THE OPEN UNIVERSITY OF SRI LANKA
FACULTY OF ENGINEERING TECHNOLOGY
MASTER OF TECHNOLOGY IN INDUSTRIAL ENGINEERING
FINAL EXAMINATION 2006/2007

MEM -7117 - STRATEGIC MANAGEMENT

035

DATE: 6th MARCH 2007
TIME: 0930 - 1230 HRS
DURATION: THREE (03) HRS

This paper consists of 04 questions. Answer only THREE (03) Questions including Question Number one (01) and any two (02) questions from the rest.

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01. Read the case titled "Mid Pacific Air" and answers the following questions.

i. Evaluate the pre-operation planning efforts of Mid Pacific Air with special emphasis on the organization's strengths and weaknesses.

(15 Marks)

ii. Discuss the likely impact on Hawaii's air career Market of Mid Pacific's entry.

(15 Marks)

iii. State and justify the objective and strategies which you believe Mid Pacific should set.

(20 Marks)
(Total 50 Marks)

02. i. Why has strategic management become so important to today's corporations?

(6 Marks)

ii. Why are strategic decisions different from other kinds of decisions?

(6 Marks)

iii. What are the basic forces that influence an organization's competitive environment?

(6 Marks)

iv. Discuss the interrelationship among general environmental forces.

(7 Marks)
(Total 25 Marks)

03. i. Explain the main components and benefits of mission statements. (10 Marks)

ii. How does strategy formulation differ from a diversified firm versus single business firm and local versus international firm? (15 Marks)

(Total 25 Marks)

04. i. Strategy evaluation and control allows an organization to take a proactive stance toward shaping its own future. Discuss the meaning of this statement. (8 Marks)

ii. Is the strategic direction endorsed by senior managers and does it take into account partners and other stakeholders views. Why? (8 Marks)

iii. The implementation of strategies is concerned with the design and management of systems to achieve the best integration of people, structure, processes, and resources in reaching organizational purposes. Discuss. (9 Marks)

(Total 25 Marks)

END

CASE

MID PACIFIC AIR

Jim D. Barnes
Brenda J. Moscove
California State College, Bakersfield

Paula M. Alden
University of Honolulu

SELECTED STRATEGIC ISSUES

- Preoperation planning for an air carrier
- Impact on air travel market of a new entrant
- Appropriate goals and strategies for a new airline in a regional market

Mid Pacific Airlines, Inc., was organized in 1979 under the proposition that it would be a regularly scheduled commercial passenger airline service in the state of Hawaii between Honolulu on the island of Oahu and Lihue and Kahalui on the islands of Kauai and Maui. Target date for the first flight was anticipated as March 15, 1981.

Prior to a stock offering, Mid Pacific had conducted preoperating development activities and, not incidentally, developed some initial tactics among which were: an assessment of the interisland passenger market in the State of Hawaii; a plan for penetrating the market; and a determination of the availability of suitable aircraft. Lease or buy strategies were developed, initial fuel commitment was arranged and space at airports was secured for the required activities of the passenger service component of the business.

Federal regulations were complied with and CAB certifications were obtained while FAA certification was still being secured. Given all of the preoperation planning and analysis, the company anticipated that, unless it received operating revenues by May,

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1981, the proceeds of its stock offering would be depleted by the expenses of operating Mid Pacific Air.

Nine hundred thousand shares of common stock were issued by Mid Pacific Air through a prospectus and a commitment made by John Muir & Company as the underwriter. The shares were issued at $5, with realization of $4,500,000 for the offering and net proceeds of approximately $3,870,000.

The net proceeds from the stock offering constituted the foundation for the emergence of Mid Pacific into the commercial passenger airline service in Hawaii. Typical of the positive approach and success-minded enthusiasm characterizing Mid-Pacific's management, the airline was the first in the country to go public before it had an airplane.

THE ENVIRONMENT

In 1980 the interisland air passenger market in the state of Hawaii was dominated by two major carriers, Hawaiian and Aloha. In addition, several small commuter airlines, like Royal Hawaiian, with a fleet of approximately fifteen eight-passenger Cessna 402s, carried passengers among the islands. Hawaiian Air operated DC 9-50s, owning at least ten aircraft, and was implementing plans to re-equip with DC 9-80s.[1] Both Hawaiian and Aloha utilized jet aircraft solely, and both airlines had sold or planned to sell or lease out aircraft.

