

# Lufthansa marketing analysis: swot and pestel



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This report will take a closer look at the turnaround of Lufthansa airlines which went from near bankruptcy in 1991 to a now profitable airline. The evolutionary patterns of strategy and structure are identified in this report as well as how strategic leadership and German culture contributed to the turnaround. Furthermore, this paper will analyse the airline industry in terms of Porter's five forces and will also take an extensive look at Lufthansa's current situation by means of a SWOT and TOWS analysis. Additionally, Lufthansa's business-level and corporate-level strategy will be identified and the Star Alliance, the world's most important airline alliance, will be discussed in detail.

## **2.0 Company Background**

The Lufthansa Aviation Group is considered to be one of the world's leading air transport corporations. It includes a number of independent group and affiliated companies with business segments in passenger airlines, logistics, aircraft maintenance, catering, tourism and IT services. Lufthansa's headquarter is located in Cologne, Germany and its operational centre for passenger and cargo services is situated in Frankfurt (Key data on environmental care and sustainability at Lufthansa 2002/2003).

Lufthansa is 78 years old and has currently about 93,000 employees worldwide and in 2003-reported revenue of about 16 billion Euros (Lufthansa - Key Figures 2003- see also Appendix I).

In terms of traffic performance, Lufthansa is in third position in worldwide passenger transport. For many years the company has also been the market leader in international cargo traffic. In 2002, Lufthansa's 368 aircrafts operated on routes to 327 destinations, carrying 50.9 million passengers

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and 1. 63 million tons of airfreight. Lufthansa was also one of the founding members of the Star Alliance in 1997, when 16 partners joined into the world's largest airline alliance (Key data on environmental care and sustainability at Lufthansa 2002/2003).

### **3.0 The Industry Background**

The organization also has to deal with cyclical risks. General economic fluctuations as well as geopolitical developments can have a large impact on the performance of the Lufthansa Group. As good examples serve the events of September 11, the Iraq conflict and the outbreak of SARS in Asia along with a stagnating global economy which seriously influenced the business activity of the entire airline industry in a negative way (Heerkens 2003).

Lufthansa is also confronted with some capital market risks as its international business activities expose it to exchange rate and interest rate fluctuations in the international money, capital and also the foreign exchange markets (Zea 2003).

A substantial threat is the price of fuel since fuel consumption remains one of the main cost items for the whole airline industry. In 2003, it contributed 7.6% to Lufthansa's total operating expenses. Fluctuations in fuel prices can have a significant affect on the organization's operating result (Lufthansa Annual Report 2003).

Furthermore there is the threat of higher costs of insuring Lufthansa's fleet. Insurance costs increased dramatically after the events of September 11 and since then stayed at a very high level. The reason for that are the massive additional premiums that are being charged for insuring against war and

similar events. In case of more wars and terrorist attacks the premiums are likely to increase even further (Zea 2003).

There are also a number of infrastructure risks that Lufthansa will have to deal with. There are plans for an extension of the runway system at Frankfurt Airport, which is a major hub for Lufthansa's operations, and is extremely important for the long-term competitiveness of the German airline. The extension project is also crucial for securing Frankfurt Airport's future as an international air traffic hub, which also applies to the building of the maintenance hangar for the new Airbus A380 super jumbo that will be used from 2007 onwards. Nonetheless, a range of operational restrictions on extending the airport has recently been debated which would hinder its efficient use. In case a solution can't be found, Lufthansa would have to relocate part of their business to alternative hubs. Additionally, bottlenecks in many European air traffic control systems cause many flight delays. The infrastructural limitations are a huge burden on the profitability of all European air carriers. On top of that, they are inhibiting the industry to keep up with the growing demand for air transport services (Lufthansa Annual Report 2003).

There are also a few risks relating to the development of alliances. One of the foundations for Lufthansa's commercial success was its integration into the Star Alliance, the world's leading airline partnership system. Currently, many of the airlines worldwide are in a loss-making situation which, in the case of a few of Lufthansa's partners like United Airlines and Air Canada, reached proportions that threatened their existence and also affects Lufthansa negatively. In regards to the Star Alliance, there are also

challenges of coordinating and incorporating strategic activities like the establishment of a common global brand, a shared technology platform as well as joint training and personnel development (Lufthansa Annual Report 2003).

