

# Accounts, airlines and exam success

Phil Waterhouse shows how an understanding of accounts and external influences can lead to more marks in your business exams

One of my students recently showed me the Flightradar24 app. Seeing how many aircraft are in the air at once really makes you appreciate why the role of air traffic controller has a reputation for being one of the most stressful jobs of all. At any one time, there are over 500,000 people airborne and in a 24-hour period millions of people will take a flight on one of the 200,000 scheduled services.

Michael Porter identified aviation as a business area with a relatively low level of profitability. Given the competitive nature of the airline industry, in terms of the five forces, it has few aspects working in its favour. However, it is of huge importance to A-level business, as it provides a rich source of information that examiners can use to create exam questions and you can use to flesh out your exam answers.

## Accounts and ratios

For the first time in about 5 years, I have found myself teaching financial accounts. Students can be intimidated by anything involving numbers, and tend to glaze over whenever accounts or ratios are discussed. This is a real shame, as these calculations offer up potentially easy marks, putting you ahead of other students. Financial accounts also provide you with a superb insight into the nuts and bolts of a business. While there is some window dressing, and historical accounts are often out of date, fundamentally, if you want to understand a business, you start with the accounts. Any plc or charity is legally obliged to publish their accounts

to the general public, at least once a year, and these can easily be found online.

Table 1 shows extracts from the accounts of both EasyJet and Ryanair for the years 2016 and 2017. From these extracts, you should be able to calculate these four ratios:

$$\text{Operating profit margin} = \frac{\text{Operating profit}}{\text{Revenue/Turnover}} \times 100$$

$$\text{Return on capital employed} = \frac{\text{Operating profit}}{\text{Total equity + Non-current liabilities}} \times 100$$

$$\text{Gearing ratio} = \frac{\text{Non-current liabilities}}{\text{Total equity}} \times 100$$

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

While you won't be given the formulae in the exam hall, and they will take some revising, as long as you have a calculator to hand you should be able to pick up fairly basic knowledge marks using these ratios.

These ratios can be used to compare the performance of the airlines on a year to year basis and against each other. You might have noticed that EasyJet publishes its figures in pounds sterling (£) while Ryanair publishes in euros (€). Therein lies the fundamental advantage of ratio analysis — by converting figures into percentages it becomes much easier to compare the two businesses.

Table 1 EasyJet and Ryanair accounts

	EasyJet 2016 (£m)	EasyJet 2017 (£m)	Ryanair 2016 (£m)	Ryanair 2017 (£m)
Revenue/turnover	4,669	5,047	6,536	6,648
Operating profit	510	404	1,460	1,534
Total equity	2,694	2,802	11,218	11,990
Current assets	1,442	1,734	4,822	4,706
Current liabilities	1,569	1,670	3,370	3,011
Non-current liabilities	1,221	1,499	4,252	4,555

As a revision exercise, you should check that you can calculate the ratios for the respective years and for the different firms. A typical exam question will ask you to judge which company is performing the strongest. Examiners are looking for you to make a judgement and justify why one firm is better than another — ratios and numbers help you to do this and are therefore a vital part of the toolkit for any A-level student.

## External influences

The numbers will only take you so far. You need to think about other external aspects that will impact on the business. A past exam question asked you to judge whether the success of an airline was more down to internal factors or external factors, and this is where you would need to realise that the financial ratios only cover part of the story.

PESTEL factors are a fundamental part of any business specification:

- political
- economic
- social
- technological

- environmental
- legal

The PESTEL factors have a huge impact on airline businesses. They are arguably as important, if not more so, than internal influences. All firms must consider them when deciding on a strategy and future path for success.

However, remember that in an exam hall, you simply won't have time to consider all the factors when writing a response. It is far better to analyse two or three of the influences in detail than simply bullet-point how all of them impact the business in question.

