

UNIVERSITY OF FORT HARE

ADVANCED STRATEGIC MANAGEMENT  
BEC 522/E

NOVEMBER EXAMINATION

2019

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Time: 3 hours  
Subject: BEC 522/E  
Marks: 75

This paper consists of 9 pages including  
the cover page

Internal Examiner  
Prof W Chinyamurindi

External Examiner  
Prof M Roberts-Lombard

INSTRUCTIONS

1. Ensure you write the correct subject name and the correct date on the cover page.
2. Ensure that your name is clearly indicated on the cover page.
3. Clearly number each question within your paper.
4. Please attempt to write as neatly as possible as illegible handwriting cannot be marked.
5. Please attempt to answer your questions in the correct order, leave space for questions you wish to answer at a later stage in the examination.

PAPER SPECIFIC INSTRUCTIONS TO CANDIDATES:

ANSWER ALL QUESTIONS.

ALL QUESTIONS ARE BASED ON THE CASE STUDY.

GOOD LUCK!

## CASE STUDY BEC 522/ E FINAL EXAM NOVEMBER 2019

### **SAX non-appeal: Take SA Express off life support and let it die**

By Guy Leitch

SA Express has been bailed out with around another R300m, but no one is saying under what conditions. The question must be asked: are we as the taxpayers not keeping the airline on life support, despite all reasonable expectations that it will never recover? Let's be clear upfront about one thing: The death of any airline is a huge loss in jobs and air transport connectivity, but there's a strong case to be made that SA Express (SAX) should be put out of its misery and allowed to die.

Figures presented to Parliament last week show that SA Express is still losing R40-million a month on its routes. Almost all of its routes are loss-making, so it cannot even cover the costs of flying, let alone its bloated overhead expenses. And the thing about SAX is that it doesn't have a case for its existence, as it has a direct competitor in Airlink that operates profitably and, like Comair and Safair, pays taxes to support its dysfunctional competitor.

If Finance Minister Tito Mboweni got his way and took SAX off life support, his decision would go straight to the heart of the ongoing debate on state ownership of airlines. In 2018, Mboweni attempted to pull the plug on further funding for SAX's big brother SAA, but was overruled. For SAX he has a stronger case and tried to refuse to pay yet another R300-million demanded by the airline.

Airlines are among the most difficult businesses to run, particularly as they are highly capital intensive with frighteningly low margins. To top it all, they exist in a stringently demanding legislative environment. Government has shown itself inept at coping with these requirements at SAA and SA Express.

No further SAX bailouts would not just be the death knell for SAX, but would be a shot fired across the bows of SAA. If Mboweni succeeded in cutting off funds to SAX, he may well succeed in doing so for SAA as well – unless SAA gets its act together, and fast. The signs are not good – it has taken SAA four months just to advertise the position of a new CEO. If SAA

fails, the scale of the disaster for South African enterprise and tourism will be far greater than the failure of SAX. And SAA employs 10,000 people, in comparison to SAX's 800.

The current noise about combining the three airlines, SAX and Mango with SAA, is just a distraction, akin to rearranging the deckchairs. The costs and difficulties of such an amalgamation would far outweigh any long-term operational cost saving. None of the airlines has the management capacity or the funds to contemplate such a merger. The reality is that SAX should have been euthanised in May 2018 when it was grounded by the Civil Aviation Authority (CAA). At that stage it was clear that it was not viable as it was unable to fund its own operations; in particular, its maintenance. And yes, contrary to SAX interim CEO Siza Mzimela's claims to Parliament, an airline that cannot afford to maintain its aircraft is not as safe as an airline that can. Think about parts being cannibalised from one airliner to keep another flying. It happens.

The Air Services Licensing Council (ASLC), is the regulator of airlines and requires that an airline be solvent. Yet SAX is hopelessly insolvent. Further, its accounts have been qualified by its auditors since 2012/13, and its 2016/17 accounts are still unaudited. Without audited financials and a solvent balance sheet, the ASLC is obliged to shut SAX down. In a press release in early September, SAX made vague assertions that it is returning to profitability. The route profitability figures show otherwise, and it must be remembered that Mzimela had promised to return the airline to profitability by April this year. The key problem SAX faces is that it lost its market to Airlink, and has also lost the confidence of its passengers.

When SAX was grounded by the CAA last year, SAA asked Airlink to step in and fly SAX's passengers. This immediately muddied the waters of what little route division between SAX and Airlink had been arranged for them by SAA, somewhat to the Competition Commission's displeasure. When SAX returned to the air in August 2018 it was unable to get its exclusive routes back, as the Competition Board would not approve a division of the market back into a cosy little duopoly. It is perhaps ironic that one of the culprits for the closure of SAX is the Competition Board as, if SAX closes, and with CemAir gone, the market will become a monopoly.

The harsh reality that few seem prepared to openly admit is that SAX is beyond saving. It has been cancelling around half its flights and according to Acsa's figures, less than 50% of its

flights are on time. These figures directly contradict SAX's On-Time Performance numbers presented to Parliament. So, you have around a 25% chance of getting to your destination, or connecting to your long-haul flight, on time. Yet Airlink has one of the best On-Time Performances in the industry.