Being part of the Star Alliance also poses the threat that Lufthansa might lose its identity. It is vital for them to preserve the Lufthansa brand (Bruch & Ghoshal 2002).

Labour unions are an additional threat; especially in Germany they have a lot of power. Labour unions can initiate strikes, which in the past have already led to delays of departures and substantial costs to Lufthansa (Steinborn 2003).

#### **4.0 The Company Objectives**

Structural analysis of an industry is a useful way of determining a company's long-term profitability. Comprehending the dynamics of the competitive forces in an industry can give an insight whether an industry is attractive and whether there are any chances for returns on capital. Michael Porter, a professor at Harvard Business School, created a framework for understanding the structure of an industry. According to Porter, the five competitive forces that can have an impact on an industry are threat of new entrants, bargaining power of suppliers, bargaining powers of buyers, competitive rivalry, as well as the threat of substitutes (Analysis of industries 2003).

#### **4. 1 Threat of new entrants**

The threat of new entrants offers the possibility that new firms are going to enter the industry, which will consequently lead to a reduction of industry returns by generally passing more value to consumers in terms of lower prices and also increasing the cost of competition. Factors like economies of scale, capital requirements, product differentiation, access to distribution channels, switching costs as well as brand value determine the threat of entry (Analysis of industries 2003).

From my point of view it currently seems very difficult to enter the airline industry as this area of business as well as the world economy is facing a period of recession. Due to large product differentiation the entry barriers are fairly high. There is a range of flag carriers, charter airlines as well as a number of low-fare airlines in the industry. All these different types of airlines offer an extensive range of products that seem to satisfy most customers needs. Additionally, entering the aviation industry requires very high capital investments because aircrafts, technical support and IT services need to be purchased or leased. This industry is also very labour and fuel intensive which requires a lot of funds. Companies with an interest in entering the market also require access to distribution channels. This means that it is necessary to gain trust within the industry so as to get access to take-off and landing spots. This can be quite challenging as national policies still play a major role in the aviation industry. Furthermore it is a requirement to obtain permission from governments to enter airspace. Moreover once the market is entered, it is very difficult to exit which raises switching costs to a high level. Throughout the last decade the market opened due to the deregulation

policy, which provided low budget airlines with an opportunity to enter the industry. The first entrants like Ryanair and Easyjet utilized this opportunity and developed strong brand names due to their first-mover advantage.

Airlines that recently entered the market that have a similar price and cost structure generally find it more difficult to generate the traffic that is required to fill the seats in their aircrafts (Jacob & Jakesova 2003).

All in all it can be said that the threat of new entrants is not that high in the airline industry in the current business environment.

#### **4. 2 Bargaining power of suppliers**

Factors that are connected with the bargaining power of suppliers include the threat of forward integration as well as the concentration of suppliers in the industry. Supplier power decreases the ability for competitors in the industry to earn higher profits (Wheelen & Hunger 2000, p. 64).

The main suppliers within the airline industry are the manufacturers of aircrafts like Airbus and Boeing, fuel suppliers such as Shell, British Petroleum and Chevron Texaco. Furthermore there are technical support and IT services as well as the catering services. Suppliers are very concentrated in the airline industry as Boeing and Airbus supply most commercial fixed-wing aircrafts. The concentration of suppliers makes it difficult for the airlines to exercise leverage over the two manufacturers and negotiate lower prices or play one supplier against the other. Moreover, at the current stage, aircrafts for long distance travel cannot be substituted by any other product, which strengthens the bargaining power of the suppliers even more. Fuel providers have an excellent bargaining position as they can increase fuel

prices without regarding the airlines as an important customer group. Forward integration, which is the expansion of a business' products or services to related areas in order to directly satisfy the customer needs, is fairly low. The reason for this is that it can be assumed that neither aircraft manufactures, fuel providers nor technical support companies will purchase an airline and staff it with flight attendants, commercial pilots, a maintenance crew and operate flights across the world (Jacob & Jaksova 2003). Nevertheless, the strong position fuel suppliers as well as the relatively strong position of manufacturers of aircrafts need to be taken into account when operating an airline.