## External influences on airlines

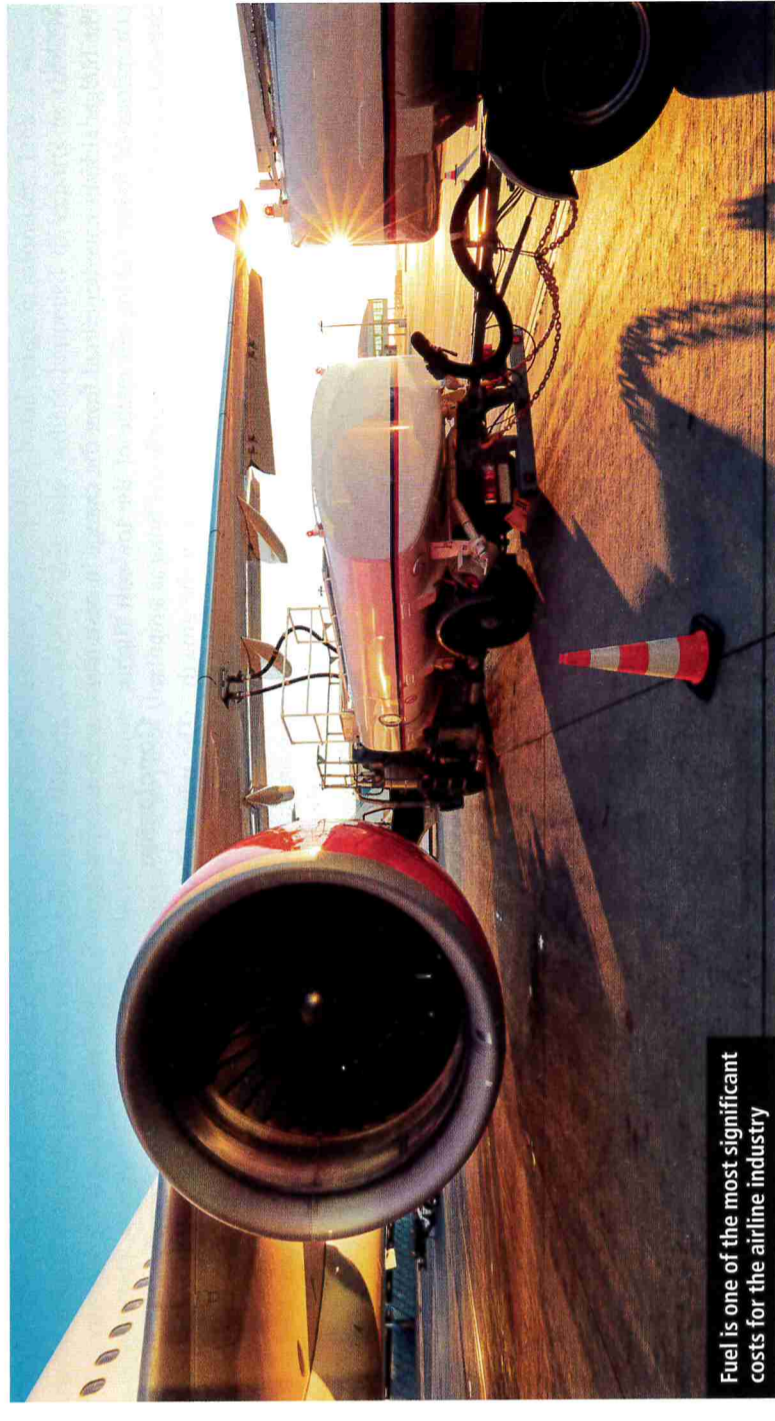
### Political

The impact of the UK referendum on leaving the European Union has caused issues for airlines. Following the referendum, the consultation period has resulted in significant uncertainty as to how businesses registered in the UK will be able to meet the challenges of not operating within the customs union.

Ryanair faces less risk, as it is registered in Ireland. UK-based EasyJet has had to come up with a contingency plan, and has already set up a separate arm of the company called EasyJet Europe, with a base in Geneva. If the negotiations do not go as planned, then the likelihood is that the firm will relocate its operations to a new headquarters within Europe. This will have an impact on jobs within the UK and could lead to negative PR for the company, which could result in lower sales, although this is unlikely as the business has built up a good reputation and customer loyalty.

### Economic

Following the decision by the UK to trigger Article 50, the value of sterling has fallen significantly. A weaker pound means that imports become relatively more expensive and exports relatively cheaper. For the airline industry, aviation fuel is one of the largest



Fuel is one of the most significant costs for the airline industry



Flying is now seen as a regular form of transportation

and most significant costs. While the airlines aim to 'hedge' against currency fluctuations by buying the fuel on the futures market, higher fuel prices will lead to higher costs.

The airlines would either have to pass these costs on to customers through higher prices, or keep prices constant and accept lower profit margins on their flights. The latter is the most likely option, given the competitive nature of the industry.

The EasyJet accounts published in November 2018 suggest that the cost per passenger (including fuel costs) was £55 and the average revenue per passenger was £61, giving a profit per passenger of £6. If costs were to increase, profit margins would be squeezed.

#### Social

The budget airlines have benefitted from the change in customer perceptions of flying, taking advantage of the low-cost flights between cities. The fact that so many people see flying as a regular and normal mode of transportation has resulted in the growth of the industry.

Only certain firms have the internal management vision to make this work profitably, and this is an area where EasyJet and Ryanair have excelled. Competitors such as BMI have fallen by the wayside. The economies of scale that the two firms have exploited and their continuous drive to be leaner and more efficient than rivals are big factors in their success.

#### Technological

Both EasyJet and Ryanair have invested considerable amounts of money in IT and in more streamlined and efficient websites and apps, which the modern consumer expects to use when making a booking. If the number of clicks and minutes spent on booking a flight can be reduced, it is likely that there will be more repeat custom. Both firms have recognised that the ease of use of technology, booking flights on your smartphone or tablet and downloading your boarding pass onto your device is an important part of their service.

#### Environmental

The low-cost airlines are viewed as significant polluters and contributors to global warming. How they will respond to this is interesting. What could be a negative can be turned into a positive with clever PR and marketing of how the firms aim to offset this pollution by adopting a greater focus on corporate social responsibility (CSR).

#### Legal

UK aviation is governed by the Civil Aviation Authority (CAA) and its ATOL protection scheme. The regulations and restrictions on firms in such an important transport industry are significant. While legal requirements potentially add costs due to the need to abide by them, they also serve a purpose in reassuring customers, and are a vital aspect for any firm operating in the industry.

#### Conclusion

The use of financial ratios and the external factors that affect firms are an essential part of any A-level business specification. Comparing the relative importance of internal vs external factors allows you to come to a decision and make an evaluative judgement.

In my opinion, the ultimate judgement in relation to the airline industry is that while the external factors must and should be considered and used when identifying the future direction of the business, the most important factor is always how well run the business is from within. Arguably that is why EasyJet and Ryanair, while facing many challenges over the years, remain at the forefront of the industry. This is not easy when the external pressures are significant, but with strong leadership and management, they have coped and dealt with these pressures better than their rivals.

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