

## **TAP in Strategic Change**

### **Abstract**

This case describes the current the business of TAP after partial privatization occurred in 2015. Having now new owners and having refurbished the board of management, the utmost strategic issue now is the future strategy of the company.

This case works out the importance and the essence of strategy in the airline business and provides a competitive analysis of the European airline industry in order to support definition of strategic plan.

**Keywords:** TAP, Portugal, airline industry, airline business, strategy, business strategy, competitive analysis, Low Cost Carrier, Full Service Carrier, and strategic management.

## **Introduction**

The airline industry is considered as being one of the most competitive industries in the world, enabling economic growth, world trade, international investment, tourism and it is also a power means in accelerating globalization. During the last decades, since the end of implementation of the three liberalization packages of European air market, the airline industry observed a huge transformation of this sector in Europe. New players, LCCs – low cost carriers, have entered into the market with a revolutionary business model that focuses on a strategy based on price rather than capacity or service level. This situation came not only to revolutionize the airline industry in terms of increasing the number of passengers using the aircraft to travel, but also in terms of increasing the number of travels by passenger. Furthermore, it brought together stiff competition in a market that until very recently was quite a closed, protected, heavy, and expensive one. In fact, it is possible to state that the sector of air transportation is substantially different from what it was in the 1950s and because of that, the sector witnessed a massive restructuring with a significant increase in M&A activity around the world.

In Portugal, the Portuguese airline, TAP - Transportes Aéreos Portugueses, was the object of privatization in November 2015. TAP was founded on 14<sup>th</sup> of March 1944 and started commercial flights in September 1946, doing connections from Lisbon to Madrid. Nowadays, the Portuguese airline operates in 38 countries worldwide with several flights for a week to 88 different destinations.

During these years until now, TAP has been doing some improvements and developments, such as increasing the number of flights, the number of destinations, acquiring new aircrafts, increasing the quality of the service and improving the customer's security. In 2013, the Global Traveler Magazine has named TAP as being the "Best Airline in Europe". Also, in 2015 was considered one of the most secure European airline to travel, reaching the 3<sup>rd</sup> place in top 10. In fact, regarding to security, the only accident with fatalities that involved TAP was in 1977, when a Boeing 727 overran the runway on landing in Madeira airport because of the bad weather conditions.

Nowadays, Atlantic Gateway Consortium, led by David Neeleman and by Humberto Pedrosa, half owns the airline capital.

## Airline industry

Over time, the airline industry has experienced several changes; it has gone through a huge influence on both the supply and the demand side. The United States airline deregulation in 1978 had affected the carrier's network strategy, resulting in a rapidly reorganization of network structures from point to point<sup>1</sup> (PP) system into a hub and spoke<sup>2</sup> (HS) system and in a use of PP system by low cost carriers (LCC), or low-fare airlines, such as Southwest Airlines. After the U.S. airline deregulation, the pressure on governments to reduce their involvement in the economics of airline competition has spread to Europe, which had similar results but the effect was not so strong when compared to U.S. market deregulation (Cento, 2009). Full services carriers (FSC), or legacy carriers, felt the need of start following the path taken by low cost carriers, so they started by increasing their efficiency and lowering their operating costs. Since then passengers are now accustomed to the low cost business model, it appears an increased demand for a higher and better service with a higher perceived value. Furthermore, *"with major increases in fuel costs and airport access costs at the more popular destinations, the low cost airlines may find it difficult to maintain their price advantage over the legacy airlines without additional runway capacity."* (Price and Hermans, 2009:125).

According to U.S. Department of Transportation (DOT), the airline industry is divided into four main categories: international, national, regional and cargo. The airlines are grouped taking into account the number of destinations, the type of routes (shorter or longer) and the amount of revenue earned:

1. International – Travel around the world and its revenues are superior to \$1 billion.
2. National – Travel in particular regions of the country, although some provide long haul and even international service. Its revenue is between \$100 million and \$1 billion.
3. Regional – Travel in single region of the country, transporting passengers between the major cities of the country and it have revenues between \$20 million – \$100 million.
4. Cargo – This kind of airlines is generally for goods transportation.

Nowadays, airline industry is completely different when compared with the years before to 1978, where the government that had the authority to defining each airline's routes and control the prices they charged supervised the industry. Today, customers that determine the prices and the service levels define the demand.

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<sup>1</sup> Point-to-point (PP) refers to a transportation system in which passengers travel directly to a destination.

<sup>2</sup> Hub and spoke (HS) refers to a system of connections arranged like a wire wheel, in which all traffic moves along spokes connected to the hub at the centre.

In Europe, the airline deregulation just happens 10 years later and was quite different from the U.S. deregulation. The liberalization of EU airline's industry was a gradual process and carried out in three phases (1987, 1990 and 1992). At the beginning, in the initial stage, the process was slow and with light impact on the industry but, after 1990s the process became bigger with higher effects in the market. The first effect, in the initial stage of deregulation has created an increase of international airline's alliances. The second effect was the development of HS system strategy by the former flag carriers (Cento, 2009). The third effect was the growth of low cost carriers started to experience a higher and faster growth after 1999. This third phase of EU airline's deregulation allowed increasing competition between LCC and FSC.

### **Low-cost carrier vs. full-service carriers**

The pioneer low cost carrier, or low-fare airline, was Southwest Airline, *"operating interstate in Texas in the USA in the early 1970s, and has grown on the back of airline deregulation in 1978 to be one of the most successful and consistently profitable US airlines"* (Price & Hermans, 2009: 117). In Europe the LCC's pioneer was Ryanair, when the Irish airline company copied the Southwest model. The business strategy of LCC is very focused and simple. Basically, these carriers *"identified the coverage-convenience trade-off that characterizes the industry and took a different approach by tipping the balance in favour of simple and efficient production processes at the cost of connectivity and network coverage"* (Daraban, 2012: 39).

In LCCs model (see Exhibit 1), the product offered is very simple and basic, not differentiated and with no in-flight service or lounge services in the airport, being charged every extra service. The use of a single type of aircraft, standardizing its fleets, allows them to have economies of scale in its acquisition, maintenance and operations. The productivity and the aircraft utilization is high, operating and being in the air, generally, more hours in a day compared with FSC. Through a yield management system, the tickets are sold in a demand and supply basis, which its price depends on the seat available. In addition, the tickets are more and more being sold and distributed via internet instead of travel agencies. These carriers use a PP network, flying from place A to B with no any connection at the airport bases. Regarding to airports, LCC tend to look for secondary or tertiary airports that offer minimum costs in terms of landing tax and handling fee, because they believe *"that passengers spend a relatively short time in an airport and are not looking for a luxury experience"* (Price & Hermans, 2009:122).