#### **4.3 Bargaining power of buyers**

Buyers can have significant power, as they are able to push down prices, and negotiate for better quality and service. Buyer power is determined by relative volume of purchase, switching cost, standardization of the product, brand identity, elasticity of demand as well as quality of service (Del Vecchio 2000). Since customers are not very concentrated and generally don't purchase plane tickets in large volumes they do not have a strong bargaining position. A single purchase of an airline ticket does not represent a significant fraction of the amount offered. Switching costs are quite low as consumers have a range of choices when selecting an airline. Due to the Internet, information about prices is also less fragmented and much easier to compare. Quite frequently, a customer can find price differences for the same flight and one seat is generally not any better, since everyone arrives at the destination at the same time. Considering the worldwide recession as well as the psychological effects of September 11, airline companies are



under substantial pressure as customers switch to alternative transportation like trains. Vacation travelers also tend to shop around for the best price. Traveling by plane is quite expensive and can make up the largest part of the expense of a family vacation. For that reason, demand is quite elastic for some buyers. As soon as the price drops, the demand increases. However, airlines can move their prices in tandem with other airlines, which forces customers to purchase tickets for the market price until a price war starts (Analysis of Industries 2003).

Nevertheless, all in all it can be said that the bargaining power of buyers is relatively low.

#### **4. 4 Threat of substitute products**

The airline industry is threatened by a number of substitutes. This threat is quite substantial within Europe, where Lufthansa's main customer base is located. Many European countries have an excellent railway system with high-speed trains like the ICE in Germany and the TGV in France. These trains can travel up to 300km/h fast and can cover large distances within the countries in just a few hours. Trains can be considered the largest threat as they offer a variety of advantages over flying. From my point of view it seems that flying is much faster, but on a domestic flight in a European country there is not much of a difference in comparison to trains. The reason for that is that it always takes a while to get to the airport, as they are mostly located further away from cities; check-in and security checks usually require being there at least an hour before take-off. After the plane has landed, it usually takes at least another 30 minutes to get out of the plane, claim the baggage and organise transportation to leave the airport. Railway

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stations on the other hand can be much more easily accessed than airports, there is no check-in and security check required and the destination railway station is generally in a very central location close to hotels or offices that need to be visited on a business trip. Furthermore, trains offer generally great scenery while travelling and also offer more legroom. Most importantly the prices are generally lower than those of prestigious airlines like Lufthansa. Alternatively, travellers could use their own car, which would be more time consuming, but would have the advantage of increased flexibility and having transportation at the destination location and not having to use public transportation or taxis. Depending on the distance, this substitute can be either more costly or less expensive (Jacob & Jaksova 2003). Moreover, short international trips to major European capitals are often done by bus and also by ferry if it is a trip to the United Kingdom. From my experience this is the most inexpensive way of travelling throughout Europe.

However, there is no real substitute to flying if the desired destination is overseas. The only alternative to planes would be ships and unless the customer is looking for a relaxing trip on the oceans, it will just take too long to reach the destination.

Recently there is also a tendency of larger companies towards purchasing corporate jets rather than flying first class. According to Costa et al. (2002) corporate jets might reduce first class traveller by 10% by 2005.

#### **4.5 Competitive rivalry**

Highly competitive industries are generally less profitable as the cost of competition is high or customers are receiving the benefits of lower prices.

Competitive rivalry is affected by industry growth, brand identity, fixed costs, as well as barriers to exit (Wheelen & Hunger 2000, p. 63).

It can be said that the airline industry is highly competitive and that industry growth is fairly moderate with airlines struggling in taking away market share from each other. The barriers to exit are considered to be very high. Planes that are grounded don't earn any returns and it is quite complicated to dispose of these assets. Due to bankruptcy laws, airlines that are in financial stress can often remain competitors for a long time (Del Vecchio 2000).

In Lufthansa's home market, the European airline industry has seen some recent changes with the development of low budget airlines that compete with the more mature airlines. Additionally, recent airline crises like September 11 put even more pressure on all competing airlines. This leads to a process of consolidation and the creation of strategic alliances. Airlines within one alliance don't tend to compete directly with each other anymore, which lead to a slight decrease of the pressure (Jacob & Jakesova 2003).