For passengers, it is difficult to differentiate between Airlink and SAX – or even SAA – as they all use the SAA booking system and even the branding is similar. This makes market differentiation almost impossible. Still, the biggest single reason for the failure of SAX has to be appalling management.

Under the glib and jolly CEO Inati Ntshanga, SAX superficially seemed to be doing okay. However, below the waterline it was leaking and even worse, a culture of a complete lack of consequence spread like metastasising cancer throughout the business. It became fertile ground for corruption, as evidenced by testimony to the Zondo Commission. This meant that the airline was ripe to be exploited by the State Capture gangsters, with fat contracts being awarded to front companies for fuel and tyres, among many other corrupt deals, which precipitated an exodus by much of the competent, non-corrupt management. Yet still Ntshanga, as the CEO, had his hands off the wheel, and it was inevitable that the airline would bankrupt itself.

The contrast between SAX and Airlink is an object lesson in airline management. Airlink has tight hands-on management and made a great effort to build a solid balance sheet, which gives it the financial strength and reserves to undertake expansion “adventures” rather than operating on a hand to mouth basis and unable to maintain its aircraft. This is business school basics – and someone with the business consulting experience of Ntshanga should have known better. The reality is that SAX has been powerless to compete against Airlink on almost all of its routes, and where it is operating successfully, to international destinations such as Lubumbashi in the Democratic Republic of Congo, it is flying under the protection of SAA.

The government can no longer afford to subsidise any of its loss-making airlines, and SAA is just a larger example of SAX. Like SAX, almost all of SAA's routes are unprofitable. It must be extremely worrying for SAA that Mboweni no longer wants to support its junior sister. SAA's turn must surely be coming next. This makes the government's need to respond to pressure from trade unions to find a strategic equity partner, or more realistically, a joint-venture partner that will have operational control, all the more urgent.

Of course, the saddest part of any airline failure is the human cost, particularly in livelihoods. Unfortunately, SAX chose to operate the now discontinued Bombardier airliners and its pilots will have to be retrained if they move across to Airlink's Embraer fleet – or upscale to Safair or Mango's Boeings, both of which are short of pilots. Fortunately, SAX pilots are held in high regard and have been in demand around the world, particularly by the Middle and Far Eastern airlines. The cost of the death of SAX in terms of air transport connectivity is harder to quantify. Almost all SAX routes are either already operated by Airlink, or could easily be taken over by that airline. This makes the CAA's killing-off of CemAir all the more tragic, as it will give Airlink a monopoly on the regional and feeder routes. Already the prices of these regional airline seats are exorbitantly expensive. Thus, we see a thriving bus industry between towns such as Hoedspruit and Nelspruit and OR Tambo, but at the cost of tourism growth.

The reality is that no country can afford to support a failing airline, least of all South Africa in its current predicament of bloated demands on the fiscus, with a simultaneous much-reduced tax base due to the contraction in the economy. A quick calculation indicates that if SAX has used R1.5-billion of taxpayer money over the past year and carried 500,000 passengers, then each passenger was subsidised by R3,000. This is a grotesque subsidy of the affluent expense account business traveller by the poor who need the money for service delivery, and is all the more reason why the government must stay out of the airline business. **DM**

<https://www.dailymaverick.co.za/article/2019-09-15-sax-non-appeal-take-sa-express-off-life-support-and-let-it-die/>

### **Government looks at merging SAA, Mango and SA Express**

Government will consider a proposal to merge South African Airways, Mango and SA Express. Presenting in parliament on Wednesday (11 September), the Department of Public Enterprises said that it has completed a study on the merger of the country's state-owned airlines. The study found that that a merger would be beneficial in the consolidation of the three airlines, and would lead to greater cost savings.

It added that the document which supports the consolidation is currently being reviewed by the government's economic cluster and will soon head to cabinet for consideration. Acting Interim CEO of SA Express, Siza Mzimela, said that she fully supported the integration of the airlines.

but what is of critical importance is how the merger is put together. The decision follows the news that the National Treasury has approved a R300 million bailout for the struggling SA Express. The airline received a R1.2 billion re-capitalisation in February 2019, however this was ring-fenced to settle government-guaranteed debt only and was not nearly enough to cover the operations of the Governance, Profitability, Operational Efficiency, Customer Value Proposition and Human Capital (G-POCH) strategy adopted by the new board, said Mzimela.

SA Express was thus left with no working capital, since RMB bank, subsequent to settling the debt using the recapitalisation funds, pulled the overdraft facility. These issues meant that the airline was forced to ground all of its flights at the end of August as it desperately sought financing.

<https://businesstech.co.za/news/government/340361/government-looks-at-merging-saa-mango-and-sa-express/>

### **SA Express to replace local flight routes with destinations on the African continent**

JOHANNESBURG - State-owned medium- to short-distance carrier SA Express has dumped local routes to focus on continental destinations as stiff competition in the market and crippling debt saw its flights grounded last week.