The environment was characterized by increased fuel costs and declining passenger counts. In 1980, Hawaiian Air showed a decrease in revenue passengers carried of 15.3 percent and revenue passenger miles decreased 13.7 percent. However, fuel cost increased 41 percent.[2] Aloha showed a decrease in revenue passengers carried of 9 percent and a revenue passenger miles decrease of 10.1 percent. Fuel cost increases were 64 percent.[3] Third quarter and cumulative earnings through the third quarter of 1980 for Aloha Airlines are reported in Exhibit 1. Historically, the two major airlines had gone through periods of profit and loss and had operated mostly under a regulated environment.

Hawaiian and Aloha sought approximately nine fare increases over a fourteen month period. Although the fare increases were instituted over several months, the incremental approach to fare increases did have the net effect of elevating prices above the level considered economically feasible by local passengers. One-way fares for Aloha and Hawaiian between Honolulu/Kahului were approximately $51 and for Royal Hawaiian, $44.[4] Furthermore, Hawaii's visitor industry was suffering from the impact of increased costs and inflation in general, with a growing dependence on Asian travelers. Traditionally, the interisland carriers had generated patronage from Mainland U.S. visitors.

Of the four major islands, Hawaii was least visited by tourists. Direct Mainland/Hilo service had dwindled to one flight per day, via United, from Los Angeles. Since

[1] Tichen, Kathy, "Fare War Hides Big Question: Is There Enough to Go Around?" *Honolulu Star Bulletin*, October 1, 1981, Section C, p. 1.

[2] *Hawaiian Air Annual Report*, 1980.

[3] *Aloha Airlines Annual Report*, 1980.

[4] Tichen, October 1, 1981, Section C, p. 1.

EXHIBIT 1 THIRD QUARTER AND CUMULATIVE EARNINGS, ALOHA AIRLINES, 1980 AND 1981

Third quarter earnings		
	1980	**1981**
Profit/Loss	$ 1.41 million	− $847 thousand
Gain/Loss per Share	.66	−.40
Revenues	$21.41 million	$21.41 million

Cumulative earnings, first three quarters, 1980 and 1981		
	1980	1981
Total Earnings	$ 4.88 million*	$ 564 thousand**
Total Earnings per Share	2.28	.27
Total Revenues	$61.75 million	$65.73 million

*$3.3 million pretax gain from aircraft sale.
**$1 million pretax gain from aircraft sale.
Source: "Aloha Reports Earnings Loss," *Star-Bulletin Advertiser*, 1981.

the bulk of the state's visitors arrive and depart from Honolulu, visitor traffic to the island of Hawaii was declining. Furthermore, the focus of visitor traffic on Hawaii had shifted to Keahole (West Hawaii) from Hilo where the main airport is located.[5] However, Maui and Kauai showed percentage increases in their visitor counts over the past few years.

Increasing deregulation, an expected downturn in passenger count, and increased cost factors characterized the interisland carrier market. Occasional market entry attempts had been made by other carriers, but no carrier had succeeded as a challenger to the two dominant airlines.

The 1979 distribution of population and number of business firms among the state's four major islands are included in Exhibit 2. The population of the other islands in the state, to include Lanai, Molokai, and Niihau, is a very small portion of the total, with business activity reduced accordingly. The economy is heavily dependent on government expenditures (including the military), the visitor industry, and agriculture.

[5] Ibid.

EXHIBIT 2 SUMMARY OF POPULATION AND NUMBER OF BUSINESS FIRMS ON FOUR MAJOR ISLANDS IN HAWAII

	Oahu	**Hawaii**	**Kauai**	**Maui**	**Total**
Population	779,300	88,400	41,500	66,000	975,200
% of Total	79.9	9.1	4.0	7.0	100
Number of Business Firms	14,282	1,887	792	1,619	18,580
% of Total	76.9	10.1	4.3	8.7	100

Source: Data Book, 1979, A Statistical Abstract, 1979.

THE EXECUTIVE TEAM

One of the fundamental requisites of sound business strategy, managerial expertise, was a recognized attribute of Mid Pacific Air. With the proceeds from the stock offering, the cumulative experience in the transportation industry of the management of Mid Pacific was brought into play. Furthermore, managerial experience in the industry on the part of key executives played a major role in the success of the stock offering itself.