By utilizing a range of strategies a company can have an effect on the five forces of competition and thus reform the attractiveness of an industry. Historically, various strategies shifted the principles of competition and future events like war or new inventions are likely to reshape the airline industry again.

Lufthansa's ability to be very cost effective is also of advantage. As part of its strategic change, Lufthansa implemented ' Program 15', a strategic cost management program. The goals of this program included an improvement

of the competitive position through a reduction in cost, internationalisation of cost-structure and making staff conscious of reducing costs in their daily work. This cost management contributed substantially to Lufthansa making profits again in 1999 (Bruch & Goshal 2000).

Generally it can be said that Lufthansa's change management during its crisis was outstanding. Its management was able to identify the signals for the potential problems, showed great strategic leadership through CEO Jürgen Weber and transformed the organization into a profitable company. This experience in strategic change management is very valuable and will surely help the organization with any challenges in the future (Bruch & Sattelberger 2001b).

Furthermore, Lufthansa's management is very conscious of the need for innovation and customer service. They developed the 'brand ambassador concept' where employees with use of personality and dedication create brand loyalty through day-to-day interactions with the customer (Rubens 2004).

They recently also introduced a range of innovations and quality improvements at their passenger airlines and some innovations will be implemented in the near future. A special focus is on the business class on long-haul routes as this segment is the most profitable one. The key feature of Lufthansa's new business class is a technically sophisticated seat that converts into a flat bed, which is 2 meters long, the longest bed in this class (Manuelli 2003). Lufthansa is also the first airline in the world that offers broadband Internet access on board its planes (Anonymous 2003).

On the ground, they are also improving procedures for their status customers with Lufthansa's Priority Service by relying on the Internet, mobile phones and check-in terminals simplify reservations and ticket sales as well as to reduce check-in times. A good example of Lufthansa's innovative strength is their new terminal at Munich Airport, which was build to optimise operational procedures. In accordance with the best international standards they reduced the minimum connecting time to 30 minutes (Lufthansa Annual Report 2003).

An additional strength of Lufthansa is that it has a policy of operating a young and modern fleet. They recently started a fleet renewal program in 2003 and by 2005 they will replace older aircrafts with ten new Airbus A340-600 jets, as well as ten new Airbus A330-300s. By 2007 the new Airbus A380 super jumbo will go into service that can carry 40% more passengers than the currently largest aircraft. The average age of Lufthansa's fleet is just under 9 years, which puts them into a good position in comparison to airline world average of almost 15 years (Lufthansa Annual Report 2003).

Another strength, which gives Lufthansa a comparative advantage, is the use of a premium executive jet service on North Atlantic routes like Düsseldorf-Newark and Munich-Newark. This involves flights in Boeing and Airbus aircrafts that were remodelled so they fit 48 business class seats only and no economy class. Lufthansa introduced this service, because they identified that these routes were in high demand for business class travellers (Ghazvinian & Fragala 2002).

Lufthansa also offers a very good website that has a lot of features the customers can utilize. Online bookings have more than doubled in 2003. Lufthansa are also constantly expanding their destinations, which can be reached with 'etix', the company's electronic tickets that offer convenient paperless travel. The number of passengers that use 'etix' is gradually increasing as it can be used to fly to 70 per cent of Lufthansa destinations (Lufthansa Annual Report 2003).

Lufthansa's Miles & More customer loyalty program is also a great tool to encourage customers to fly Lufthansa again. The program has grown in popularity since it was introduced ten years ago and developed into the leading frequent flyer program in Europe (Miles & More).

Furthermore, Lufthansa is one of the founding members of the Star Alliance, the world's leading airline alliance. The alliance was voted "Alliance of the Year" in 2003 on three different occasions (Lufthansa Annual Report 2003).

The Lufthansa group consists of seven independent subsidiaries. Lufthansa centrally coordinates their strategy development process. A principal element of the Lufthansa group is clear customer-supplier-relationships between the seven companies. However, the relationships between the individual companies are a weakness, as they don't function as planned. Lufthansa has not reached the required relationships for a market-based internal coordination. So far, the internal customers don't act as normal customers yet since the demand conditions, which they would never demand with other external business partners (Bruch & Ghoshal 2000).

