

3 British Airways Plc

History and development

3.1. The world's first daily international scheduled flight took place on 25 August 1919, when a British aeroplane flew from Hounslow to Le Bourget. The company responsible was privately-owned, as were three other airlines which soon joined it in operating cross-Channel services; however, by 1922 all four needed Government subsidies to survive, and in 1926 they were consolidated into Imperial Airways Ltd. During the next 13 years Imperial, still in receipt of a subsidy, extended its operations to all parts of the Empire; a particularly important part of its activities was the carriage of mail. An attempt to start a regular transatlantic service was made in 1937, when a flying boat named Caledonia made the crossing, but regular flights by British aircraft did not start until 1939.

3.2. In 1924 the Government had undertaken not to subsidise any other operator, but in 1936 it began to subsidise British Airways Ltd. This was a privately-owned company formed the previous year by a merger of three independent British airlines (other airlines were acquired later), and competing aggressively with Imperial on European routes. Concern was meanwhile being expressed about Imperial's efficiency, and in 1939 it was nationalised together with British Airways. The two airlines were combined to form the British Overseas Airways Corporation (BOAC) which began operating in April 1940 and was to play an important role during the second World War.

3.3. At the end of the war the Civil Aviation Act 1946 created British European Airways (BEA) and British South American Airways (BSAA) from the relevant divisions of BOAC; it further provided that no airline other than the three state-owned carriers could operate scheduled services from the United Kingdom. BOAC moved its operating base to Heathrow in the same year. A couple of years later all three airlines were making losses; they were operating with aircraft adapted from war use, and the demand for air transport was less than they had expected. In 1949 BOAC and BSAA were combined. During the 1950s and 1960s air transport became more common, and BOAC and BEA expanded their operations and acquired modern aircraft. They were now significant competitors with other international carriers and dominated all other British airlines, even though scheduled competition was allowed from 1960 (see paragraph 2.2). Nevertheless up to the mid-1960s BOAC frequently made losses, and so occasionally did BEA.

3.4. In 1969 the Edwards Report (see paragraph 2.2) proposed that ownership of both state airlines should be vested in a National Air Holdings Board, with the object of developing a common strategy for state-owned aviation interests. The Government's response was to form the British Airways Board, which took over control of the two airlines from September 1972; however, they continued to be run by and large as separate businesses. The route networks were finally integrated in 1974 when the two airlines merged and became known as British Airways (BA).

3.5. In the mid-1970s economic recession and the rising cost of fuel forced BA to reduce the frequency of some of its services. It was one of the world's largest airlines but it was also overmanned, and productivity per employee was low in comparison with much of the rest of the industry. BA reviewed its operations in 1978-79, and concluded that it should seek to solve its problems not by reducing staff but by expanding operations. The further recession which followed almost at once, affecting the entire civil aviation industry, frustrated this strategy.

Recent events

3.6. Plans to privatise BA were first announced in July 1979. However, the company was fast becoming less profitable, and in the year ended 31 March 1981

it made a loss before tax of £141 million. In February 1981 Lord King of Wartnaby was appointed chairman, with the remit of returning the company to profitability and preparing it for privatisation; he was responsible for the recruitment of the present Chief Executive and Chief Financial Officer. The new regime sought to make changes by reorganising and improving BA's physical assets, by making it more responsive to the needs and expectations of its customers, and by a reorganisation of company activities and management.

3.7. The reorganisation of physical assets took the following forms:

- (a) Staff numbers were reduced through early retirement, redeployment and voluntary redundancies. Steps had already been taken to achieve this: in September 1981 there were 50,816 staff employed in airline activities, whereas in mid-1979 there had been 58,200. During the financial year ending 31 March 1984 there were on average 36,096; numbers have since risen (to an average of 39,498 during the financial year ending 31 March 1987) but productivity has also increased.
- (b) The fleet was modernised, by the acquisition of new, generally larger, aircraft and the accelerated disposal of old. At the same time utilisation of the fleet was improved following a review of maintenance procedures.
- (c) Control systems and terminal facilities, in the United Kingdom and abroad, were improved.

3.8. Responsiveness to customers' needs and expectations has been instilled in staff through training programmes, which have been concerned not only with face-to-face relationships with customers but also with the airline's procedures for dealing with the public. These procedures have been improved, in some cases because of suggestions from employees made as a result of efforts to involve them more in the running of the airline. Staff training has been complemented by a marketing campaign intended to create a new image of BA as a company giving an efficient, friendly, high quality service offering value for money. Lord King told us that the slogan 'The consumer is our boss' now appears on BA's boardroom door.

3.9. BA's management was reorganised between 1983 and 1986. Much of this reorganisation concentrated on the commercial and marketing divisions; as part of the marketing effort new classes of air travel have been created and service standards have been enhanced.