In contrast, FSC (see Exhibit 1) have a completely different business strategy supported by a hub-and-spoke network, that *"allow them to achieve maximum connectivity for as many*

*demand categories as possible (i.e. take anyone from anywhere to everywhere), consistent with the 'full service' label"* (Daraban, 2012: 38). The HS network will also increase the average's time and the circuitous routings of passenger's trips. On the other hand, with a HS network it is expected to have a reduction on the passenger's schedule delay time, by offering an increased flight frequency. The FSCs usually charges higher prices, however they have in-flight entertainment, checked baggage, meals, beverages and comforts included in the ticket price. The fleet it is not homogenous or standardize, operating with several types of aircrafts. The primary airports, which have better accessibility, are the first choice of these carriers instead of the secondary airports, which have lower cost and weak accessibility. The aircraft utilization is not very high, being in air few hours per day when compared with low-fare airlines. Typically, in FSCs its cabins have two or three service classes and fewer seats in each aircraft than the LCCs. Moreover, the business model builds upon airline alliances, allowing code-sharing agreements. Based on airline alliances and the HS network, FSC can have diversified routes and increase the probability of connecting outbound flights with the inbound and enabling them to offer around the world offerings.

Nonetheless, the LCCs started to adopt similar strategies. For instance, EasyJet has a focus on major airports like Gatwick (London) or Orly (France). Another example is Germanwings that is one of the few LCCs that has introduced a flyer program. There also other airline carriers that have opted by a business model which contains elements from LCCs and others elements from legacy carriers, such as in the case of Air Berlin.

With increased competition, the differentiating factors become more and more important. There are several differentiating factors that airlines can use to differentiate its service, to compete for and to retain clients: airfares price, airport connections, number of baggage allowed, on time performance, primary airports, services in-flight (meal, comfort, on-board sales, advertising), passengers boarding bridges, class segmentation, and others differentiators. The key to survive and to have sustainable competitive advantage in this market goes through a deep understanding about the passengers.

### **Forces that affect the industry**

Airbus and Boeing are the airplane constructors that dominate the commercial airline industry. Moreover, the external environment affects all the industry's inputs (fuel, labour and aircraft) and as they are standardized, the airline companies only seem to differentiate with services (meal, comfort, on-board sales, advertising, baggage allowance, on-time performance, and others). Regarding to costs, the switching costs between airline's companies are relatively low due to most of the people have a tendency to choose the flight based on where they want to

go, price and on time. This tendency can, sometimes, turn into loyalty to some airline's companies. Although, this is not enough for high switching costs, because there are others relevant information that passengers may look for when choosing the flight. Each airline has a specific niche and as consequence each of them provide a specific service – some companies do focus on costs while others focus on providing very good amenities to their passengers. In the airline industry, there are some substitute products such as passengers can always choose other transportations such as car, bus, train or boat to travel and to get to their destination. Notwithstanding, there are switching costs or factors associated with connections that can be more expensive than a plane ticket.

As previously mentioned, this industry is one of the most competitive industries in the world and this situation results from:

- The high number of competitors, that does not change regularly, being stable in the long run;
- The fixed costs that are very high and make difficulties for companies to leave this industry – existence of loan agreements in order to stay;
- The products (service) involved and/or planes, that are very complex;
- The increased power of LCCs revolutionized the airline market and increased the competition among the FSC.

In line with these factors and being the airline industry one of the most competitive industries in the world, it is required a huge amount of capital investment to enter in this industry. Furthermore, when airlines have to exist it may be necessary to write down and absorb many losses. Despite the fact of having low switching costs, which might increase the entrance of new companies in the market, it is not enough to have a high threat. Additionally, passengers have a great power inside of the airline industry, since they have several airlines to choose and they only chose the one that can give them perceived value. Consistent to this, to have a well-known name and to have a brand name recognition are two important things in this kind of industry.

The year of 2015 was a good year for airlines in general. According to IATA Annual Report 2016, the world's airline, in the previous year, carried more than 3.5 billion of people and transported 52.2 million metric tons of cargo, an improvement compared to the 3.3 billion of passengers carried in 2014 and to the 51.5 million metric tons of cargo transported. In 2015, the industry employed approximately 10 million of people, which managed a fleet of 26,000 aircraft with an average of 100,000 flights per day over a global network of 51,000 route.

The ASK<sup>3</sup> - Available Seat Kilometre and the RPK<sup>4</sup> – Revenue Passenger Kilometre are the most used indicators to evaluate the performance of an airline. The ASK is related with the capacity of operations and the RPK is related with the traffic of passengers. Regarding to RPK, it grew 7.4% in 2015 and the capacity (ASK) increased 6.7% compared to the 5.5 % recorded in 2014. Also, there was an improvement in the world's airline load factor<sup>5</sup>, which increased 0.6 percentage points over the 2014 percentage, recorded in 2015 a value of 80.4%. The airline industry recorded a net income of EUR 31.9 billion, on revenues of EUR 649.4 billion. Additionally, there was an increase of 4 billion gallons in the fuel consumption to the 78 billion gallons consumed in 2014. However, since the fuel price decreased, the fuel expenses also decreased from EUR 204.1 billion in 2014 to EUR 163.4 in 2015.

In Europe, similarly to other regions in the world, the airlines had a good 2015. The RPK grew 0.3 percentage points over the 2014 percentage, recorded a value of 6.0 % in 2015, faster than the ASK growth of 4.8% in 2015. The load factor was 80.9 % in the previous year. There was a substantially increased of the net income in 2015, having airlines reached a value of EUR 6,8 billion compared to EUR 903.1 million recorded in 2014. In 2015, the Europe's three airlines with a higher operating margin were Ryanair (24.5%), Wizz Air (16.5%) and EasyJet (14.9%), all of them LCCs. After them, Icelandair (11.9%), IAG (11.5%) and Aeroflot (10.6%) recorded the highest margin in the FSCs market.

