation in the company and the codes of conduct, also training programs are giving to top managers and subordinators, human resource activities will be part in create a stimuli on ethical & moral behaviors. All these activities are monitor for further evaluation for company's performance measure

Passengers

Aeroflot passengers are to be aware of the companies approach and responsibilities, the company will announce on their interest on safety and secure flight on brochure, leaflets, commercials and advertisements, company's website and regional agencies in a different way; however the important is that Aeroflot will improve the treatment toward customers and adapt the work procedure, to be more efficiently focused on customers needs by treat with more delicateness and respectful behavior.

Chapter VI • Financial Forecasts

In August 2008, Aeroflot published income figures of airlines in 2007 and reached 15th place in the category (operative margin). Among the largest airline groups in Europe, assessed on their revenue, Aeroflot reaches 13th place, in the worldwide ranking the leading Russian airline places 44th. Aeroflot's standing 2007 in passenger numbers improved by three places to 41st worldwide.

Aeroflot financial forecast for the next 3 years is expect to increase 10 % profit on each year

Profit & Loss statement (Millions)

	9m. 2011	9m. 2010	9m. 2009	9m. 2008	9m. 2007
Revenues	3814,1	3995,2	3983,3	3579,2	2797,6
Operating costs	3336,93	3500,18	3544,08	3243,5	2275,8
Operating profit	477,17	495,02	439,22	335,7	521,8
Profit before income tax	329,2	376,1	385,55	275,3	539,2
Net profit (excluded subsidiaries)	147,97	118,92	53,67	60,40	-17,40
Net profit (included subsidiaries)	206	188	168	152	351,5

Operating Profit (millions)

	9 m. 2011	9 m. 2010	9 m. 2009	9 m. 2008	9 m. 2007
Regular passenger traffic	2969,4	3100,5	3009,4	2755,5	2121,4
Charter passenger traffic	116,6	130	122	88,8	17,3
Cargo traffic	244	256,7	300	244,9	187,2
Other revenue	484,1	508	551,9	487	471,7
Total	3814,1	3995,2	3983,3	3576,2	2797,6

Main operating Cost (millions)

	9m. 2011	9m. 2010	9m. 2009	9m. 2008	9m. 2007
Fuel	1221,29	1222	1000	1249,30	730,90
Staff costs	633,05	667	600	519,70	358,40
Aircraft and traffic servicing	389,45	400	500	454,80	364,40
Maintenance	233,8	260	260	211,40	150,10
Sales and marketing	250,23	294	434,3	172,30	149,70
Operating lease	143	147	159	144,80	112,50
Amortization	110,48	110,48	110,48	121,00	105,30
Passenger services	103,23	101	116	106,30	73,40
Administration and general expenses	120	133	150	100,30	77,60
Communication expenses	45	44,2	70	50,60	44,20
Custom duties	16	28	40,3	19,1	32,5
Insurance expenses	16	18,5	18	16,4	16
Education and certification of pilots	6,4	12	9	8,3	7,4
Other costs	49	63	77	68,8	53,4
Total Cost	3336,93	3500,18	3544,08	3243,10	2275,80

Balance Sheet (millions)

	9m. 2011	9m. 2010	9m. 2009	9m. 2008	9m. 2009
Current assets	1689,9	1800	1763,2	1450,6	1303,1
Long-term assets	2252,4	2612,3	2603	2268	2095,2
Total assets	3942,3	4412,3	4366,2	3718,6	3398,3
Current liabilities	1400	1265	1465	1245,8	1012,9
Long-term liabilities	1023,8	1246,5	1175	1247,4	1200,3
Equity	1423,5	1750,8	1621,2	1167,6	1112,2
Minority interest	95	150	105	57,8	72,9
Total liabilities and Equity	3942,3	4412,3	4366,2	3718,6	3398,3

Chapter VII • Conclusions

Financial crisis that lasts from the end of year 2008 highly affected economy and people's welfare. Nowadays it's becoming very difficult to companies to survive and compete at the market and the Airlines industry is not an exception. Russian market of civil aviation is highly affected by the crisis, and therefore by declining demand for Airlines services. Even leading and biggest industry companies, like Aeroflot, have to change its strategy in order not to lose its market share.

