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ADVANCED GCE**

2880/CS

BUSINESS STUDIES

Business Strategy

CASE STUDY

To be opened on receipt

JUNE 2009

SUITABLE FOR VISUALLY IMPAIRED CANDIDATES

INSTRUCTIONS TO CANDIDATES

- **This Case Study must be opened and given to Candidates on receipt.**

INFORMATION FOR CANDIDATES

- **This Case Study may NOT be taken into the examination room.**

THE AIRPORT OF CENTRAL ENGLAND LIMITED (ACE)

At just over 2,933 metres long, the main runway at The Airport of Central England (ACE), is one of the longest in the UK. ACE is a wholly owned subsidiary of English Regional Airports (ERA) which itself is owned by a publicly quoted infrastructure company, Zest Holdings plc. ERA operates three commercial airports in England, but ACE is by far and away the largest by any measure of size. Of the three, ACE is the only one that has any significant cargo traffic, and is the only one licensed to operate 24 hours per day. The airport has four main income streams: commercial aviation, rent, cargo and car parking. In the year just ended, 2008, ACE had revenues of a little over £54m, with an average net margin of 10.5%. 5 10

As the name implies, ACE is situated in central England. It faces competition from three other commercial airports within a 60 mile radius. The newest of these, D, commenced commercial operations in 2005 after the current owners bought the airport following its closure as an RAF base. 15 20

TABLE 1: IMMEDIATE COMPETITORS' DATA

Airport	Runway length, metres	Distance from ACE, miles
ACE	2,933	0
B	2,652	37
C	2,008	40
D	2,892	57

In addition to the above, there are several other airports serving the private aviation market, but none

is now suitable for commercial aviation due to their limited electronics and lack of facilities. There are two active RAF bases, each with a runway in excess of 2,700m, both within 50 miles of ACE. 25

Although ACE's location brings with it competition, it also offers considerable advantages. Some recent research conducted for ACE suggests that there are nearly 11m people living within a 90 minute car journey from the airport. In 2006 ACE served over 4.5m passengers, the majority of whom arrived by private car. To accommodate them, ACE has 7,000 car parking spaces on site. Rent from its car parks is an important source of income and ACE's pricing structure deliberately seeks to exploit some passengers' insensitivity to price. Hence, the 856 spaces nearest to the single terminal building are priced at a premium rate: 0 to 15 minutes free, then £5 per hour. In contrast, spaces in the medium and long term car parks are priced at £20 for the first two days, then rising by £5 per additional day. 30 35 40

The UK commercial aviation market has enjoyed rapid growth in the last decade. The primary reason for this has been the deregulation of the European market, and the consequent rise of the budget airlines. The rise of the budget airlines has heralded significant changes. Last year, nearly 72% of all passengers flying from ACE did so on a scheduled service. Further, most flights are intra-European and operated by medium sized aircraft, such as the Boeing 737. In the budget airline market, competitive position is driven primarily by low fares and, as such, the airlines in this market are obsessive about their costs. For ACE this means pressure on its staff to turn aircraft around as quickly as is safely possible. It also means that each carrier is very keen to know what its competitors are charged for landing 45 50 55

fees, but will keep its own fees a closely guarded secret. Although landing fees are negotiated with each individual airline, an average would be about £150. That the airlines have themselves encouraged passengers not to take checkable baggage has saved ACE time and staff costs in baggage handling. Further, for the next three year contract, ACE has been able to increase retail rents in its terminal building by 25% because of tenants' uplift in business. This has come about because of a combination of two factors:

- to ensure that the aircraft leave on schedule, the airlines demand that passengers check in two hours prior to departure;
- enhanced security measures necessitated because of the perceived terrorist threat to civil aviation.