### **Future trends**

In the future, the airline industry will experience some changes. In a study conducted by IATA, "*Vision 2050*", the major changes seems to relate with market's dimension, technology and customer's priorities.

Considering the study mentioned, the global population will grow more than 20% over the next 40 years. Furthermore, the GDP of G20 will increase from \$38 trillion in 2009 to \$170 trillion in 2050 and China, India, Brazil, Russia and Mexico will comprise just over 50% of the GDP of the G20 countries. The advances in technology will revolutionize even more people lives, becoming the access to all type of information at real-time and anywhere in the world something acquired and banal the society in 2050. As stated by IATA, virtually all people will manage their lives using Lifestyle Integrated Management Pods (LIMPs) – portable devices

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<sup>3</sup> The ASK is obtained by multiplying the total number of seats available for scheduled passengers and the total number of kilometres those seats were flown.

<sup>4</sup> The RPK is obtained by multiplying the total number of revenue-paying passengers by the number of kilometers traveled.

<sup>5</sup> The Load Factor is the ratio of passenger-kilometers travelled to seat-kilometers available.

that have all essential personal data related to their owners. *“Through LIMPs, individuals can manage literally every part of their lives, including all communications, entertainment, business, commercial and information needs. They contain all biometric data and allow individuals to constantly monitor their own health and, to a certain extent, fix health problems that arise. They facilitate the buying, selling and shipping of goods from any point to any destination”* (IATA – Vision 2050: 60). However, the differences between developed and non-developed countries will continue to be observed, despite of all technology advance and of all economic and population growth.

Concerning about the passenger market, it will expand and increasingly diversified. This industry carried 2.4 billion of passengers and 40 million tons of goods in 2010 will probably carry 16 billion of passengers and 400 million tons of goods in 2050. People will prefer to travel by air instead of doing it by car or other type of transport, since by air will be faster, safer and seamless than today. The availability of technology in airplane will be different too. In-flight entertainment systems will not be present on most airplanes, as the majority of customers become to have their personal audio and video entertainment. In the future, the customer's top priorities will be safety and security. In the future, although price still a key driver of consumer choice, it will not be at customer's top priorities due the access of information which made price transparency absolute. Aircraft design will also suffer changes with the intention of being more comfortable, affordable and environment friendly. Regarding to fuel consumption, it will be more efficient than ever and the landing and take-off oxides of nitrogen will decrease.

### **TAP: the History**

TAP is a Portuguese airline that was created on 14 March 1945 by Humberto Delgado, the then Director of the Civil Aviation Office. The first commercial flight, Lisbon-Madrid, occurred in September 1946. Afterwards, new routes were established, namely, between Lisbon, Luanda and Maputo (then Lourenço Marques). Later on, the air service extended to Paris (1948), Seville (1948), and London (1949). Until the April Revolution, the company continued to develop some routes across the world, launching during the 1960s flights for Porto Santo, Goa, Rio de Janeiro, Geneva, Munich, Frankfurt, Funchal and others.

At the beginning of 1974, TAP operated with 32 advanced aircrafts that were operating to more than 40 destinations, in four continents.

After the 1974 revolution, the TAP became a stated-owned company. It was in the 1980s that the company made a re-branding, which included new uniforms, logo and aircraft colours. Also, launched the in-flight magazine, created the Executive Class and opened a new cargo

terminal at Lisbon airport. During the 1990s, for the first time, TAP had more than three million of passengers in a year. It was the decade of the first commercial jet designed by computer – the Boeing 777. Also, TAP developed flights from Porto to Barcelona and Basel and reopen the route to Salvador da Bahia.

The first decade of the 21<sup>st</sup> century was very important for the Portuguese airline's economic growth, with profits of several million euros. During this first decade, TAP made a rebranding, presented a new image, including a new logo and a new name – TAP Portugal. The main purpose and goal of this “rebranding” was communicate its modernity, lightness and to reinforce the name its name. The year 2005, was remarkable for TAP as it became full member of Star Alliance and one year after, in 2006, the Portuguese airline signed a deal with Espírito Santo International for the acquisition of 99.81% of the Portuguese regional airline – Portugália.

During the following years, TAP won several awards in many different categories, just to name a few:

- “World’s Leading Airline to Africa” (World Travel Awards in 2011 and 2012);
- “World’s Leading Airline to South of America” (World Travel Awards in 2009, 2010, 2011 and 2012);
- “Best Executive Class” (Business Destinations, a British magazine, in 2013);
- “Leading European Airline to Africa and South America” (World Travel Awards, in 2014 and 2015).

In 2014, TAP started 11 new destinations, having, nowadays, connections around 81 destinations in 34 countries. In average, the Portuguese airline has around 2500 flights in a week and has a fleet of 77 aircraft.

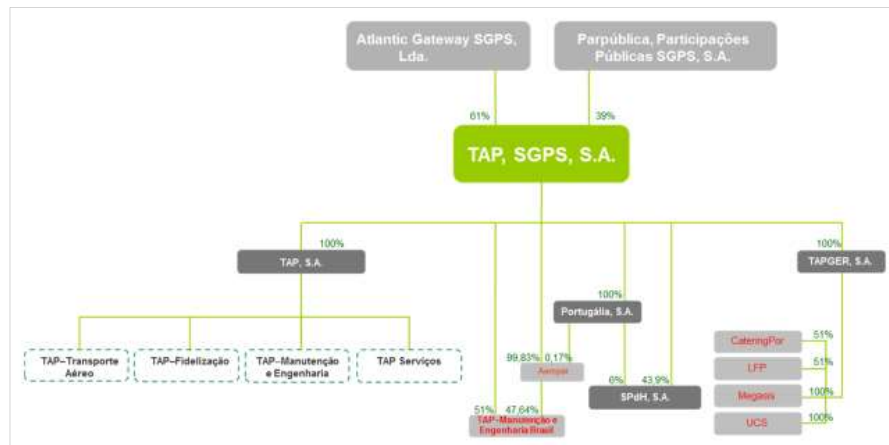
Once the Portuguese Government decided to sell the company, TAP experienced a profound organizational change, and it was effectively privatized in November 2015. The Portuguese Airline was sold to the Atlantic Gateway Consortium, a joint venture between David Neeleman, owner of Azul Brazilian Airlines, and Humberto Pedrosa, owner of Grupo Barraqueiro, who take control of 61% of the capital of the TAP.