Deep analysis of Aeroflot Company showed us that Aeroflot is leading company at its market in all aspects: Aeroflot has the biggest fleet, highest market share and best financial performance comparing with its rivals. Aeroflot's strategy before crisis did not suggested any serious changes to be made within the company, it was aiming at further positive develop as an international class company. Recently Aeroflot signed agreements with its main Airplanes suppliers Boeing and Airbus to buy 44 new planes. Also company reached the agreement with GazpromNeft on a fixed fuel prices in order to avoid threat of fuel prices fluctuations and sufficiently reduce its price.

In spite of good overall performance, the analysis pinpointed the weak sides of Aeroflot and possible threats for them. The main problems of Aeroflot are connected mainly with internal operations of the company. There are many unsatisfied customers with level of personnel training, quality and coziness of economy class; price/quality ratio is worse than competitors'. The main threat for Aeroflot is a new competitor which will be fully subsidized by Russian government.

The based on the analysis strategy for Aeroflot aims at improving the economy class and overall level of service and attracting more customers at the same time. To achieve this Aeroflot starts improving quality of its services and decreases the tickets prices, and therefore it gives competitive advantage of price/quality ratio. So Aeroflot decreases its profit margin, but attracts new customers and increases sales volume. To implement this strategy, Aeroflot has stable financial basis and government support.

Implementation of the chosen strategy is connected with serious improvements in economy class, such as replace of old seats with new more comfortable ones, improving food and services available for passengers. At the same time Aeroflot introduce technical changes, connected with check-in of passengers and baggage delivery system. Aeroflot will spend more time in order to train its staff better, because it's one of the main reasons of customers' grievances.

To sum up, the suggested changes in company's operations and strategy will positively affect company performance; and as a result will improve customers' satisfaction; will help to survive at the time of crisis and to avoid serious losses, and will strengthen the base for company's further development.

Chapter VIII • Appendix

I. External Analysis: Strategic Question and Article

Question: How the prohibition of foreign investments will affect Aeroflot Airlines and the alliance in which it participates?

June 5, 2008

Russia enacts new law on foreign investments in strategic areas¹⁵

By Ben Aris in Berlin

Investors bit their tongues after the Kremlin introduced a new law on strategic sectors in April to limit foreign participation in 42 different sectors. The hope was that although some businesses have, in effect, been put off-limits to non-Russians, at least the clear rules would improve the investment climate as the uncertainty over the fate of foreign money in things like oil and gas was definitely hurting it.

Deputy Prime Minister and Finance Minister Alexei Kudrin has already called for the number of strategic sectors to be reduced on June 2, but conceded that for the time being the new controversial law adopted at the end of April was probably an improvement.

The Kremlin's liberal faction hates the strategic sector's legal ring fence. But the law signed by then-president Vladimir Putin on April 29, "On Procedures for Foreign Investments in Companies of Strategic Significance for National Defense and Security," doesn't ban foreign investment completely in these sectors. However, it does restrict them to owning no more than either 10% or 25% of companies, depending on the sector. And less well published were the parallel changes in the law "On Subsoil" that together with the strategic sectors law now more clearly govern foreign investors access to the all important oil and gas sector.

The first victim of the new law came only a month later. Deutsche Bank Trust Company Americas said on June 3 that it has stopped issuing Global Depositary Receipts (GDR) for shares of a number of Russian issuers indefinitely because of the restrictions. Among the companies affected are steelmakers Severstal and Novolipetsk, silver miner Polymetal, gas producer Novatek and oil producer Bashneft.

Deutsche Bank did not explain why it had cancelled these GDR programmes, only that the books had been closed "until further notice." A source with knowledge of the situation told Interfax that the law enacted in May restricting foreign investment in strategic sectors of the Russian economy was to blame and that the law needs to be changed for the books to reopen.

Foreign investors who want to work in one of the sensitive industries, such as oil and gas, gold mining, defense, nuclear energy, bits of telecommunications, the media, aviation or aerospace, to name but a few, now have to apply for special permission to a governmental commission.

The introduction of the law provoked a storm of criticism bemoaning the "creeping state-ism" of the increasingly autocratic Putin administration. However, the irony of the new law is that the uncertain fate for foreign investors already working in these sectors - particularly following the Yukos affair - has been a bigger drag on inbound investment and that the clarity of the law will probably boost investment in the short-term. "But it is not just Russia," Alexey Frolov, a partner at Baker & McKenzie in Moscow, said in a recent report on the strategic sectors law. "The rest of the world has been busily introducing very similar laws to protect their

¹⁵ <http://www.russiaprofile.org/page.php?pageid=Business+New+Europe&articleid=a1212652503>

own industries from foreign investors."

