

Sample term paper on strategy

[Business](#), [Company](#)



JetBlue Airways Corporation is an American airline which provides low cost, but high quality services by imposing advance technology and effective customer service. The airline was founded in 1998 and is headquartered in Long Island City nearer to New York City (JetBlue Airways).

The fundamental business strategy is cost leadership and differentiation.

JetBlue Airways has aggressively cut down the cost without neglecting the quality and comforts that customers want. Company aimed to develop efficient cost structure which supported low fare rates with standard quality services. The fares offered by company are almost 50% lower than other airlines. For instance, a trip from Florida to New York is priced at \$500 by large airlines while JetBlue Airways charge \$140 only, accounting customers to purchase a ticket in seven days advance. This decision benefited the company to gain cost leadership during incorporating innovation and quality services for its customers such as e-ticketing, and in-flight leisure.

Management also decided to eliminate meal service on the flight in order to reduce the cost regardless of flight duration. The reason behind its success is its differentiation along with cost leadership that attracted the potential customers and sustained the customer base. However, this strategy seems to be unsustainable for a longer period as the business has now moved from startup stage. Currently, company has to struggle to maintain its value while encountering intense competition in the industry since many companies are replicating the same business model as of JetBlue Airways.

The company has certain strengths that give an edge over its competitors. The major strengths include:

- Low cost of operations
- Efficient human resources
- Valuable and quality customer services
- Use of hi-tech and advance technology in its operations and customer services

Nevertheless, JetBlue Airways faces up to numerous weaknesses due to increased competition, which includes:

- Weak financial exposure
- A new company as compared to other large and experienced players
- Company has been employing particular fleet only

FINANCIAL ANALYSIS:

JetBlue Airways is a passenger airline, which consists of 49 EMBRAER 190 and 120 Airbus A320 aircrafts that render services on point-to-point routes.

To analyze the financial performance of the company, the company's financial statements has been examined, thoroughly, while observing the growing or declining trends in its income statement, cash flow statement and balance sheet over a period.

The income statement of the company depicts that revenues have increased significantly by 9. 21% that has reached to \$5441 million in 2013, consequently boosting net income by 31. 25% from \$86 million in 2011 to \$168 million in 2013 (Financial Times a), as shown in graph below:

(Financial Times a)

(Financial Times a)

Moreover, JetBlue Airways has improved its cash reserves from \$-491 million to \$43 million during 2012-2013 which represents the increment by 23.63%, as presented in the graph below. This improvement is because of less use of cash in investing and financing activities that are \$476 million and \$239 million respectively in 2013 as compared to previous years (Financial Times a). However, company has successfully generated \$758 million from its operating activities (Financial Times a).

(Financial Times a)

Balance sheet of JetBlue Airways signifies that its assets have increased to \$7350 million in 2013 from \$7071 million in 2011 as company has reduced short-term investments and cash holdings. Moreover, liabilities have declined to \$5216 million representing slight reduction in company's debts (Financial Times a).

Financial gearing ratios depicts that JetBlue Airways is encountering an adverse situation means there is a high risk that the company cannot efficiently pay off its debts as its debt-to-total assets and debt-to-equity depict ratio of 0.71 and 2.44 respectively (as shown in appendix).

Comparatively to its major competitors, the ratios are higher. Moreover, company is highly geared and largely relies on borrowings for a major part of its capital. JetBlue Airways showed the profitability ratio of 3% in 2013, attributed to improved net income, profit margins. While competitors like Allegiant Travel Co. and Spirit Airlines Inc has shown profit margin of around 10% (Financial Times b, c). Also, profit generation by employing total assets and total equity is relatively low, presenting ratios 2% of ROA and 8% of ROE (as shown in appendix). This ratio represents that company is making profit

from its assets and equity but with a slower pace than its competitors. However, company's liquidity position is quite vulnerable, representing current and quick ratio of 0.56 and 0.54 which is below its industrial average of 1.5 (as shown in appendix).

CORPORATE FINANCE:

The capital expenditure of JetBlue Airways is increasing and is expected to increase in coming years as company has planned to purchase new aircrafts and expand its operation by qualifying its services more efficiently than its previous records. Company has accounted the capital expenditure of \$365 million in 2013 for 3 Airbus A320 aircraft, 7 highly advanced EMBRAER 190 aircraft and 4 Airbus A321. Moreover, its investing activities include the net purchase of \$161 million in investment securities. Now, company has planned to buy 9 Airbus A321 in 2014 during 12 in 2015 and 2016 and 3 additional Airbus A320 in 2016. Similarly, company continues to expand more on aircraft purchases in coming years. Company is expected to increase its due payments in long-term debts and capital lease obligations and flight equipment obligations. Company will need to undertake the expansion activities by improving its operational activities in order to raise funds to overcome its debts and, on the other hand, raising funds while accessing to capital market.

The company has reduced the total debt balance by \$570 million since 2009, and will continue to decline, in order to meet the obligations. Initially, company will focus on deploying available cash to pay off its debts and expand operations that will ultimately improve shareholders' returns and increase the balance sheet. Majority of the capital expenditure will be

balanced by effective cost control by the company; while, maintaining a competitive cost. Its competitive cost will be maintained by adopting differentiation and cost effective strategies which are competitive in the industry. Moreover, it is anticipated that new product offerings like Fly-Fi and Mint will further improve the revenue based performance. As the debts are decreasing despite expansion, company will report decrement in interest expense and financial risk in business.

In addition, if company fails to meet the debts and various fixed obligations, in that case company will look for obtaining additional equity and access capital markets to raise funds. In other case, company will issue covenant or restrict its operations to perform efficiently in coming years. Since, it is essential to maintain balance between debt and equity. Declining debts to zero will also create a gap and increase the cost of equity as company will increase its financing through equity only. Company can raise its funds by issuing securities to public, to balance the gap.