The consortium that won the company's privatization, in June 2015, has promised to buy more aircrafts so, in January 2016, TAP has announced an order of new 8 ATR 72-600, 9 Embraer 190, two A330-200 and the creation of a new brand, TAP Express, that will replace Portugália PGA Airlines. Nowadays, TAP has a fleet of 88 aircrafts (63 TAP Portugal and 25 TAP Express).

### TAP organizational structure

As shown in Figure 1, Atlantic Gateway Consortium is the major owner of TAP Group, with 61 % of the group and TAP S.A. belongs 100% to TAP Group.

**FIGURE 1 – TAP SGPS, S.A. ORGANIZATIONAL CHART**



Source: TAP Annual Report 2015

### Fleet, product and destinations

TAP boasts a fleet of 63 Airbus aircraft, being 4 Airbus A340-300, 16 Airbus A330-200, 3 Airbus A321-200, 19 Airbus A320-200 and 21 Airbus A319-100. Also, has another 25 at the service of TAP Express, being a total of 88 aircrafts.

Nowadays, the Portuguese Airline fly for 88 different destinations across Europe, Africa, North America and South Africa. Furthermore, TAP have some European and African destinations that are being operated by TAP Express.

TAP has a portfolio with five main categories: *tap|discount*, *tap|basic*, *tap|classic*, *tap|plus* and *tap|executive*. Each of these products is associated with different services, relating to reservations and some advantages on the ground and on board (please see Exhibit 3).

#### 2.3.4. Performance indicators

Through the following graphics it is possible to see that both ASK and RPK have been increasing along these years. Regarding to Available Seat Kilometre (Exhibit 4), TAP had a Compounded Annual Growth Rate of 189.4 %, between 2000 and 2015. Concerning the Revenue Passenger Kilometre (Exhibit 5), TAP had a Compounded Annual Growth Rate of 223.7%, between 2000 and 2015. Having the ASK and RPK it is possible to determine the

Load Factor<sup>6</sup> (RPK/ASK). In 2014, it was 80.56% and in 2015, it was 81.24% having increased 0.84 % between 2014 and 2015.

Besides these indicators previous mentioned, there are others that can be used to do a deeper analysis of TAP's performance. TAP SGPS, S.A. ended 2015 with a net income (Exhibit 5) of EUR - 156 million, which became more negative when compared to the EUR - 85.1 million recorded in 2014. Regarding to TAP S.A., the company recorded a net income of EUR - 99 million, which is more negative in EUR 52.6 million than the EUR – 46.4 million recorded in 2014. The situation of Venezuela, had an important impact on the negative results of 2015, since the amounts were withheld due to the economic crisis. The Company said that approximately EUR 91.4 million were held in Venezuela and without this effect, the net income of TAP SA. would be EUR - 7.6 million.

Regarding to operating income (Exhibit 7), TAP SGPS, S.A. recorded a result of EUR -105.7 million in 2015, compared to the EUR 2,6 million verified in 2014. The profit before taxes (Exhibit 8) remained negative in 2015. The company recorded a profit before taxes of EUR - 168.9 million, being more negative in EUR 90.1 million, compared the EUR -78.8 million verified in 2014.

Additionally, according to TAP Annual Report 2015, the Company's debt recorded a decrease of EUR 1,062 million in 2014 to EUR 942 million in 2015. This decrease was related to some reimbursements done last year that benefiting from the process of TAP capitalization, and it is Atlantic Gateway Group that is supporting it. Although, the Company had an improvement on its operating costs, which down to EUR 2,269 million in 2015 against to EUR 2,341 million in 2014. The improvement on TAP's operating costs is achieved through the reinforcement of cost containment measures, in which the Company spent EUR 660 million in 2015 compared with EUR 798 million spent in 2014, and due the decrease seen in fuel prices.

Regarding to the passenger's revenues, in 2015, the Portuguese Airline had a decrease of 5.2% in air transport revenues compared to previous year. TAP recorded revenues of EUR 2,227 million in 2015 against to EUR 2,343 million in 2014. Both in 2014 to 2015 the regions with higher airfare selling were Europe and South Atlantic. Considering these two regions, although not significant, there was a decrease in South Atlantic, which down to 32.72% in 2015 against to 33.88% in 2015, and an increase in Europe, which up to 38.36% in 2015 against to 36.74% in 2014.

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<sup>6</sup> The Load Factor is the ratio of passenger-kilometers travelled to seat-kilometers available.

## Competitors

As previously stated, the airline industry is one of the most competitive industries in the world, especially since the airline liberalization. Nowadays, the main competitors of TAP are not only FSC but also LCC, since these carriers have been increasingly influencing and significant in this industry. Regarding to FSC, the main competitors are Lufthansa Group, Air France KLM and IAG and concerning to LCC, the main competitors are Ryanair and EasyJet.

- **Lufthansa Group** – Founded in 1953, Lufthansa is the largest German airline and, when combined with its subsidiaries, it becomes the largest airline in Europe. Its subsidiaries are Austrian Airlines, Swiss International Air Lines, and Eurowings (including Germanwings).
- **Air France KLM** – These airline was a merger between Air France and Netherlands-based KLM in 2004. One of the Air France KLM subsidiary is Transavia, which is a LCC. Additionally, Transavia maintains Transavia France as its French subsidiary.
- **IAG (International Airlines Group)** – This group is a holding company created in 2011, from the merge of British Airways and Iberia. The British Airways, founded in 1924, is the second largest in Europe and it is one of the largest airlines in the world. The Iberia is the flag carrier of Spain, founded in 1927.
- **Ryanair** – Is an Irish airline low-cost, founded in 1985, whose headquarter is located in Dublin, Ireland. Ryanair is considered as one of the largest LCC in Europe.
- **EasyJet** – Is a British LCC, founded in 1991 and based at London Luton Airport. It is the leading airline in Europe, in the LCC market.

There are several differences between TAP and its main competitors regarding to passengers, routes, fleets and employees (please see Exhibit 9 and Exhibit 10). Ryanair was the airline that had more passengers in 2014, with 81.7 million of passengers carried. Although, in 2015 the airline which carried more passengers was Lufthansa Group, around 107.7 million of passengers. In turn, TAP was the one that carried less passengers in 2014 as also in 2015, 11.4 million and 11.3 million respectively.