In essence these factors mean that ACE's departure hall is filled with a captive market for its many retail outlets. Although air passenger numbers have grown, so has cargo tonnage (see Table 2). ACE is the UK's third largest cargo airport after Heathrow and Gatwick. Heathrow is the UK's largest freight airport in terms of overall tonnage, most of which is so-called 'belly-hold' freight. In contrast, ACE has almost no presence in the 'belly-hold' market, but it dominates the UK pure cargo market. ACE is particularly strong in the express freight market. In 2001, a specialist carrier invested £35m in a purpose built parcel and cargo distribution facility on the ACE site.

TABLE 2: ACE, CARGO AND MAIL TONNAGE,
000 TONNES

Year	Cargo	Mail
1996	105	11
1999	129	13
2002	220	14
2005	274	26
2008	317	28

For the non-passenger market ACE has a number of significant attractions:

- **runway length allows the use of very large aircraft;** **90**
- **the Civil Aviation Authority (CAA) allows ACE to operate 24 hours per day;**
- **it is estimated that nearly 90% of the population of England and Wales is within a four hour journey for a large lorry.** **95**

As the airport expands, so does the demand for labour. In 2008 there were about 250 staff employed by ACE, with another 6,500 employed by nearly 100 companies directly associated with the airport. Both of these figures are set to rise in the coming five years as expansion continues. To facilitate this growth, ERA wants to transfer some employees from ACE to itself. These staff are mainly concerned with safety and emergencies, for example, fire crew. Staff would be assigned to the ERA airports so as to make the most effective use of them throughout the year. However, **100**
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this is being opposed by the fire crews. Table 3 sets out how the fire crews' employment conditions would change if the transfer is implemented.

TABLE 3: FIVE CREWS' EMPLOYMENT CONDITIONS

	Existing	Management proposal	Trade union response
Pay	£12.45 per hour	Salary of £28,540	£15.00 per hour
Shift allowance	£50 per week	n/a	£58 per week
Working hours	38 per week Overtime @ 1.5x	n/a	35 per week Overtime @ 1.5x
Away allowance*	£45 per day	n/a	£50 per day
Holiday entitlement	25 days (5 weeks)	30 days (6 weeks)	30 days (6 weeks)
Pension	Final salary	Cash purchase	Final salary

* Paid when an ACE employee is temporarily transferred to another ERA operation.

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Managers at both ACE and ERA have decided to start the transfer process with the fire crews as they are seen as the most militant of ACE's employees. Recently, an attempt by ACE's management to transfer the twice daily visual runway safety inspection to the fire crews was unsuccessful. The fire crews argued that getting them to do this task compromised airport safety. By not being on stand-by in the fire station their response time to any emergency would be greater. The airport cannot operate unless it has the prescribed minimum fire crew cover stipulated by the CAA.

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Although ACE is a major source of employment in its community there are sections of the community which are highly critical of it. The majority of this criticism surrounds traffic and aircraft noise, especially aircraft flights at night. Increasing the number of cargo flights at night is a key objective for ACE as it seeks to grow its cargo market. However, this growth will only be possible if ACE can persuade its cargo customers to invest in the latest generation of quieter aircraft. To do this, ACE has introduced a charge determined by aircraft noise ‘foot print’ rather than a single fee per movement. Similarly, ACE wishes to see passenger numbers grow, but given that the projected growth is in the intra-European market, most of this growth will necessarily be day flights.

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The capacity of the airport is limited by, amongst other things, two key factors – both relating to aircraft movements. First, aircraft parking space on the ground. The rise of the budget carriers has, however, meant that the average time a passenger aircraft will be parked on the ground between flights at one of ACE’s 30 passenger gates has reduced to 54 minutes. The size of the separate handling area for cargo aircraft is such that aircraft parking space is not an issue.

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The second factor is flight separation. For any aircraft following a larger one, e.g. Boeing 767, standard operating practices require five minutes separation, whereas this time reduces to two minutes if following a medium sized aircraft type, e.g. Boeing 737.