Arthur D. Lewis is the Chairman of the Board of Directors and a Director of Mid Pacific. His background includes service in various capacities for airline, bus, and railroad transportation organizations. He was the President and Chief Executive Officer of the American Bus Association as well as Chairman of the Board and Chief Executive Officer of the United States Railway Association. Lewis also acted in several executive capacities with Eastern Airlines, Hawaiian Airlines, and American Airlines.

John J. Higgins is the President of Mid Pacific. He served as Executive Vice President, Chief Operating Officer, and Director of Hawaiian Airlines, Inc., a direct competitor in the regional market. He also served as Vice President for Finance for World Airways and as a consultant to Capitol International Airways.

Nolan J. Kramer is the Senior Vice President for Marketing and Customer Services of Mid Pacific. He was employed for thirty-eight years at Hawaiian Air, including the period 1971–79, when he was Vice President for Sales.

Edward S. Nielsen is the Vice President for Finance and Administration and Secretary/Treasurer of Mid Pacific. Previous service includes Controller of Hawaiian Airlines and Vice President and Controller of Bishop Trust Company.

The executive team is well-acquainted with the airline industry and the Hawaii market, with many years of experience in the industry and in the state. The individuals comprising the team were, of course, well known within the regional market. Furthermore, the management team utilized the services of Alliance III, an airline consulting group, and John Muir & Company to add to their expertise. In addition, Keith Haugen was appointed Manager for Public Relations and Advertising. Haugen is well acquainted with the Hawaiian business climate and has an established reputation for understanding and promoting Hawaiian culture.

THE COMPANY NAME

Several company names were considered by management. A name amenable to the Hawaiian market, but not limiting identity only to that market, was desired. Management finally selected Mid Pacific Air as a suitable name for the organization. Of course, many of the names initially considered were not available for use.

THE AIRCRAFT DECISIONS

Various types of lease-or-buy arrangements were investigated for the planes that Mid Pacific intended to put into service. It was decided to lease three jet-prop aircraft of the

YS-11 class. This is the same type of plane used by Piedmont Airlines, and the safety record of the plane at Piedmont Airlines was a key factor in the decision.

Of course, cost of operating the jet-prop airplane was one of the most significant considerations. The jet-prop was believed to be more economical to operate in the Hawaiian market than the competitors' more sophisticated jets. The resulting savings, in fuel costs for example, allowed for substantial ticket price reductions below competitors' fares while permitting Mid Pacific to realize profits. Furthermore, at the time the aircraft was selected, the executives ascertained the availability of fuel and aircraft and aircraft renovation costs. Regulations affecting the cost of flight operation related to type of aircraft were also evaluated as part of the selection process.

PERSONNEL PRACTICES

The attractions of "pioneering" with a new airline and of Hawaii itself as a place to live enabled Mid Pacific to select pilots from a pool of experienced applicants. Because safety was a prime concern of management and was a necessary component for establishing credibility for the new airline, experience was not sacrificed for cost in key positions. The Maintenance Manager with Mid Pacific was from Piedmont Airlines and brought with him a background of knowledge and experience in dealing with the aircraft. Also, the Manager of In-flight Services is a former flight attendant and instructor with Piedmont who possesses a wealth of experience. Other positions were filled with applicants mainly from Hawaii. An intensive training program preceded actual operation. Developing policies, hiring personnel, and training personnel adequately before the target date for operation were major endeavors. By utilizing non-unionized staff and having a ratio of part-time help far in excess of full-time help, Mid Pacific kept its payroll costs down compared to other airlines.

ROUTE SELECTION/SCHEDULING/FARE STRUCTURE

The two years of planning that went into the development of Mid Pacific were well spent. Initially, the advantages and disadvantages of mirroring the air routes already serviced by the two major local airlines, Hawaiian and Aloha, were analyzed. Among other things, analysis of industry data revealed that there were more than 2.24 million annual boardings between Honolulu and Lihue. These boardings were serviced primarily by only two scheduled carriers. By comparison to the New York to Washington, D.C., boardings of 2.25 million serviced by 6 or 7 scheduled carriers, Mid Pacific decided there was room for one more airline in the Hawaiian market. Furthermore, of the total number of passengers carried by Aloha and Hawaiian Air, 70 percent were visitor traffic and 30 percent were local traffic.