Ryanair and EasyJet are the airlines with more routes, both in 2014 and 2015 (Exhibit 9 and Exhibit 10). In fact, since these carriers are a short haul point-to-point airline, they can operate in short-haul flights and make restricted flight connections. Additionally, LCC are not flag carriers so they can have more than one operational base in different countries, which allow them to fly for lots of destinations from that operational base.

Considering the number of employees, these carriers have a lower number compared to TAP or other FSC. This fact has a huge impact on the efficiency of the operating costs of LCC. One

of the TAP's huge problems is the high number of employees, which leads to present employee's costs too much high (please Exhibit 11 and Exhibit 12).

As previous mentioned, LCCs are much more cost efficient than FSCs. The major costs of an airline are regarding to employees and to fuel. The fuel costs represent a higher percentage in the total operational costs, although it is not so easy to manage this cost since the fuel price is under control of airlines.

The CASK<sup>7</sup>, cost per available seat kilometre, is used to measure the airline's costs. Through the following tables (table 5 and 6), it is possible to observe that the CASK, in 2014 and also 2015, is lower in Ryanair and EasyJet. This lower CASK concerns the cost efficiency of these airlines and, in turn, will be translated into higher operating margins. Regarding to FSC, the one that had a lower CASK was Air France KLM for the years of 2014 and 2015.

The other important performance indicator used to compare the efficiency of several airlines, is the RASK<sup>8</sup>, revenue per available seat kilometre. Generally, the higher the RASK, the better is the efficiency, assuming that the CASK remains constant. Regarding to FSCs, Lufthansa presented, in 2014 and 2015, the higher RASK, EUR Cent 9.1 and EUR Cent 9.2 respectively, compared to TAP, Air France KLM and IAG (Exhibit 11 and Exhibit 12). About the LCCs, the ones that had a higher RASK, in 2014 and 2015, was EasyJet, with a value of EUR Cent 6.7 and EUR Cent 6.8 respectively.

None of the airlines had a load factor of 100%, but, as expected the higher load factor were from a LCC, EasyJet had a load factor of 91 % in 2014 and 91.6 % in 2015. TAP also increased its load factor, moving from 80 % in 2014 to approximately 81% in 2015.

The net income was positive in both years for all airlines, with the exception of TAP. The Portuguese airline presented, in both years, a negative net income. In 2014, TAP recorded a net income of EUR -85.1 million and in 2015 of EUR – 151.8 million.

### **TAP Business strategy**

TAP is probably the only airline in the world whose founder was a hero of freedom. For the Portuguese citizens, Humberto Delgado is the man who directly challenged the dictator Salazar. Since 1945, the year it was founded, TAP has been a national symbol. From the beginning, the strategic priority of the TAP has been meeting the customers' expectations.

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<sup>7</sup> CASK is calculated by taking all of an airline's operating expenses and dividing it by ASK.

<sup>8</sup> RASK is calculated by dividing the airline passenger's revenues by ASK.

The company continually seeks to provide them the best and easiest solutions for their trips, adding more value to the offered services/products.

TAP focuses its business in a model of full service carrier, offering a differentiated product/service compared to others airlines. This fact, allows TAP to create brand perception, customer value and customer loyalty. One example of a differentiated service that TAP offers is the Premium Customer Center. At Lisbon airport, the Portuguese airline has a desk to serve the business/corporate segment and to provide them a superior service focused on speed and efficiency. Additionally, the Company offers a portfolio of diversified products, which each product type has different specifications to fulfil the different needs of its passengers. TAP also has a great personalized and high customer service that is transversal to all segments. For instance, assistance in case of lost luggage; priority luggage reclaims; to arrange the most suitable time for boarding; escort to the check-in desk and to the aircraft; transport by exclusive vehicle; updated information and other service offers.

Beyond the concern and focus on customer, TAP also has a strong focus on continuous improvement of the routes, destinations and fleet. It was in 2001 that adopted a strategy of hub, being the Lisbon Airport the center of TAP's operations. This strategic decision allowed the Company to take advantage to fly to several destinations in Europe, Africa and North and South America. Nowadays, TAP has around 88 different destinations, with a huge focus on destination for PALOP (African Countries of Portuguese Official Language).

At the end of 2014, TAP has started to define a new strategic plan for the period comprised between 2015 and 2020. This strategic plan englobes six strategic axes (TAP Annual Report 2015, 2016:21-22), in order to increase its global market presence and so in the airline industry:

1. To renovate and expand the all fleets;
2. An evolution in the business model – to offer customers more options to create new products/services in addition to the trip;
3. Automation and improved customer experience – to make more digital and more automated the customer facing processes;
4. To consolidate TAP's grow and increase the focus on the hub – to build and to reinforce the Lisbon hub and to launch the Lisbon-Oporto Air Shuttle;
5. To improve operational efficiency – to optimize the company cost's structure.
6. Repositioning of the maintenance and engineering business units in Portugal and also in Brazil.

The year 2015 was a year of suspense in the company due to the ongoing process of privatization but even though the company has decided to initiate a new strategy to be

implemented in the beginning of 2016. This strategy includes some changes to the fleet, product, network and a capitalization plan. Furthermore, after the TAP's privatization, the Atlantic Gateway consortium reaffirmed to continue with the commitment to (TAP Annual Report 2015, 2016:23)

- *Complying with public service obligations;*
- *Maintaining the integrity, corporate identity and autonomy of the TAP Group;*
- *Preserving the TAP brand and its association with Portugal, ensuring that its headquarters remain in the Country;*
- *Maintaining and reinforcing the hub in Lisbon;*
- *Contributing to the development of the national economy;*
- *Entering into commitments with regard to labour stability, developing, and making the best use of human resources.*

In follow-up to the strategic plan set for the coming years, the company highlighted the following strategic points for the period of 2016-2017:

- The capitalization plan, with an investment of EUR 350 million;
- The creation of a new brand – TAP Express. This new brand will replace PGA Airlines and will mainly serve domestic and regional routes;
- Continuing to serve Portugal and PALOPs;
- To make changes in the fleet with the goal of positioning TAP among the best world's airline and to guarantee connections between Europe, Africa, Brazil and North America.