3.10. BA returned to profit in the year ended 31 March 1983 and, as Table 3.3 shows, has remained profitable ever since. In April 1984 assets and liabilities of the statutory corporation were vested in British Airways Plc, the shares in which were offered for sale to the public in January 1987. BA's first annual report since privatisation shows that at 21 May 1987 it had 420,526 shareholders of whom 98 per cent, owning 13.65 per cent of the equity, had 1,000 shares each or less.

BA's activities

3.11. BA's principal activity is the operation of international and domestic scheduled air services. It operates out of 16 United Kingdom airports; by far the greatest number of its international flights leave from Heathrow, but there are also international departures from Gatwick, Birmingham, Edinburgh, Glasgow, Manchester and Sumburgh. It flies to some 145 destinations in 68 countries, and in the calendar year 1986 carried 4.4 million domestic scheduled passengers and 12.6 million international; this makes it the world's largest carrier of international scheduled passengers (and the ninth largest of international and domestic scheduled passengers combined). At 31 March 1987 BA and British Airtours had 164 aircraft, of which 13 were on short-term leases. Another 22 were on order.

3.12. In the year ended 31 March 1987 BA carried 291,000 tonnes of cargo (including mail) in the holds of scheduled passenger aircraft. It has cargo centres at Heathrow, Birmingham and Manchester, and a trucking hub at Maastricht which takes European freight by road to Heathrow for transfer to long-haul flights.

3.13. BA's whole-plane charter business is principally operated by British Airtours Ltd, a wholly-owned subsidiary based at Gatwick. 2.6 million charter passengers were carried in 1986. Some part-charter passengers are carried on scheduled flights.

3.14. BA's inclusive tour businesses are significant users of its own aircraft. They operate under a number of names (Sovereign, Enterprise, Flair, Martin Rooks, Speedbird, Poundstretcher, and Dollarstretcher) and have made small losses before tax for the last four financial years.¹ Tickets for these and BA's scheduled services are sold not only through travel agents but through BA's own High Street shops, which also arrange hotel accommodation and car hire on a commission basis.

3.15. BA has its principal aircraft maintenance base at Heathrow, but some on-line engineering capability exists at about three-quarters of the airports to which BA operates scheduled services, including Gatwick. Most engine maintenance work is carried out by BA Engine Overhaul Ltd, a wholly-owned subsidiary which also carries out work for third parties. A number of other airline services are also sold to third parties, such as ground handling, in-flight catering, telecommunications, provision of flight simulators and data processing.

3.16. BA also has an 82 per cent share in Travicom, the principal provider in the United Kingdom of automated multiple access travel booking services to travel agents. (BCG owns the remaining 18 per cent.) In July 1987 BA announced that it was participating in a joint venture to develop, operate and sell an advanced computer reservation system (see paragraph 2.86).

Financial information

3.17. BA makes up its accounts to 31 March each year under the historical cost convention modified by the inclusion of certain properties at valuation.

3.18. Table 3.1 sets out summaries of BA's financial position according to information extracted from its restated balance sheets, together with its capital commitments, at 31 March in each of the years 1983 to 1987 inclusive.

TABLE 3.1 BA: summarised group balance sheets and capital commitments

	<i>£ million</i>				
	1983	31 March			1987
	1984	1985	1986		
Tangible fixed assets	1,079	1,263	1,247	1,315	1,300
Investments	20	20	4	5	5
Stocks and debtors less liabilities (other than net borrowings)	(109)	(240)	(316)	(413)	(505)
Capital employed	990	1,043	935	907	800
Net borrowings*	(1,016)	(868)	(563)	(322)	(128)
Net tangible assets	(26)	175	372	585	672
Share capital and reserves	(117)	128	286	480	605
Minorities	—	1	1	2	1
	(117)	129	287	482	606
Provisions for liabilities and charges†	91	46	85	103	66
	(26)	175	372	585	672
Capital commitments:					
Contracted for	341	181	127	254	1,518
Authorised but not contracted for	56	58	69	79	29
	397	239	196	333	1,547
Gearing (borrowing: capital reserves and minorities) (%)	Infinite	673	196	67	21

Source: MMC from BA data.

* 'Net borrowings' consist of loans, finance leases and bank overdrafts, less cash and current asset investments (short-term loans and deposits).

† In accordance with the Commission's usual practice, provisions for liabilities and charges which have not yet crystallised have not been deducted from assets in arriving at net tangible assets. At 31 March 1987 these provisions consisted of:

Pensions and similar obligations	20
Deferred taxation	2
Provision for antitrust litigation costs	25
Other provisions	19
	<u>66</u>

¹ During the course of our inquiry BA merged its Sovereign, Enterprise, Flair, Martin Rooks and Speedbird tour businesses with those of Sunmed.

