

**2009**

Aeroflot  
Company

# **INTERNAL ANALYSIS OF AEROFLOT**

HAN University • Arnhem • February 2009

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## Chapter I • SWOT analysis

### 1.01 Strengths

- Aeroflot is one of the longest-established airlines in the world and one of the best-known brands in the business.
- Aeroflot is a member of the SkyTeam global alliance.
- In 2007 Aeroflot successfully obtained renewal of its IOSA (IATA Operational Safety Audit) certification, confirming its compliance with new tougher IOSA rules.
- Aeroflot showed strong operational and financial results in 2007.
- Aeroflot's reputation for dependability also played an important role: the Company's quality management system and flight safety match the highest international standards.
- Aeroflot is leader on the Russian air transport industry.
- Aeroflot agrees fixed price formula for jet fuel with Russian oil companies.
- Aeroflot has unique product which competes successfully with its European competitors- Aeroflot Bonus

### 1.02 Weakness

- Aeroflot management should pay more attention to its subsidiaries' pilot training and technical services<sup>1</sup>.
- Aeroflot isn't active at small regional airports.
- The lack of systems providing customers' feedback does not allow the company to focus completely on the changing demand.

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<sup>1</sup> [http://vtbcapital.ru/upload/iblock/1ac/mc080915\\_abr.pdf](http://vtbcapital.ru/upload/iblock/1ac/mc080915_abr.pdf)  
<http://www.m-travel.com/news/2008/07/demographics-in.html>

### 1.03 Opportunities

- Expecting steady growth of 4.7% on domestic passengers which is a major positive for air carriers in general<sup>2</sup>.
- A new terminal for VIP aviation may be constructed in Pulkovo, St Petersburg. The project is estimated \$100 million.
- Aeroflot intends to bid in a tender for privatising Czech Airlines<sup>3</sup>.

### 1.04 Threats

- High aircraft fuel costs
- Aeroflot will be suffering from the consequences of the latest crash as well as the regulatory restrictions, which, is being imposed to support the new state-owned airline created by Rostekhnologii.
- The Russian government has cancelled import duties on civil aircraft seating up to 50 for nine months<sup>4</sup>.

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<sup>2</sup> [http://unlease.ru/download/2003\\_June\\_16-17\\_Medzhibovsky\\_Ilyushin\(Eng\).pdf](http://unlease.ru/download/2003_June_16-17_Medzhibovsky_Ilyushin(Eng).pdf)

<sup>3</sup> <https://www.uktradeinvest.gov.uk/ukti/ShowDoc/BEA+Repository/345/427797>

<sup>4</sup> <https://www.uktradeinvest.gov.uk/ukti/ShowDoc/BEA+Repository/345/427797>

### 1.05 Conclusion

Aeroflot provides its passengers with very high quality of service. Aeroflot mainly aims at business passengers and it is essential that one of the main keys to brand loyalty is quality of service. It provides its passengers with tasty food; the distance between rows is bigger than in competitors' planes, staff offers you duty free goods. All the seats are made from leather and business class is extremely comfortable.

Brand Image. Aeroflot is the oldest airline company in Russia. Most people when speak about Russian civil aviation mean Aeroflot company. More than that, Russian government holds 51% of company's shares and that fact also adds value to the Aeroflot's Brand Image.

Sky Team alliance. Aeroflot has entered Sky Team Alliance in 2006. That helps company to wide its routes network, providing passengers with 841 Destinations in 162 countries.

Good financial performance. Having a look at financial indicators of Aeroflot over the last years we can conclude that company brings good profit to its shareholders and profit growths every year (21.4% over 2007<sup>5</sup> and 36% over 2006<sup>6</sup>).

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<sup>5</sup> [http://old.aeroflot.ru/eng/attach.asp?a\\_no=2367](http://old.aeroflot.ru/eng/attach.asp?a_no=2367)

<sup>6</sup> [http://old.aeroflot.ru/eng/attach.asp?a\\_no=2058](http://old.aeroflot.ru/eng/attach.asp?a_no=2058)

## Chapter II • the 7S Model

### II.01 Strategy

The main strategic goal of Aeroflot Airlines is to develop an international class company based on the best traditions of Russia's aviation. The company strives to achieve this goal by developing a number of strategies in order to meet both the internal and the external factors that may influence the achievement of their goal.