The "International Investment Perspectives: Freedom of Investment in a Changing World" study conducted by the Organisation of Economic Co-operation and Development (OECD) in 2007 revealed that several countries have recently tightened their regulation and administrative practices to restrict foreign presence in sensitive areas. France and Germany have made themselves the butt of jokes for introducing closed lists of sectors and activities that restrict access for foreign investors on security grounds. Likewise the US Congress last year amended the procedures under the Exon-Florio Amendment (first enacted in 1988 to counter the perceived threat of the Japanese expansion), adding critical infrastructure and foreign government controlled transactions to items for review by the Committee on Foreign Investment in the US - a committee that has come close to shooting down several recent acquisitions by Russian companies in the US, according to bne sources. In Canada and Japan, an overhaul of foreign investment regulations related to national security is also under consideration.

"The OECD report calls for an open investment regime, but admits that ownership of mineral producing companies has become a political issue. According to the report, these concerns have been further strengthened by deliberate investment strategies in some countries to secure control over such resources for political or national security reasons as much for economic reasons. Russia's move to establish a framework for addressing national security concerns in investment policy is not at all out of place, but actually in line with what the rest of the world is doing," says Frolov.

II. Internal Analysis: Strategic Question and Article

Question: Does Aeroflot need to improve its internal operations?

Bad customer service

Novosti Newspaper

Aeroflot Air lines

Murmansk

This is bring in your kind notice that I booked a ticket on your air lines no ETKT 555 4993625057 with the name Asim Ali Fehmi Delhi – Toronto- Delhi. I am a frequent traveller but this is the first time that I got the chance to travel with your carrier. Unfortunately I had to face many problems on board which can be described as under point 1 wise.

1. When I pre-poned my flight at that time I had to pay 65 \$ extra. were as I was told at the time of booking that the first change was permitted.

2. I called up the Brampton, Toronto office on 10th morning and confirmed my seat and the meal to the receptionist at 10.40. and she confirmed that I was allotted the seats 19 H from Toronto to Moscow and seat 9 H from Moscow to Delhi. But when I reached the Airport at 4.00 Pm to board the plane whose departure time was 7.30. I was told no those seats were given to some other passenger. Even though I reached the counter 3.50 hours before the departure time. Which was a big surprise for me. As this never happen with any other international airlines.

3. As I had opted for the special meal at the time of the booking. So I was served the special vegetarian meal on my way to the Delhi to Toronto. As the quality of the vegetarian meal was not good and I am a Muslim by religion. So on my back tip I had opted for the Muslim meal which was confirmed to me before by your Toronto office operator. but surprisingly when the food was served I was asked to take normal chicken food which was served to every one. Which was against my religion. So when I raised the voice against it then the Air hostess came to me and showed her list and told me that we don't have any person with the name Fehmi in list of special meal. My name was not there for the veg food nor the Muslim food. Which was really surprising to see that when I had ordered in advance and it is mention on my name also on the computer then also my name was not there in the list.

So I want to ask the management was that my mistake or the airline mistake. When a religious man like me is not served with the proper halal food which was ordered at the time of booking.