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TABLE 4: AIR TRAFFIC MOVEMENTS AT ACE

	Day	Night
2006 (actual)		
Passenger	38,600	4,500
Cargo and mail	6,900	15,300
2016 (projected)		
Passenger	65,300	7,500
Cargo and mail	10,400	27,800

Recently, ACE has been approached by a potential new customer, Air Executive (AE). ACE believes it could charge AE £400 for each departure. AE's market is the premium business traveller, operating its fleet of Boeing 767– 400 in a single class configuration, giving a capacity of 105 passengers, compared to a 767's notional capacity of 304 passengers. The initial plan is single daily flights, one to North America, a second to India and the third to China. AE would require departure times between about 18.30 – 19.30 with the return, inbound, flights landing at 07.30 – 08.30. The aircraft would then remain on the ground until evening departure. AE would require its own separate check-in and lounge facilities. Typically, business travellers want to arrive at the airport as close to departure time as possible, check-in quickly and then board their flight. Unlike most other passengers, they are often chauffeured to the airport.

In the longer term, ACE is set to grow, see Table 4. In 2007, about 5.1m passengers flew from ACE. This figure is projected to rise to 11.4m in 2016. Securing the resources needed to enable this growth objective

to be achieved is a major concern. Similarly, much depends upon whether the significant rise in UK air travel continues into the next decade. In 2007, 230m passengers flew to and from the UK, up from 105m in 1990. Although loved by many in the general population, air travel is increasingly attracting criticism, not least because of its environmental impact. For example, as long ago as 1994 the government created a fiscal measure, Air Passenger Duty, to discourage flying and its impact on pollution. However, critics have pointed out that this is a relatively poor means of reducing demand, particularly given the price inelastic nature of air travel within the budget airline market.

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To seek to offset some of the criticism of the externalities created by air travel, ACE has pledged to become carbon neutral in its operation by 2016. Hence, ambitious plans are being drawn up to install various technologies which will reduce ACE's 'carbon footprint'. These range from the installation of low energy light bulbs throughout the terminal and office buildings, to building a railway spur to link ACE with the national rail network. Consultants to ACE have estimated the three miles of track required would cost £2.95m per mile and take three years to complete, with a further £3.4m needed for changes to the terminal at ACE.

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APPENDIX 1

ACE VALUES; OUR 4CS.

At the heart of everything we do must be a consideration of our 4 Cs; colleagues, customers, community and company. Everything we do, whatever it is, must be directed at improving the experience of each. We will strive for integrity, demonstrating the highest standards of personal and professional ethics, always being open and honest and taking responsibility for our actions.

1. COLLEAGUES

Colleague abilities and attitudes are central to our success and so we will value, empower, and invest in them to enable them to deliver their best for the benefit of all.

2. CUSTOMERS

Our aim is to exceed our customers' expectations through our passion for service. To do this we need to know and understand all our customers, be they large or small, ad hoc or frequent.