The strategies they have developed are the following:

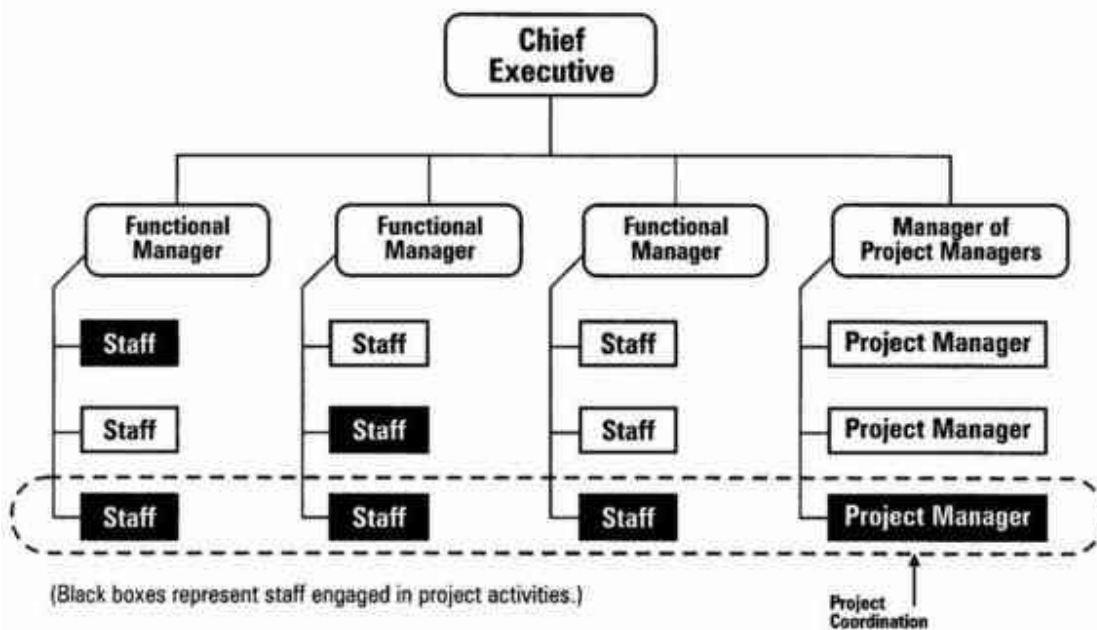
- Providing passengers transportation to most large cities in the world by establishing its own system of routes both convenient for passengers and cost efficient as well as to co-operate with airline partner companies. This strategy is designed in order to overcome the competitive advantage of a number of European Airlines such as Air France and British Airways and strengthen its image and leading position in Russia and Eastern Europe.
- To provide passengers with stable service quality on the level of its competitors or even higher
- To reach the level of production and economic indicators of the members of the Association of European Airline Companies and to establish an effective system of relations and co operations inside Aeroflot and to international airlines and associations.

These strategies are set in order to increase the market share in the home market; to increase Aeroflot's relative market share in the high-class passenger transportation compared with foreign competitors; satisfying better the customers by developing a network which main principles are focusing on the most profitable segments of the market and the increase of comfortable transfer possibilities; to switch over to up-to-date fuel efficient and more comfortable airline.



**II.02 Structure**

There are three types of organizational structure. Aeroflot Airlines is built on the basis of matrix structure. It is a combination between divisional structure and functional structure. It allows to use the strengths of both the structures, despite the dual authority. However, the organizational structure is very useful to multinational companies such as Aeroflot Airlines.



In the matrix organization, each manager reports directly to the general manager or board of management. However, each manager who reports has his authority and power when it comes to the projects to be implemented.

The basis for the matrix organization is to create synergism through shared responsibility between project and functional management.

- Management

The management board consists of twenty two officers and directors. The chairman from 1997 is Valery Okulov. The other members are directors of Strategic Program Realization, Finance and Planning, Deputy General Directors, transport Support, Management-Flight, Administration, est.

### II.03 Systems

The management systems are modern tools of the corporate management. It aims at the implementation of the potentially possible improving of the products or services which are resented to the customers.

- ISO 9001:2000

The quality system set up by Aeroflot meets the standards of the international quality system ISO 9001:2000. The company's system is called JSC "Aeroflot" and it is a system directed to perfecting the overall performance of the organization, related with safe and regular passenger transportation with the high quality of the services.