Another weakness is that the openness for change has almost vanished since Lufthansa's amazing turnaround was achieved. During the turnaround, changes were implemented very quickly, but today it takes a very long time for small innovations to take place. Lufthansa also admits not to be perfect in the areas of punctuality, luggage safety, waiting periods, technical reliability and telephone availability, but is in the process of improving this situation (Bruch & Ghoshal 2000).

Another weakness could be that Lufthansa does not do anything about their low-budget competitors in the European market. Lufthansa's management claims that they would not start a low-fare airline under its name, as it would cannibalize its own traffic and damage its brands (Anonymous 2002).

## **5.0 Economic strategy of Lufthansa**

According to Hitt (2003, p. 122), a Economic strategy is an integrated and coordinated set of commitments and actions the firm uses to gain a competitive advantage by exploiting core competencies in specific product markets.

The literature suggests that there are a number of different business-level strategies. However, I believe that in the case of Lufthansa an integrated cost leadership/differentiation strategy is used. The reason for this is that Lufthansa operates globally and therefore it is vital for them to implement cost leadership strategies as well as differentiation strategies in order to develop competitive advantages.

Lufthansa's " Program 15" serves as a good example of a cost leadership strategy. After Lufthansa had undergone privatization they implemented this  
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extensive strategic costs management program with the goal of reducing overall unit cost by 20% within five years (Bruch & Sattelberger 2001a).

In terms of a differentiation strategy, Lufthansa constantly tries to come up with a range of innovative ideas to stay ahead of the competition. A list of these ideas could be seen in the strengths section of my SWOT analysis of Lufthansa.

It can be concluded that Lufthansa has made the right decision to implement an integrated cost leadership/differentiation strategy, since the literature also suggests that there is a relationship between the successful use of this strategy and above-average returns (Hitt 2003, p. 135).

### **5. 1 Corporate-level strategy of Lufthansa**

According to Hitt, a corporate level strategy involves specific actions by a company to gain a competitive advantage by having a group of different businesses competing in several industries (2003, p. 183).

In the case of Lufthansa, the organisation consists of seven economically independent subsidiaries that include LH Passenger Service, LH Cargo AG, LH Skychef, LH Ground Services, LH Technical Services, Thomas Cook Travel Agency and LH IT services. The individual Lufthansa companies are quite successful. LH Technical services, LH Skychef and LH Ground Services are number one in their market (Bruch & Ghoshal 2000).

Product diversification, a primary corporate-level strategy deals with the scope of the industries and markets in which the company competes in addition to how managers buy, establish and sell different businesses to



equal skills and strengths. In regards to Lufthansa, the organisation uses a related diversification corporate-level strategy which means that Lufthansa generates more than 30% of its sales revenue outside a dominated business and its businesses are related to each other since Lufthansa centrally coordinates their strategy development process. Lufthansa's motives for such a corporate level strategy are likely to be issues such as taking advantage of economies of scope, sharing activities, transfer of core competencies, and an increase in market power as well as blocking competitors through multipoint competition (Hitt 2003, p. 187).

## **5.2 Strategic Alliances**

While concentrating on internal costs and structural redevelopment, Lufthansa also worked on its external relationships by implementing the strategy: 'growth through partnerships' (Bruch & Sattelberger 2001b).

While in other industries globalization triggered a wave of mergers of companies that operate internationally; airlines had to look for alternatives because national ownership regulations do not allow cross-border mergers. No airline worldwide has the capacity infrastructure to offer a suitable network by itself. Only through cooperating and alliances can the industry cater for the mobility requirements of the world economy. Therefore, founding the Star Alliance was a logical consequence and Lufthansa was one of the key-founding members of the first airline network in the world (Global Network - Five years of Star Alliance).

The purpose of the Star Alliance is to realize higher revenues and decrease costs by exploiting synergy effects. The synergies range from shared use of

ground facilities like check-in-counters, a city office in Paris and also airport terminals. At the airports in Frankfurt, Copenhagen, Shanghai and Beijing the Star Alliance has its own check-in area with staff member of partner airlines. In addition the first Star Alliance Lounge went into service 2001 at Zürich airport.