The group said it had decided to leave the local routes on stiff competition from low-cost airlines. It said it had asked the government for a R300million short-term financial boost to run its operations until it implemented its turnaround strategy. It said the strategy, which has already cost it more than R1.2billion in historical debt, would include the downsizing on its staff complement.

“The R1.2bn helped to resolve solvency issues, but not operational capital, what we are expecting as shareholder support will be sufficient for the short-term while we implement our strategy,” interim chief executive Siza Mzimela said. SA Express has struggled to stay afloat as it has depleted its working capital with most lenders reluctant to give it a loan on the grounds of its weak balance sheet.

The government has also shown reluctance in extending further guarantees. Last year the South African Civil Aviation Authority suspended its certificates of airworthiness for nine of the 21

aircraft operated by the airline, with the watchdog citing non-compliance in relation to 17 specific findings.

Yesterday, a full complement of executives told the media that the airline had a clean bill of health after negotiating terms with key creditors, including Airports Company South Africa, which is owed more than R71m. It said what it needed now was a short-term cash injection for operational expenses.

Mzimela conceded that SA Express was ready to be integrated into the structure proposed by the departments of Enterprises and Treasury as part of a turnaround plan for transport state-owned enterprises. “There had been some level of arrangements made, our key focus is to ensure not to add to that legacy debt,” Mzimela said. “We cannot speak on behalf of the major shareholder, but it is common knowledge where the government has indicated its intention to integrate all state aviation assets, from our perspective, we will work in support of that direction.”

Mzimela said SA Express said the focus was now on operating in secondary markets such as Lubumbashi in the Democratic Republic of Congo and other continental routes. She said the airline had been squeezed out of the local primary markets principally between Johannesburg to Cape Town, Bloemfontein, George and Durban. Mzimela said SA Express was now finalising the process of rightsizing its operations. “The grounding (last week) has allowed us to identify skills and roles that needed to be reviewed,” she said.

Mzimela, however, refuted that the grounding was as a result of financial liquidity challenges facing the airline. “For the period that we were grounded, the historical debt situation got worse, because we still had fixed costs, but we were not generating any revenue,” Mzimela said. “What we are asking for, what we are hoping for from the stakeholder, in terms on what we would have based our projections on, was a R300m facility.”

<https://www.iol.co.za/business-report/companies/sa-express-to-replace-local-flight-routes-with-destinations-on-the-african-continent-32252323>

### **SA Express says it's on the right track despite suspensions**

Struggling domestic and regional carrier SA Express is confident that it is making progress stabilising its business, following the recent grounding of its aircrafts over debt. The airline has

experienced operational hurdles in recent years, including the 2018 suspension of its fleet by the aviation authority over safety concerns. On Thursday, the management of SA Express appeared unfazed by the airline's brief suspension by Airports Company South Africa (ACSA) **over non-payment of debt which is said to be around R71m.**

Acting chair Kugan Thaver told media that the state-owned carrier was solvent, since it relaunched its operations 2018, and that the 24-hour disturbance last week had been resolved through partial payment of the debt. "While it is true that the airline has experienced a few challenging times over the past few years, is is also incontestable that we are now charting a new path," said Thaver. The airline was in January granted a R1.2bn guarantee from the state, which has been earmarked for settlement of historic debt. A new business strategy, which involves rightsizing of the workforce, is being implemented in a bid to steer the company out of a financial crisis.

Acting CEO Siza Mzimela said the airline had withdrawn from servicing routes between Johannesburg and Richards Bay, Johannesburg and George, and cut out the Durban hub to focus on its Johannesburg and Cape Town hubs. Mzimela said one of the challenges identified was that the airline had in the past "spread itself too thinly" and it will now focus on markets where its services are most required. Like some other state-owned entities, SA Express has been impacted by allegations of irregularly expenditure and corruption. Evidence presented before the Commission of Inquiry into State Capture has detailed numerous acts irregular financial conduct in the awarding of contracts by the airline, including the 2015 contract between the airline and the North West Department of Safety and Transport to operate the Mafikeng and Pilanesberg airport. Thaver said an investigations into the North West contract were underway.

<https://www.fin24.com/Companies/Industrial/sa-express-says-its-on-the-right-track-despite-suspensions-20190905>

**QUESTION ONE****[25]**

- 1.1 Explain the key drivers that are affecting an organisation such as SA Express within the South African market. (10)
- 1.2 Briefly conduct a situational analysis for SA Express (only use information available in the case). (15)

**QUESTION TWO****[25]**

- 2.1 Comment on the different strategies that SA express can use to be competitive. What could make these strategies be successful especially for a brand like SA Express that receives bail out from the state. (15)
- 2.2 You have been hired as a consultant to assist SA Express especially concerning matters of leadership. Suggest ways in which the CEO Siza Mzimela can create a culture amongst leaders to assist SA Express. (10)

**QUESTION THREE****[25]**

- 3.1 The government has proposed a merger between SAA, Mango and SA Express. Explore the pros and cons of a merger within the context of the airline industry not only for three parties but also other players in the industry. (15)
- 3.2 SA Express is considering entering international markets. Suggest why SA Express would consider doing so especially given its failure within the local market. What can be done differently internationally? (10)

**Total: 75 marks**