- The "Hidden Passenger" method

Its purpose is to estimates the degree of the customers' satisfaction by using various market researches, passengers' inquiries, analysis of messages, est.

- Open Line

It encourages the analysis of the feedback received from the customers and based on which alignments in strategies concerning customer satisfaction.

- IATA

It assesses the performance of the company by comparing it with the performance of the leading airlines in the world.

- IOSA ( International Operational Safety Audit)

It is a harmonized standard of the world wide aircraft industry in the field of transportation and safety. The system constantly maintains, improves and assesses in accordance with the changing requirements of the aircraft branch and regulating instruments.

The other four Ss from the McKinsey model are less tangible and are more cultural oriented.

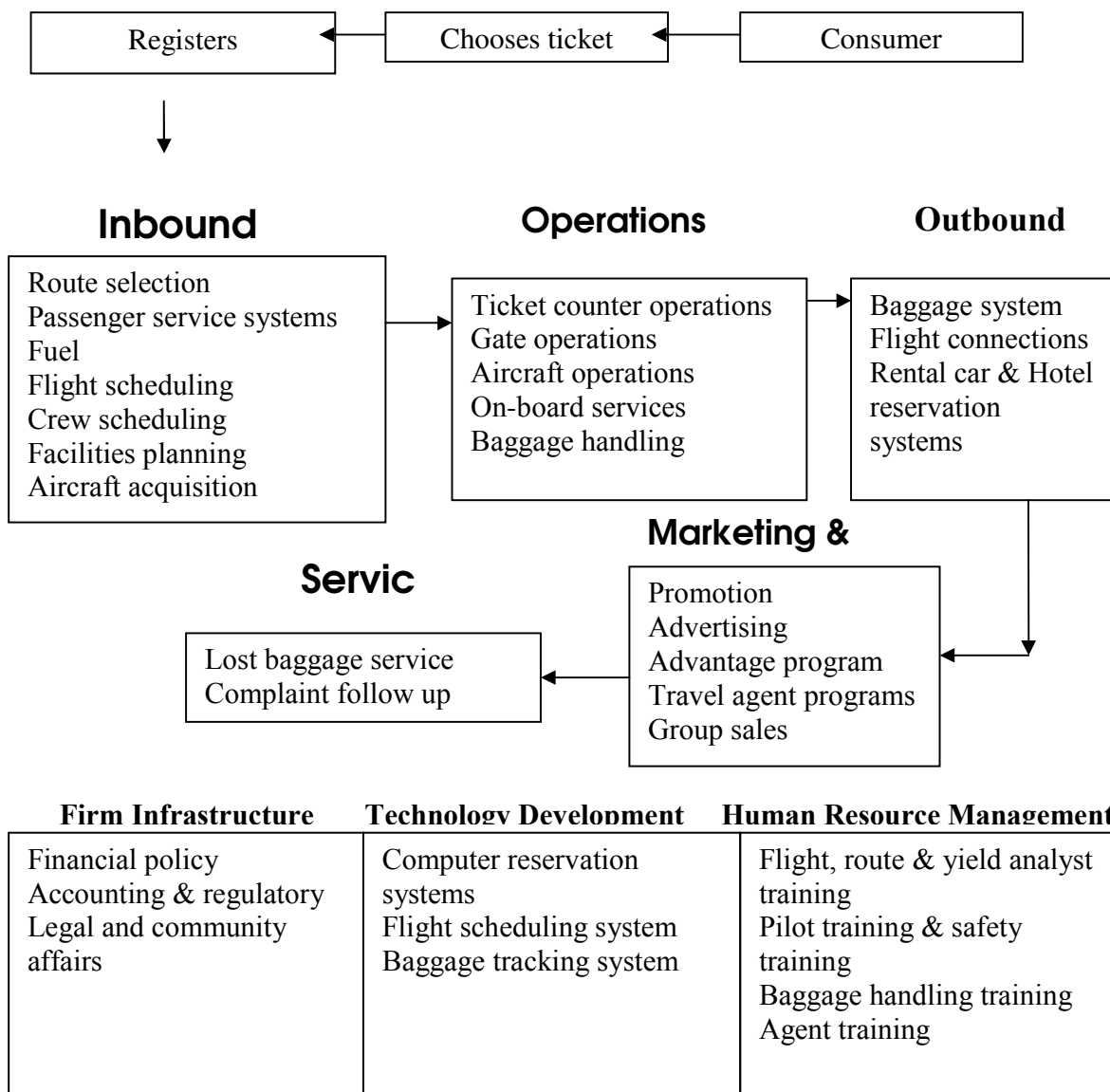
These are:

- Skills: the capabilities that exist within the company;
- Shared Values: all the values and beliefs of the organization;
- Staff: the company's personnel resources and how are they developed and motivated;
- Style: the leadership approach of the top management and the company's operating approach.