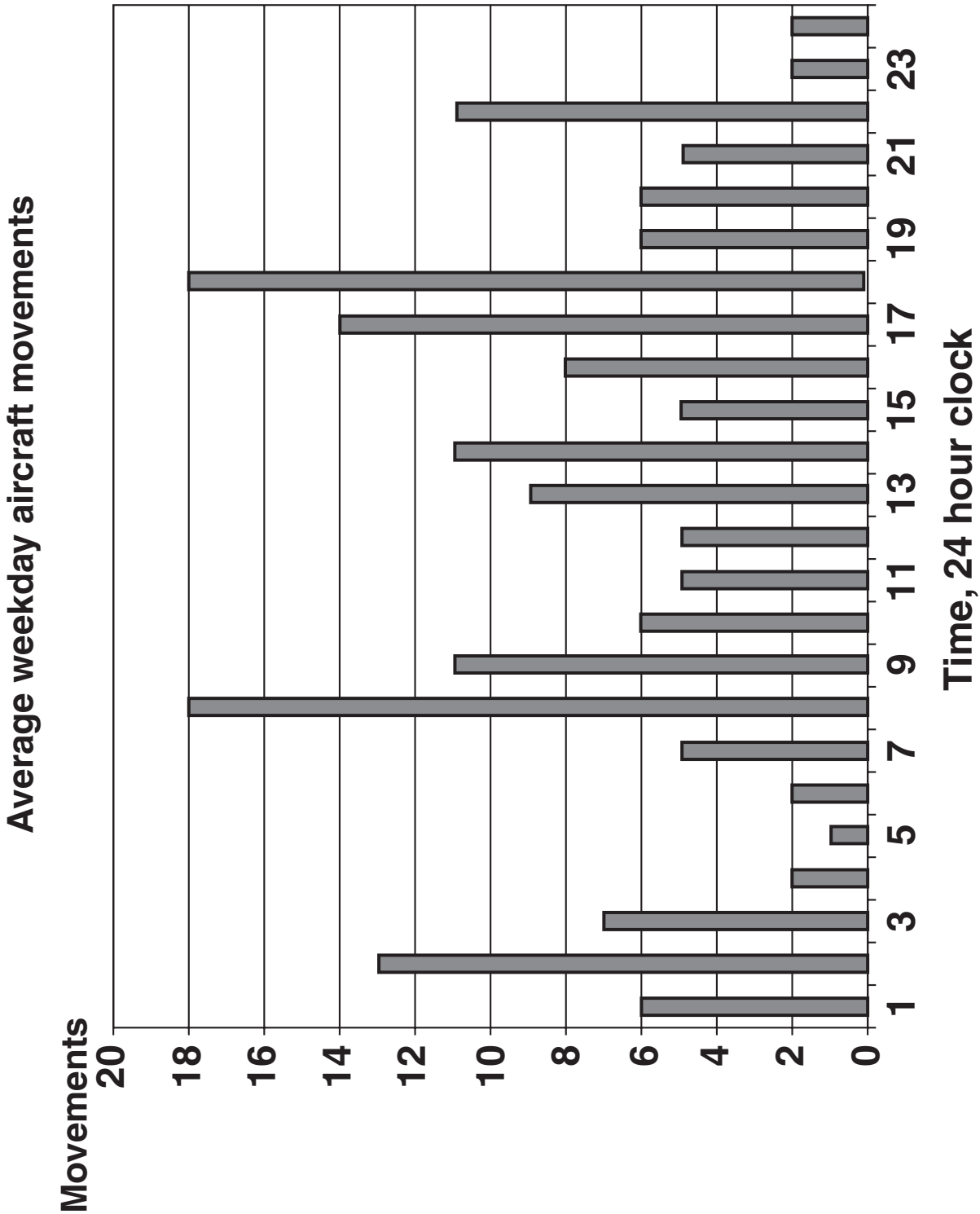
3. COMMUNITY

We will always be aware of the needs of our community and, through attention to corporate citizenship, we will contribute to their social and economic well-being.

4. COMPANY

Operating in a competitive market place we must always be in the lead. We will do this through innovative solutions and constant examination of what we do, challenging existing routines and practices, and seeking to simplify process for the benefit of all, ensuring shareholders receive, in the long term, appropriate rewards for the risk they take.

APPENDIX 2



APPENDIX 3

THE AIRPORT OF CENTRAL ENGLAND LTD

**Balance Sheet as at 01 December 2008
(unaudited)**

£000s

Fixed Assets	Tangibles	509,864
	Investments and other ventures.....	14,361
		<u>524,225</u>

Current Assets		
	Stock	1,285
	Debtors	14,156
	Short-term bank deposits and prepayments	3,494
	Cash	8,565
		<u>27,500</u>

Current Liabilities		
	Creditors falling due within one year	6,674

Net Current Assets	20,826
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Total Assets less Current Liabilities	<u>545,051</u>
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Creditors falling due after one year	
	Bank and other borrowings
	316,708

Net Assets	<u><u>228,343</u></u>
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Share Capital⁽¹⁾	56
Profit and Loss account.....	228,287

Equity shareholders' funds	<u><u>228,343</u></u>
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**(1) Authorised share capital 100,000 £1 ordinary
shares**

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