MANAGEMENT:

Structure of compensation package is significant to attract, appoint, and retain employees in an organization. The strategies like rewards, and individual recognition are necessary to implement effective compensation structure. Salaries and benefits are the second largest expense, accounting for 23% of total operating expenses in the year 2013. Company offers attractive compensation packages to its employees, crewmembers, and pilots. As of 2013 statistics, total compensation of JetBlue Airline is accumulated to \$8, 563, 327, which has reported the increase of around 20. 21% over the last year (Morning Star, a). The following chart represents the

increasing trend in total executive compensation over the period of five years.

(Morning Star, a)

Moreover, the annual salary of CEO and president of the company is reported as \$8, 563, 327 in 2013 which has increased from the previous year that is \$7, 123, 449. CEO compensation is representing the increase by 24. 59% (Morning Star, a). If the compensation rate is compared with its competitors like, Southwest Airlines Co., its can be clearly seen in the chart that company's total compensation has declined to \$11, 903, 928 accounting for 12. 21% decrement in compensation (Morning Star, b).

(Morning Star, a)

Its compensation package for executives has increased to \$11, 903, 928 in 2013 from \$11, 643, 758 in 2012, which signifies the slighter change in one year period. Similarly, the compensation for CEO of Southwest Airlines Co. has enhanced to \$4, 036, 167 in 2013 from last year's \$4, 031, 359. The compensation increment indicates only 0. 12% increase in one year. This increase signifies that company is compensating its employees, especially CEO of the company with suitable packages in order to retain them and attract more potential employees (Morning Star, a).

As of JetBlue Airways' annual report, company mostly relies on share-based compensation for CEOs. This structure may discourage their expertise and skills as they will be paid according to the proportion of their shares in the company. Compensation structure must have effective alignment with company's goals related to revenues and returns. If CEOs are paid based on

the impact based compensation either long-term or short-term, this will increasingly improve the company's overall performance.

VALUATION:

In order to identify the value of the company, discounted cash flow method has been used. Discounted cash flow determines the value of the company today while making the estimations of how much cash the company is going to generate in coming years. Discounted cash flows analysis of the company depicts that company is having enough cash that could attract the investors in the future. JetBlue Airways' discounted cash flow is calculated as \$0.31484012 per share (as shown in appendix). This figure signifies that the share must be valued as according to discounted cash flow which is \$0.31484012 per share (as shown in appendix). It is reported as \$10.89 considering the stock price value of the company. This figure depicts that share value is much greater than discounted cash flow per share. The share of JetBlue Airways is overvalued in the market. The share value must maintain the rate of \$0.31484012 in order to be effective. This overvaluation may have resulted from an emotional buying spurt that increases the prices of stocks in the market or may have resulted due to weaker financial position of the company in the industry.

HEDGING AND JET BLUE:

Hedging is a method to manage risk associated with investment in the derivatives markets. Companies hedge them in order to reduce their risk. Large companies are risk averse as they invest personal assets and labors in the company. The risk is undiversified; therefore, they hedge. To decline

estimated bankruptcy costs is another reason so as to avoid transfer of assets to third parties. Thirdly, companies can be undiversified in terms of products and geography and may not have access to capital markets. In this case, companies transfer risk to risk bearers that are well diversified and have good access to capital markets. Companies hedge to obtain the optimal mix of equity and debt financing. Companies transfer the risk to other firms and further take more debts for operations. Hedging also reduces tax liability as most of the insurance policies are tax deductible. Moreover, companies also hedge to decrease some information asymmetry issues. As companies, today compete in the global market; they hedge financial price risk to develop competitiveness of the company.

Fuel prices have a severe impact on airline operations including decline profits, increase forecasted budgets. Airlines should hedge their jet fuel prices that allow diminishing price exposure and hence controlling their fuel costs. An airline's operating cost can be affected by 25-40% due to fluctuating jet fuel prices. Another reason is price competition in the airline industry. Airlines can gain considerable competitive advantage by hedging commodity price risk. However, airline should hedge some proportion of exposure rather than all.

Jet fuel swaps are normally used hedging tool in this particular industry. Swaps are contracts in which airline company agree with the bank or any oil company to exchange intermittent payments considering the spot market price of jet fuel in a particular market. Most commonly, fixed price of jet fuel is set that airline company pay for a specific period. By making this payment to the counterparty, that agrees at floating price of jet fuel and hence

indicate the spot market. In this case, future prices are published by independent publication.

Another method used is call options, in which holder has the right (not obligation) to purchase particular amount of fuel, at placed prices in a particular period, which in turn pay an upfront premium. It is more like an insurance agreement, which disburse if fuel prices increase more than contracted price. Similar airline disburses upfront premium for call option, apart from whether company has received payment from option or not (Corley).

Collars, such as caps, are also used to avoid the effects of increment in jet fuel prices, since the highest price payable is placed. In this strategy, lowest price is also set in which airline company cannot take advantage from decrement in prices below lowest set price. An upfront original premium payment may not necessarily require depending on the structure of the collar. They are also taken as cost transaction (SDGM).

The hedging tools used by airlines depend on various factors as market structure, liquidity, cash availability, budget, company's strategy of risk management and trade. Airline use basis swap for lasting hedges. Combining heating oil swap, to initially hedge fuel prices, with a basis swap will give an advantage to match its hedge to its actual physical experience (SDGM).

JetBlue Airways should use jet fuel swap and caps agreements as fuel hedge contracts. Also, company can use fixed forward price contracts in which fixed prices will be paid for a particular quantity to be brought at a future date.

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APPENDIX