However, Aeroflot does not provide sufficient information based on which these could be analyzed.

## Chapter III • Value Chain Analysis

**Inbound** of Aeroflot is controlled in a very proper manner. Aeroflot interact with business consumers and economic consumers, both groups consume during the flight destination. In this case inventory are the regular preparation that is needed before the flight to take off, Aeroflot's suppliers should be on time with delivering of inventory before schedule time to take off. Let's move on into the value chain of Aeroflot, then we can see how each department is interacting with each other therefore is adding value into the chain.



### **III.01 Operation**

Operations consist of receiving the passengers at the entry of the airport, preparation at the gate to board aircraft, passport checking before entering aircraft. Aircraft control checks before departure like for instance examine the plain for defects or problems that could arise during the journey. The onboard services during the flight are operated by the crew members who serve the passengers. The baggage's is placed in the aircraft in order to fly to the destination.

### **III.02 Outbound**

Outbound of Aeroflot consists in operation that occurs when the aircraft arrive on a destination; the baggage is disposed to the baggage lines where the passengers are waiting at the arriving hall to pick up their baggages. Passengers who travel to various destinations may have to take two or more aircraft daily to reach to their destination. Rental car & Hotel reservation system is taking care to distribute the passengers to their final destinations.

### **III.03 Marketing & Sales**

Aeroflot is the leader in development of modern sales methods and distribution channels on the Russian air transport market. The Company has strong working relationships with leading international booking and distribution systems, such as: Sabre Travel Network, Amadeus, Galileo, WorldSpan and the Sirena Travel automated booking system. Aeroflot was the first Company in Russia to introduce electronic tickets and is rapidly developing its Internet sales with every year. The sales system in Russia consists of several elements. This is the Company's own sales channels: representative offices and Aeroflot branches in various regions of the country; the Company's sales offices network in Moscow; a call center for information and bookings via phone as well as their online resources via <http://www.aeroflot.ru>. Agent sales channels include: a network of agencies in Moscow and in Russia region. The network of ticket agencies and of the Company's own offices in Russia and worldwide is very extensive and offers excellent geographical coverage.

### III.04 Services

Aeroflot offer service of lost & found baggage's, the passengers can complain at the department of lost & found desk for their missing baggage's and usually a report is issued accounting the lost baggage and immediately an investigation is handled by the department personnel. For complains about inappropriate services, there is an complains office body meant for customer on the airport or alternatively the passengers could be contacted online via office feedback service provided by the Aeroflot's website.

### III.05 Firm Infrastructure

In order to cut cost and perform effectively, Aeroflot's decided to align the IT strategy with its overall business strategy, with a focus on Aeroflot's infrastructure and organization. Now, base on up-to-date information from the information system, the company is able to interconnect departments and obtain right information to be process and analyse the cost behaviour. By doing this Aeroflot has been able to minimize and hedge the financial risk, using a variety of instruments, such as: fixing of variable interest rates on leasing agreements; calculation and setting of limits on operations with guarantees of bank customers and Aeroflot agents; calculation of personal limits of agents for ticket sales; bank options; price setting in contracts for fuel – pricing, hedging,ect. Although, Aeroflot is spending time in analyze data and cutting cost , it negotiate new hull insurance on aircraft and airline legal liability insurance. The whole renewable insurance system is automated whereby the insurance has to be validating at different department before it is applying to an aircraft. Aeroflot maintain a safety infrastructure by coordinate all organization procedures under validation codes and ranking level, the business model allows Aeroflot to concentrate on the management decisions and strategy without having to worry too much about its financial performance.