According to TAP Annual Report 2015 (2016:23), *"The strategy remains focused on diversifying the portfolio in order to meet the product changes seen in the market, thereby expanding the customer range and increasing gains in efficiency and in the consolidation of production processes"*.

## **Privatization**

The process of TAP privatization goes back to the year of 2012, in which the only interested at the end of the process, was the entrepreneur Germán Efromovich. On December 20<sup>th</sup>, the Portuguese Government decided to postpone the process of privatization until 2013. Before that, both parties concluded that it was a communication failure and it has caused disruption in the business of TAP and Germán Efromovich ensured that he was going keep interested in the privatization of TAP, so the government decided to delay the process until 2014.

On November of 2014, the Portuguese Government announced that the privatization process was reopened. The form of privatization was direct sale of 66% of the airline's capital - 61% of sales from direct investors; 5% for employees of TAP SGP and the remaining 34% was to be held by the government for two years. The submission date of tenders for the acquisition of TAP was on May of 2015 and at by that time, the parties who have submitted their proposal were David Neeleman, CEO of Azul Airlines and JetBlue Airways, along with Humberto Pedrosa, Germán Efromovich, CEO of Avianca, and Miguel Pais do Amaral. However, Miguel Pais do Amaral has been excluded as his proposal did not meet one of the requirements' specifications.

In June of 2015, the Portuguese Government accepted the purchase proposal of TAP Portugal by David Neeleman and Humberto Pedrosa. The airline's sale process was completed on November 12<sup>nd</sup> with the signing of the contract, in which David Neeleman and Humberto Pedrosa take control of 61% of the capital of the TAP.

Recently, The Portuguese Government has bought back 11% of the shares, so the Portuguese Republic owns 50% of the TAP.

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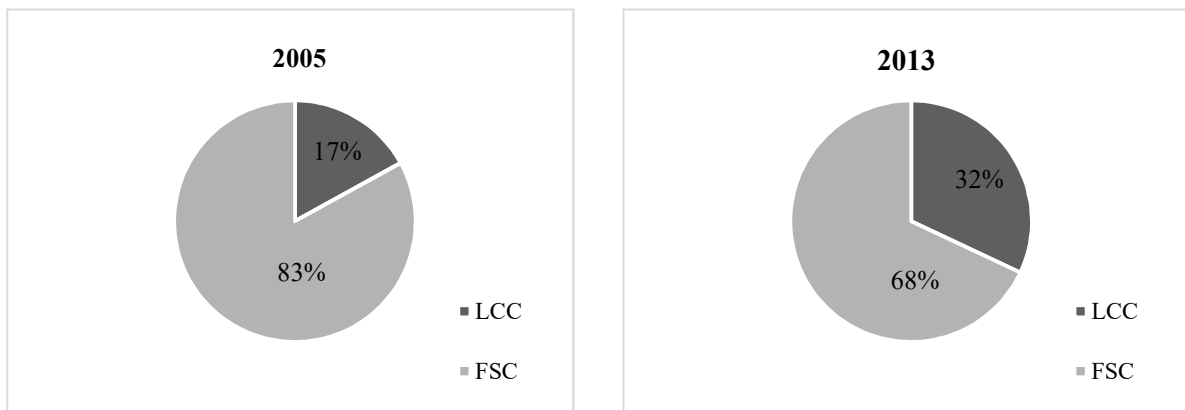
## **ANNEXES**

**EXHIBIT 1 - DIFFERENCES BETWEEN LCC AND FSC**

<i>Product features</i>	<i>LCC</i>	<i>FSC</i>
<i>Brand</i>	One brand: low fare	Brand extensions: fare + service
<i>Airports</i>	Secondary	Primary
<i>Connections</i>	Point-to-point	Interlining, code share, global alliances
<i>Class segmentation</i>	One class (high density)	Two or three classes (dilution of seating capacity)
<i>In-flight</i>	Pay for amenities	Complementary extras
<i>Aircraft Utilization</i>	Very high	Medium to high: union contracts
<i>Turnaround time</i>	25 minutes	Low turnaround: congestion/labour
<i>Product</i>	One product: low fare	Multiple integrated products
<i>Ancillary revenue</i>	Focus on the primary product	Advertising, on-board sales
<i>Aircraft</i>	Single type: commonality	Multiple types: scheduling complexities
<i>Seating</i>	Small pitch, no assignment	Generous pitch, offers seat assignment
<i>Customer service</i>	Generally, under performs	Full service, offers reliability
<i>Operational activities</i>	Focus on core (flying)	Extensions: passengers, maintenance, cargo






Source: Adapted from O'Connell & Williams, 2005

**EXHIBIT 2 - COMPARISON BETWEEN AIRLINE MARKET 2005 VS 2013 (IN %)**



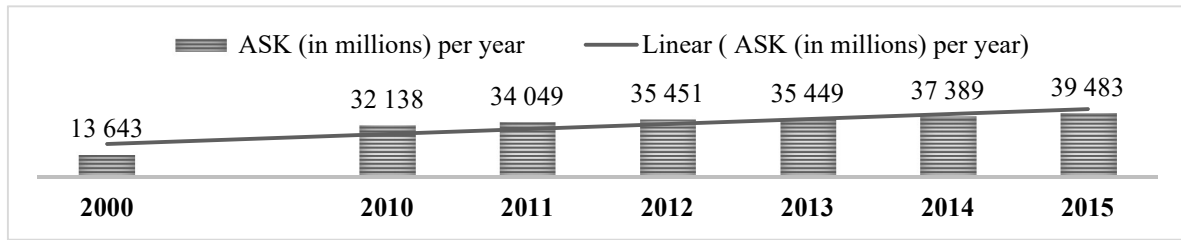
Source: Adapted from Airline Profiler: International Low-Cost Airline Market Research, 2015

**EXHIBIT 3 - TAP PORTFOLIO**

	
For those looking for excellent opportunities to travel at very low prices.	
<ul style="list-style-type: none"> <li>▪ Ticket changes allowed;</li> <li>▪ Miles accrual;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Meal;</li> <li>▪ On board entertainment.</li> </ul>
	
For those who plan their holidays, an economic solution that still has advantages.	
<ul style="list-style-type: none"> <li>▪ Ticket changes allowed;</li> <li>▪ Miles accrual;</li> <li>▪ Seat Reservation;</li> <li>▪ Newspapers and Magazines;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Information via SMS;</li> <li>▪ Meal;</li> <li>▪ On board entertainment.</li> </ul>
	