There has been a substantial reduction in gearing as calculated in the above table, which was down to 21 per cent at 31 March 1987. There were, however, capital commitments of £1,547 million at that date, over double the group's net tangible assets. These capital commitments included £1,190 million relating to the acquisition of 16 Boeing 747-400 aircraft and ten spare engines. BA has arrangements through a facility provided by a syndicate of banks to acquire these aircraft on an operating lease¹ basis for an initial period of five years, with an option to extend for a further four years. It also has an option to convert these operating leases to finance leases¹ for the remaining period of an 18-year term from delivery. It has stated that its current intention is to take up the operating lease arrangements.

3.19. Details of BA's tangible fixed assets at 31 March 1987 are set out in Table 3.2.

TABLE 3.2 BA: group tangible fixed assets at 31 March 1987

	<i>At cost or valuation</i>	<i>Depreciation</i>	<i>£ million Net book amount</i>
Fleet	2,218	1,202	1,016
Property	273	105	168
Equipment	258	142	116
	<u>2,749</u>	<u>1,449</u>	<u>1,300</u>

Source: BA.

Assets acquired under finance leases are treated as if they had been purchased outright. Fleet assets, owned or held on finance leases with a nominal option exercise price, are depreciated so as to write them down to their estimated residual value at the end of their planned operational lives. Fleet assets held on finance leases where the option exercise price is other than nominal are depreciated over the primary lease period if this is shorter. Properties, other than those of a specialised use, such as hangars and aircraft maintenance buildings, were professionally valued on 31 March 1984 and are included on the basis of that valuation, with subsequent expenditure at cost less depreciation. All property and equipment, apart from freehold land, is depreciated on the basis of its expected useful life and, in the case of leasehold properties, over the duration of the lease if shorter.

3.20. Table 3.3 summarises BA's restated profit and loss accounts for the last five years.

TABLE 3.3 BA: group summarised profit and loss accounts

	<i>1982-83</i>	<i>1983-84</i>	<i>1984-85</i>	<i>1985-86</i>	<i>£ million 1986-87</i>
Turnover	2,497	2,514	2,943	3,149	3,263
Operating expenditure	(2,312)	(2,246)	(2,651)	(2,951)	(3,090)
Operating surplus	185	268	292	198	173
Other income*	19	26	12	36	19
Finance charges	(130)	(109)	(113)	(39)	(30)
Profit on ordinary activities before taxation	74	185	191	195	162
Taxation and minority interests	(10)	(2)	(5)	(2)	(14)
Profit for the year before extraordinary items	64	183	186	193	148
Extraordinary items	26	33	(12)	(12)	4
Profit for the year after extraordinary items	90	216	174	181	152
Dividends	—	—	—	—	(30)
Retained profit	90	216	174	181	122

Source: BA.

* Mainly interest receivable and profits on disposals, although in 1984-85 these were less an exceptional item in respect of Laker antitrust and associated class actions.

¹ A finance lease is a lease that transfers substantially all the risks and rewards of ownership of an asset to a lessee. It is in many ways analogous to a hire purchase agreement. An operating lease is a lease other than a finance lease.

3.21. BA's 1986-87 turnover of £3,263 million can be analysed by activities and by geographical areas as shown in Table 3.4.

TABLE 3.4 BA: analyses of turnover, 1986-87

	<i>£ million</i>	
<i>By activities</i>		
Airline operations:		
Scheduled services—		
Passenger (including baggage)	2,425	
Freight and mail	261	
	2,686	
Non-scheduled services		141
Aircraft maintenance and other airline services		227
		3,054
Inclusive tour holidays		178
Other		13
		3,245
Activities since discontinued		18
		3,263
<i>By geographical areas</i>		
United Kingdom		331
Continental Europe		1,085
		1,416
Europe		982
The Americas		185
Africa		662
Middle East, Far East and Australia		3,245
Activities since discontinued		18
		3,263

Source: BA.

3.22. Table 3.5 summarises BA's source and application of funds statements for the last five years. It shows that over the period funds generated from operations, amounting to £1,415 million, have covered capital expenditure of £1,080 million and that there has been a reduction of £803 million in loans and finance leases.

TABLE 3.5 BA: summarised group source and application of funds statements

	1982-83	1983-84	1984-85	1985-86	1986-87	<i>£ million</i> 5-year total
<i>Source of funds</i>						
Profit on ordinary activities before taxation	74	185	191	195	162	807
Extraordinary items and profits on disposals	(8)	28	(30)	(21)	(1)	(32)
Depreciation and other items not involving the movement of funds	42	58	216	171	153	640
	108	271	377	345	314	1,415
Funds generated from operations						
Disposals of fixed assets, investments and subsidiaries	131	11	48	23	28	241
Decrease/(increase) in working capital	(25)	135	25	124	(32)	227
	214	417	450	492	310	1,883
<i>Application of funds</i>						
Capital expenditure	180	253	120	282	245	1,080
Net decrease in loans and finance leases	34	164	330	210	65	803
	214	417	450	492	310	1,883

Source: BA.