### **III.06 Technology & Development**

Aeroflot new online booking service minimizes the cost by reducing paper expenses and focus on E-ticket sales. Base on this automated system, passengers could book tickets through the online reservation system. In the mean time in the reservation procedure Aeroflot's flight scheduling system offers flight choices on the possible flight destinations. This system interactivity makes Aeroflot flexible to manage growth in passenger volume as well as giving cost savings on behalf of customer service. Aeroflot has just recently introduced new baggage tracking system. That is the so called WorldTracer<sup>7</sup> system, it is meant for baggage tracing and tracking, the system facilitates the search for missing baggage's and has proven to significantly reduce the amount of passenger complaints.

### **III.07 Human resource & Management**

Base on routes and flight destination an analysis will be made if there is needed to arrange some trainings for new crew members base on their knowledge on aircraft or because of deficiency on personnel. Aeroflot Pilots are required to reinforce their qualification by training for the sake of better security and safety. Each new bought aircraft includes innovations therefore requiring constant improvements in pilot training programs and the company personnel motivation systems. Sales agents training is a vital item which reflects in sales increases and improvements in agencies infrastructure thus providing them with the latest news about the company services and technologies. By embarking the outlined above enablers, Aeroflot is able to deliver relevant information about passenger accommodation and safety on flights as well as improvements in the service quality and company profits.

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<sup>7</sup> <http://www.evaint.com/article/16/159/Alliance-standards-at-Aeroflot.aspx>



## Chapter IV • Quality of Service

Aeroflot provides its passengers with very high quality of service. Aeroflot mainly aims at business passengers and one of the main keys to brand loyalty is quality of service. It provides its passengers with tasty food and extended product offerings including alcoholic beverages, the distance between passenger seats is bigger than the competitors', whereby all seats are made from leather and in the business class is extremely comfortable.

However, the overall good quality of service is in general in good shape, some customers have reported problems with some of the flights delivered by Aeroflot. Such of problems that have been reported are: about some plains of Aeroflot are deteriorated in such manner; (the seats are too old and its furniture scratchy, the personnel to some of the flights seemed to be not enough helpful in other words uninterested to passengers needs. Another serious problem outlined by some of the Aeroflot passengers is the lack of announcement in English during some flights, some of the flights which were also announced in English was announced with a really bad accent and were hardly understand, this kind of problems are quite typical for flights served by Aeroflot for the domestic airlines. In general it is reported by many that a lot of the Aeroflot personnel lacks proper English command. The grievances found to be most irritating for Aeroflot's international lines where a lot of International Business people fly on a regular basis. Another research also found out that some passengers report to have experienced problems with slowness with food services during flight.

The main reason of dissatisfaction is the lack of Aeroflot personnel politeness, some of the employees' attitude is described by unsatisfied passengers as quite a lot "Soviet" still. Another crucial flight disappointment experienced by passengers was the long customer lines for customs; some have report that they have to wait for 2.5 hours in order to check their luggage. Of course the above mentioned dissatisfaction is an exception with only some of the flights.

There are a lot of reports of international and domestic passengers who report that the services, food and check in of Aeroflot went quite well for them and Aeroflot's planes are really convenient, the flight seats are more than comfortable, the food is on a perfect quality level. In order to be more objective concerning Aeroflot's Quality of Service we and be able to determine Aeroflot on a quality scale we used Airline Quality (The world's largest database of Airline and Airport reviews for over 620 airlines and 645 airports. Flight reviews, lounge Reviews, seat review etc.). Airline Quality research has concluded the following about Aeroflot's quality performance.