For those looking for some flexibility and the convenience of classical TAP.	
<ul style="list-style-type: none"> <li>▪ Ticket changes allowed;</li> <li>▪ Partial refund;</li> <li>▪ Miles accrual;</li> <li>▪ Seat reservation;</li> <li>▪ Upgrade with Victoria miles;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Newspapers and Magazines;</li> <li>▪ Information via SMS;</li> <li>▪ Meal;</li> <li>▪ On board entertainment.</li> </ul>
	
If you are looking for speed and total flexibility, this is your solution.	
<ul style="list-style-type: none"> <li>▪ No charge for ticket changes;</li> <li>▪ Total refund;</li> <li>▪ Miles accrual;</li> <li>▪ Priority Check-in;</li> <li>▪ Priority security/x-ray;</li> <li>▪ Priority Baggage;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Seat reservation;</li> <li>▪ Upgrade with Victoria miles;</li> <li>▪ Newspaper and Magazines;</li> <li>▪ Information via SMS;</li> <li>▪ Meal;</li> <li>▪ On board entertainment.</li> </ul>
	
At the airport and on board, exclusive personalized service and maximum comfort allow you to work or relax as you wish.	
<ul style="list-style-type: none"> <li>▪ No charge for ticket changes;</li> <li>▪ Total refund;</li> <li>▪ Miles accrual;</li> <li>▪ Priority Check-in;</li> <li>▪ Priority security/x-ray;</li> <li>▪ Lounge access;</li> <li>▪ Access to Premium Customer Center;</li> <li>▪ Priority Baggage;</li> <li>▪ Seat reservation;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Differentiated boarding/disembarkation;</li> <li>▪ Free Parking &amp; ValetXpress;</li> <li>▪ On board newspaper and magazine;</li> <li>▪ Information via SMS;</li> <li>▪ Wardrobe;</li> <li>▪ Amenity-kit (long haul);</li> <li>▪ Executive meal with option;</li> <li>▪ On board entertainment;</li> <li>▪ Exclusive benefits with TAP ground partners.</li> </ul>

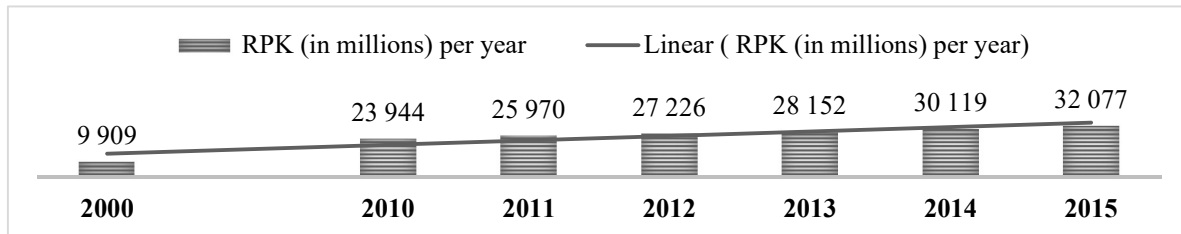
Source: Adapted from TAP Corporate – TAP Products, 2016

**EXHIBIT4 - TAP AVAILABLE SEAT KILOMETRE**



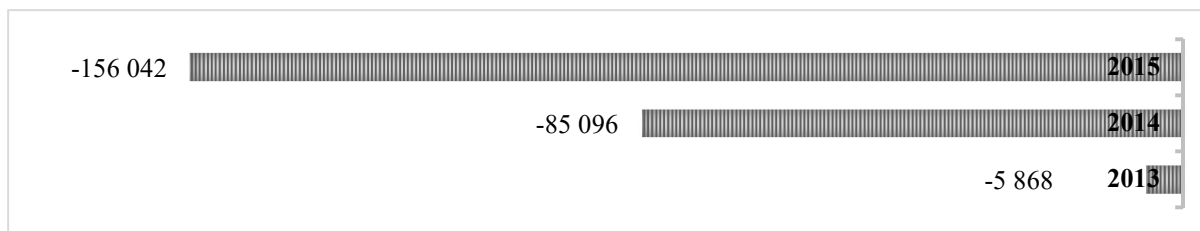
Source: Own creation based on TAP Annual Report 2014 and 2015

**EXHIBIT 5 - TAP REVENUE PASSANGER KILOMETRE**



Source: Own creation based on TAP Annual Report 2014 and 2015

**EXHIBIT 6 - TAP SGPS, S.A. NET INCOME 2013-2015 (IN THOUSANDS €)**



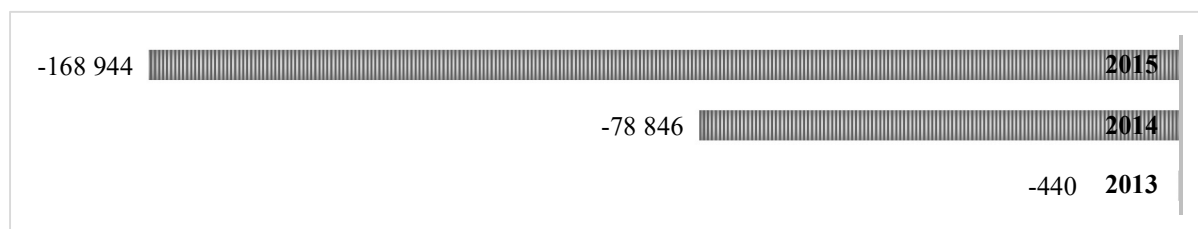
Source: Own creation based on TAP Annual Report 2014 / 2015

**EXHIBIT 7 – TAP SGPS, S.A. OPERATING INCOME 2013-2015 (IN THOUSANDS €)**



Source: Own creation based on TAP Annual Report 2014 / 2015

**EXHIBIT 8 - TAP SGPS, S.A. PROFIT BEFORE TAXES 2013 - 2015 (IN THOUSANDS €)**



Source: Own creation based on TAP Annual Report 2014 / 2015

**EXHIBIT 9 - COMPARISON BETWEEN TAP AND ITS COMPETITORS IN 2014**

	TAP	Lufthansa Group	Air France KLM	IAG	Ryanair	EasyJet
<i>N° Passengers (Million)</i>	11.4	77.5	77.5	77	81.7	64.8
<i>N° of Routes</i>	87	235	316	NA	1600	675
<i>Fleets</i>	77	423	571	459	297	226
<i>N° of Employees</i>	10,882	188,973	97,847	59,484	9,501	10,342