Other advantages include common frequent flyer programs, joint travel agency contracts collective market research and joint purchasing of materials and equipment (Economic effects for the airlines).

Alliance members can also use code sharing - a system by which two or more airlines agree to use the same flight number for a flight in order to attract more business by means of extending their networks through partner airlines (Collis 1998).

Besides cost-saving synergies, the combined networks of Star Alliance members also offer many customer benefits. In comparison with other industry alliances, the Star Alliance is the recognized market leader (see Appendix 2). For 82 % of all offered flight connections, the Star Alliance is the fastest network. Every four seconds an aircraft of the Star Alliance starts or lands somewhere in the world and it possible to fly once round the world in 36 hours with Star Alliance airlines. Other fundamentals of its brand value include the presence of its members in important home markets and large international hubs, a high degree of customer recognition, excellent service and good cooperation between the frequent-flyer programs of the individual airlines. Furthermore each airline has its individual strengths with a strong market position in its home bases and regional hubs like Lufthansa in

Germany. Due to the good cooperation, a whole network of these hubs was established and regional strengths complement each other (see Appendix 3). Additionally, most members also have regional alliances with smaller airlines, which improve the Star Alliance network even further (Global Network – Five years of Star Alliance).

Research has also shown that alliances result in lower ticket prices and more flight connections. It is suggested that there is a price advantage of an average 6% in comparison with conventional tariffs. In terms of the Star Alliance this leads to estimated passenger savings of between 50 and 82 million dollars per year.

Additionally due to the sharing of terminals service counters of the airlines are more easily seen and found and walking distances are decreased. Having counters in the same area at airports also creates a single contact point and improves changes and baggage loading. Staff members of partner airlines can also help and advise customers with enquiries on behalf of the entire alliance.

For the alliance to work properly certain level of quality needs to be ensured. This is achieved through frequent mutual quality checks. Jointly agreed quality standards in the areas of security, services and environmental protection are checked on a regular basis (Global Network – Five years of Star Alliance).

### **5. 3 Strategic Leadership and German Culture**

Strategic leadership, which is ' the ability to anticipate, envision, maintain flexibility and empower others to create strategic change as necessary' (Hitt <https://assignbuster.com/lufthansa-marketing-analysis-swot-and-pestel/>

2003, p. 386) was extremely important in Lufthansa's turnaround. The main responsibility for effective strategic leadership generally rests at the top, especially with the CEO, but also with other recognized strategic leaders like members of the board of directors and the top management team. In the case of Lufthansa, the formulation and implementation of strategies was also in the hands of the top-level management, in particular Dr. Jürgen Weber, who was Lufthansa's CEO at the time.

In 1992 Jürgen Weber realized the full extent of Lufthansa's problems and called for a " crisis management meeting" with 20 carefully selected senior managers. The outcome of this meeting was " Program 93", 131 key actions aimed at drastically cutting about 8, 000 jobs, lowering non-personnel costs, reducing the aircraft fleet as well as increasing revenues by DM 700 million to reduce the losses of DM 1. 3 billion. The Executive Board then appointed a number of different teams that had the task to achieve the implementation of these 131 projects. Line management was responsible for the implementation of the staff cuts. It was seen as important for the success of " Program 93 that line managers took that responsibility to realize the unavoidable cuts, on the one hand, but also to motivate the remaining employees, on the other hand. Jürgen Weber also created the OPS team (Operations Team) as a forceful engine in the process of implementing the 131 actions. They constantly monitored, created activities, advised and supported the line managers who were ultimately responsible for the implementation process. Weber showed his total support for the OPS team and personally supported them in many ways. He also implemented visible

actions like a 10% reduction of the salaries of all Executive board members (Bruch & Ghoshal 2000).

Furthermore, to convey and spread these actions, Lufthansa implemented Town Meetings, which were initially an idea by General Electric. A typical agenda of a Town Meeting would mainly involve a talk with the particular Lufthansa unit's management about problems and plans. An extensive dialogue then follows with the employees where the top-management explains latest plans and also listens to the concerns and suggestions of staff members. Jürgen Weber decided to hold as many