## Internal Analysis of Aeroflot Airlines: International Marketing Management

<i>Aeroflot Summary Quality Ranking<sup>8</sup></i>	
Combined Quality of Product / Staff service in airport and onboard environments	
Business Class	4 Star status
Economy Class	3 Star status
Airport Services	
Check-In service - Business Class	3 Star status
Check-In service - Economy Class	2 Star status
Transfer Services - Business Class	2 Star status
Transfer Services - Economy Class	2 Star status
Arrival Services	3 Star status
Business Class Lounge - product facilities	2 Star status
Business Class Lounge - staff service	3 Star status
Onboard Features	
Inflight entertainment may vary according to aircraft type	
Cabin Safety Procedures	4 Star status
Inflight Entertainment - Business class	4 Star status
Inflight Entertainment - Economy class	2 Star status
Amenities, Blankets, Pillows, Towels etc	3 Star status
Airline Magazine, Newspapers & other mags	4 Star status
Cabin Seat Comfort	
Seating may vary according to aircraft type	
Business Class - long haul	4 Star status
Business Class - regional / short haul	4 Star status
Economy Class - long haul	3 Star status
Economy Class - regional / short haul	3 Star status
Onboard Catering	
Business Class meals - long haul	4 Star status
Business Class meals - short haul	4 Star status
Economy Class meals - long haul	4 Star status
Economy Class meals - short haul	3 Star rating
Cabin Staff Service	
Business Class - service efficiency	4 Star status
Business Class - staff attitude & friendliness	4 Star status
Economy Class - service efficiency	4 Star status
Economy Class - staff attitude & friendliness	3 Star status
Responding to Passenger requests	3 Star status

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Cabin presence through flights	3 Star status
Assisting Parents with children	4 Star status
Staff Language Skills	3 Star status

### Table Legend

5 Stars = Excellent	4 Stars = Good	3 Stars = Fair	2 Stars = Poor
1 Star = Very Poor			

**IV.01 Aeroflot Strategy to reduce and resolve its current quality services problems**

Aeroflot is already aware of the grievances and complains about quality of air flight service. In a response to the problems Aeroflot has created a strategy targeting service quality improvements. These consist in improvement of its business-class, introduction of new system of training the staff, significant changes into the menu and increase in number of entertaining programs and services during the flight and after it. As a result consequence of implementation of the strategy for company development, 10% growth in customer satisfaction is expected until the end of 2011.

In the near future Aeroflot is to significantly increase passenger service quality. The company plans to have two-class cabins provided with the improved business class. New service conceptions tested in many directions will be spread out to all the flights. Special trainings of stewards and other staff who deal with customers are to be conducted; significant changes are to be introduced into the menu and the range of on-board entertainment programs is to be enriched.

The company plans to resolve its grievances about ineffective flights services through developing its personnel. Aeroflot's goal in the sphere of personnel management is to provide its employees with attractive opportunities of professional development and competitive wages, to provide social protection, to attract highly skilled people by the perspective of professional development. A crucial issue is to establish the system of efficiency rates that allows measuring the contribution to the achievement of the company's strategic goals of each department and person separately, linked to the system of remuneration of labor and strategy realization.

## Chapter V • Benchmarking

Group	Flight Safety	Financial resource	Customer service capabilities	Rank internal sustainability	Relative cost position	Quality service Performance	Technological skills	Rank Overall	weighted overall strength
Aeroflot	2	3	2	3	3	2	2	3	20
Transaero	2	2	1	1	2	4	4	2	17
S7	2	2	2	2	3	2	1	2	16
Rossiya	2	1	1	2	1	3	2	2	14

- **Flight safety:** The assurance of the flight is secure
- **Financial resource:** places where the company can retrieve money.
- **Customer service capabilities:** Functionalities that a customer service can perform.
- **Ranking internal sustainability:** Identify & measure criteria for internal resources.
- **Relative cost position:** The position where the market price is greater than the cost in the value chain.
- **Quality service Performance:** A degree or grade where the overall service is acceptable during the process in the value chain.
- **Technological skills:** Based on abilities of company scientific and industrial process.
- **Ranking overall:** Having higher position in relation to others.

**Ranking table from 1 to 5**

**This table explains the comparison in several criteria's of how each company have been performed.**



## Chapter VI • Cost Competitiveness

Airline industry is an industry in which involved a lot of costs. You can divide all costs into four parts. They are:

- Fuel costs
- Costs on personnel
- Costs of equipment
- Costs of repair of equipment

#### VI.01 Fuel costs

Fuel prices were rising dramatically over past years and fuel is the major cost in airline business. In 2008 Aeroflot had agreed on a formula to establish fuel prices with the country's largest crude producers, led by GazpromNeft.<sup>9</sup> The parties agreed to switch to long-term contracts on fixed fuel prices. GazpromNeft is the oil arm of the national energy giant Gazprom.

The fuel price agreement is an efficient way of enabling the airline to be more flexible in planning its fuel expenses and would offer a certain amount of insurance against price fluctuations. This agreement will help Aeroflot sufficiently reduce fuel costs and spend on fuel much less than its competitors who are buying fuel on market price.