Source: Own creation based on Companies Annual Report 2015

**EXHIBIT 10 - COMPARISON BETWEEN TAP AND ITS COMPETITORS IN 2015**

	TAP	Lufthansa Group	Air France KLM	IAG	Ryanair	EasyJet
<i>N° Passengers (Million)</i>	11.3	107.7	89.8	88	101	68.6
<i>N° of Routes</i>	88	211	573	344	1800	735
<i>Fleets</i>	88	268	564	529	300	241
<i>N° of Employees</i>	11,023	120,652	96,417	60,862	9,586	9,015

Source: Own creation based on Companies Annual Report 2015

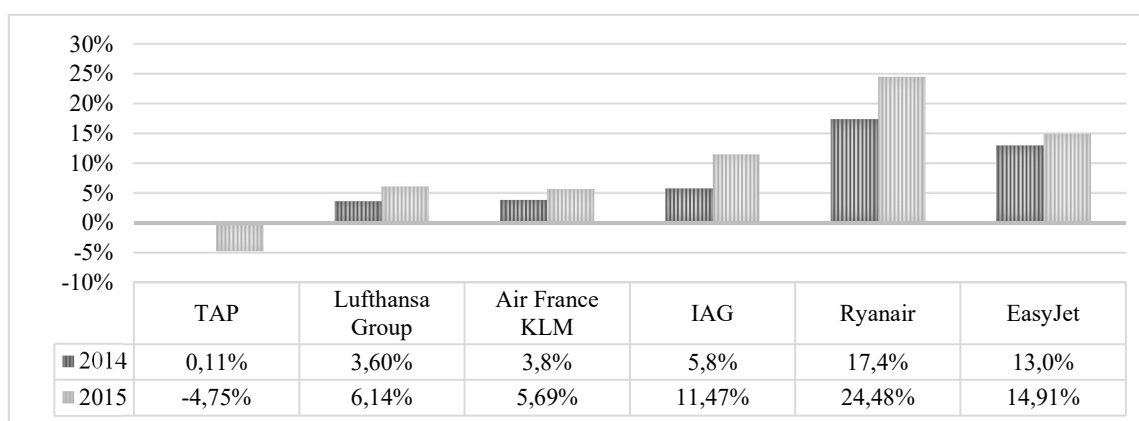
**EXHIBIT 11 - PERFORMANCE INDICATORS OF TAP AND ITS COMPETITORS IN 2014**

	TAP	Lufthansa Group	Air France KLM	IAG	Ryanair	EasyJet
<i>Load Factor</i>	80%	80.1%	85%	80%	82.5%	91%
<i>ASK (Million)</i>	37,389 €	268,105 €	270,789 €	251,931 €	77,917 €	94,779.8 €
<i>RPK (Million)</i>	30,119 €	214,641 €	229,347 €	202,562 €	64,470 €	86,923.3 €
<i>RASK (EUR cent)</i>	6.3 €	9.1 €	6.9 €	7.1 €	4.9 €	6.8 €
<i>CASK (EUR cent)</i>	8.2 €	8.8 €	7.2 €	7.5 €	5.6 €	5.9 €
<i>CASK ex-fuel (EUR cent)</i>	6.1 €	6.5 €	6.9 €	5.1 €	3.0 €	4.1 €
<i>Passenger Revenues (Million)</i>	2,342.6 €	24,388 €	19,570 €	17,825 €	3,789.5 €	5,317.9 €
<i>Fuel Costs (Million)</i>	797.8 €	6,751 €	6,629 €	5,987 €	2,013.1 €	1,491 €
<i>Employee Costs (Million)</i>	578.9 €	7,335 €	7,636 €	4,585 €	463.6 €	<b>662.7 €</b>
<i>Operating Profit (Million)</i>	2.6 €	879 €	751 €	1,029 €	658.6 €	692.5 €
<i>Net Income (Million)</i>	(85.1 €)	55 €	-216 €	1,003 €	522.8 €	536.3 €

Source: Own creation based on Companies Annual Report 2015

**EXHIBIT 12 - PERFORMANCE INDICATORS OF TAP AND ITS COMPETITORS IN 2015**

	TAP	Lufthansa Group	Air France KLM	IAG	Ryanair	EasyJet <sup>9</sup>
<i>Load Factor</i>	81%	80.4%	85.5%	81.4%	91%	91.6%
<i>ASK (Million)</i>	39,483 €	273,975 €	276,899 €	272,702 €	79,690 €	99,929.7 €
<i>RPK (Million)</i>	32,077 €	220,400 €	235,715 €	221,996 €	70,331 €	92,508.2 €
<i>RASK (EUR cent)</i>	5.5 €	9.2 €	7.1 €	7.5 €	5.4 €	6.7 €
<i>CASK (EUR cent)</i>	6.9 €	8.9 €	6.8 €	7.5 €	5.8 €	5.7 €
<i>CASK ex-fuel (EUR cent)</i>	5.2 €	6.9 €	6.7 €	5.3 €	3.3 €	3.3 €
<i>Passenger Revenues (Million)</i>	2,226.8 €	25,322 €	19,570 €	20,350 €	4,260.3 €	5,501.5 €
<i>Fuel Costs (Million)</i>	660.3 €	5,784 €	6,183 €	6,082 €	1,992.1 €	1,429 €
<i>Employee Costs (Million)</i>	566.4 €	8,075 €	7,852 €	4,905 €	502.9 €	693.6 €
<i>Operating Profit (Million)</i>	(105.8 €)	1,555 €	1,115 €	2,335 €	1,042.9 €	820 €
<i>Net Income (Million)</i>	(151.8 €)	1,698 €	127 €	1,516 €	866.7 €	653 €

**EXHIBIT 12 - OPERATING MARGINS OF TAP AND ITS COMPETITORS IN 2014 AND 2015**

Source: Own creation based on Companies Annual Report 2015

<sup>9</sup> The calculations are based on the daily (05-07-2016) reference rates published by Banco de Portugal and the European Central Bank.