III.Crafting Strategies: Strategic Question

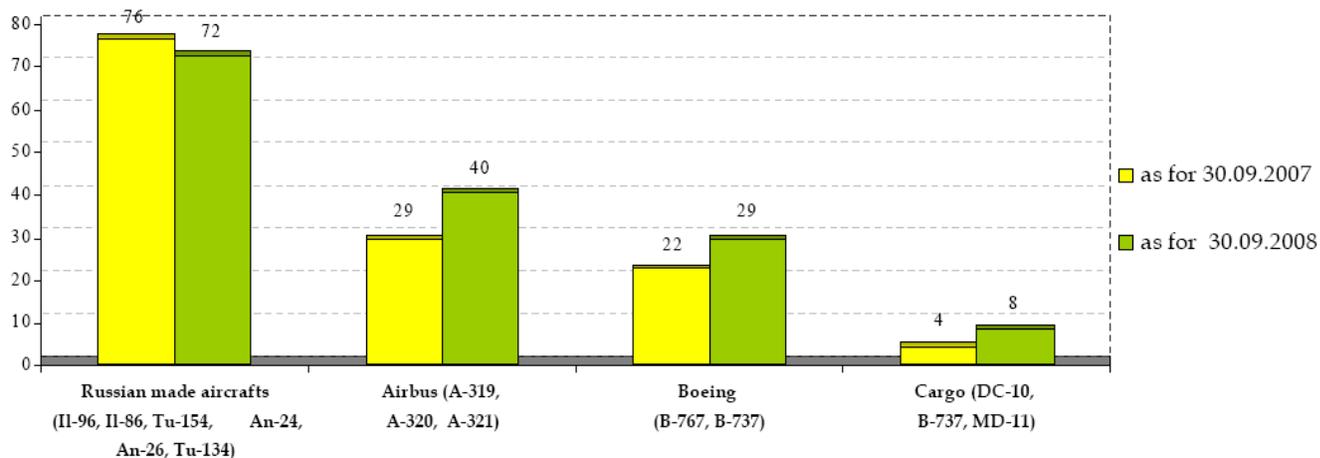
Question: What changes are required in Aeroflot strategy to sustain its leading market position?

IV.Implementing Strategies: Strategic Question

Question: How Aeroflot is going to implement its new strategies?

V. Financial Forecasts

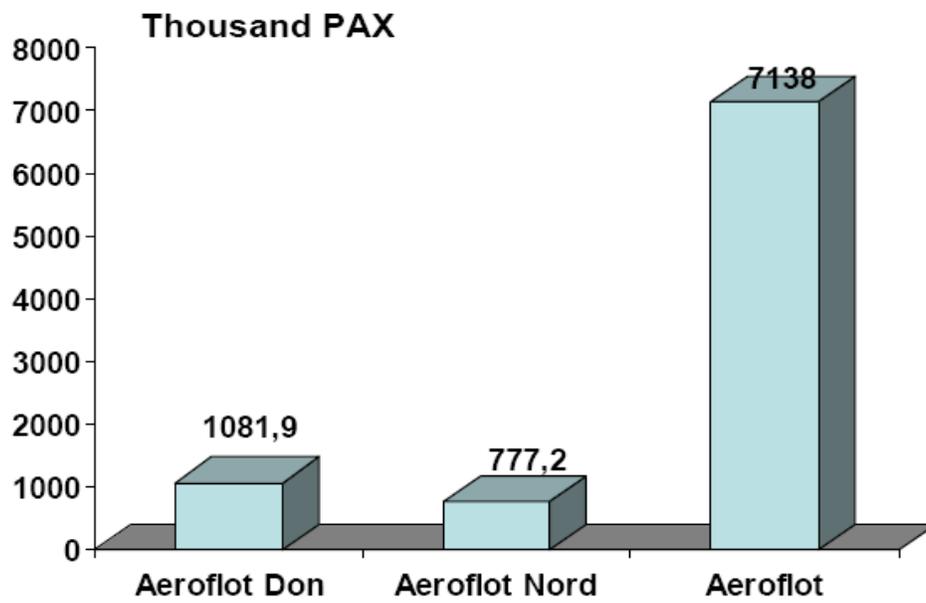
Balance (million USD)				
	30.09.2008	31.12.2007	change	%
Current assets	1,450.6	1,303.1	147.5	11.3%
Long-term assets	2,268.0	2,095.2	172.8	8.2%
Total assets	3,718.6	3,398.3	320.3	9.4%
Current liabilities	1,245.8	1,012.9	232.9	23.0%
Long-term liabilities	1,247.4	1,200.3	47.1	3.9%
Equity	1,167.6	1,112.2	55.4	5.0%
Minority interest	57.8	72.9	(15.1)	(20.7)%
Total liabilities and Equity	3,718.6	3,398.3	320.3	9.4%



Operating profit

(million USD)

	9 M. 2008	9 M. 2007	change	%
Regular passenger traffic	2,755.5	2,121.4	643.1	29.9%
Charter passenger traffic	88.8	17.3	71.5	413.3%
Cargo traffic	244.9	187.2	57.7	30.8%
Other revenue	487.0	471.7	15.3	3.3%
Total operating profit	3,576.2	2,797.6	778.6	27.8%



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