#### VI.02 Costs on personnel

Costs on personnel include wages and training expenses. Aeroflot aims at business customers and provides its passengers with high-quality service. That is why wages in Aeroflot are higher than wages of its competitors.

Speaking about training expenses, Aeroflot spends on it much less than other Russian airlines. Aeroflot has the biggest training centre for its personnel in Russia. That helps sufficiently cut costs on personnel training. Some other airlines also train their staff in this centre.

### VI.03 Costs of equipment

In 2007, Aeroflot signed multi-billion US dollar deals to buy 22 Airbus A350 jets and 22 Boeing B787 Dream liners. Such long-term relationship with producers of planes sufficiently cuts costs of equipment.

### VI.04 Costs of repair of equipment

Aeroflot's fleet, which is among Europe's most modern, youngest and fastest growing, consists of 90 aircraft, confirming the airline's commitment to the highest economic, safety, ecological and noise standards. In 2009 the company is planning to receive the total of 24 brand-new modern planes. Other Airlines in Russia are budget airlines and they mostly buy old planes, cutting costs of equipment, but increasing service costs, because old planes break more often than new ones.

### VI.05 Conclusion

Comparing overall costs of Aeroflot and its competitors we can conclude that Aeroflot wins in this component. Aeroflot establishes long-term agreements with its suppliers and it helps sufficiently reduce costs over time.

## Chapter VII • Scope of Sales

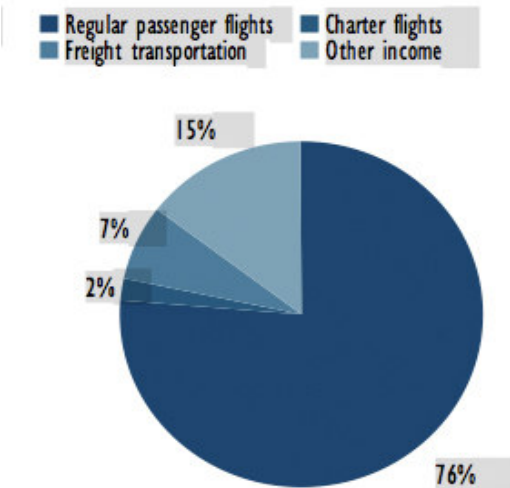
	Profit and loss statement (million USD)		
	1 <sup>st</sup> half 2008	1 <sup>st</sup> half 2007	Change
Revenues	2,138.40	1,665.30	473.1
Operating costs	2,001.60	1,408.50	593.1
	136.8	256.8	
Operating profit			120
Net profit	72.2	161.2	89

The 28.4% revenue growth in 1<sup>st</sup> half of 2008 was counterbalance by the 42.1% rise in costs and a high tax rate of 55.4%. Aeroflot benefited from solid growth in 1<sup>st</sup> half of 2008, with passenger turnover rising by 15.2%, and the company has yet to see any marked deceleration in 2<sup>nd</sup> half of 2008. In addition, pricing increases implemented during the summer season are expected to continue into autumn. This leads us to believe that the airline is on track to achieving revenue growth of 20% or more in 2008.

By looking at the information given to us for 1<sup>st</sup> half of 2008 and 1<sup>st</sup> half of 2007 we can see that the company is making about 50% less operating and net profit than in year 2007. The main reasons for that is the Economic crisis, the new competitor who is entering the Russian market, Russian Airline, to absorb carriers crippled by the financial crisis and because of Aeroflot new strategies to augment the market share and modernize its fleet and operations. Until now the company bought about 100 new aircrafts and 20 more are in order. This is an airline that is taking operational innovation very acutely and it is looking for higher profit in long-term period.

<sup>10</sup> Fig1.1

**Chart 2: Revenue breakdown, %**



Source: Company data, Gazprombank estimates

As it is shown in the figure above, we can see that the company is making 76% by Regular passenger flights, 2% by charter flights, 15% by Freight transportation and 7% by other earnings. The largest growth of passenger numbers – by 22.4% – was on long-haul international routes to destinations outside Russia and the CIS (the so-called “far abroad”).

Growth on routes inside Russia was 16.7% and passenger carrying on CIS routes expanded by 12.8%. Aeroflot doesn't provide services to the small markets, like the Siberian, where small planes are needed with 15 – 20 seats.