Mid Pacific managers determined that it was more advantageous to service two of the neighboring islands from Oahu than to just imitate the competitors' routes to all the major islands. Consequently, their efforts were devoted to developing the finest alternative service possible to the chosen destinations. Exhibit 3 includes proposed air routes at the beginning of service. Possible breakeven at the initial fares planned, 140,000 passengers, might be anticipated for July, after four months of actual opera-

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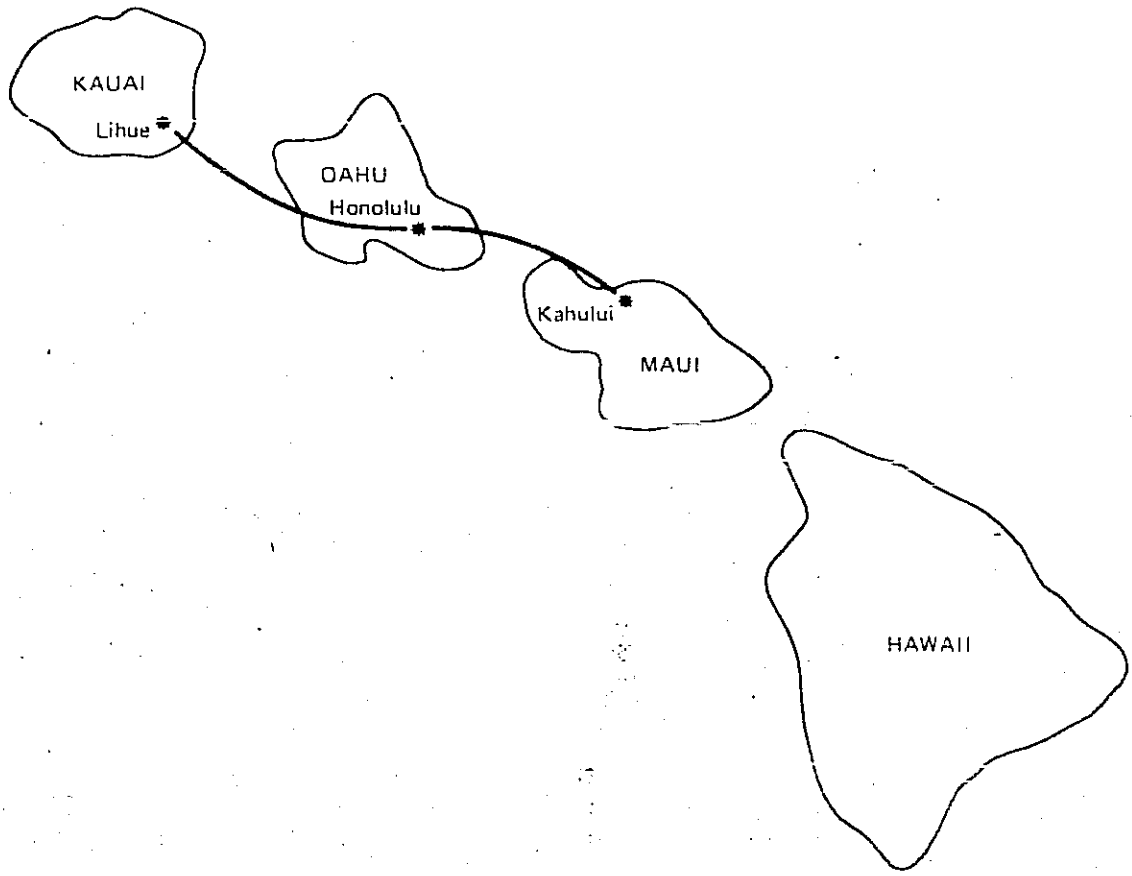

EXHIBIT 3 PROPOSED ROUTES AT BEGINNING OF SERVICE

tion. In fact, Mid Pacific could operate at 70 percent capacity with a fare of $22 and break even.

Flight service was to be phased in during the months of March and April. Exhibit 4 contains the timetable and initial projected fares, which were lower than Hawaiian and Aloha fares at that time. Basic one-way fares were $33 for Honolulu/Maui/Honolulu and Honolulu/Kauai/Honolulu. For Kauai/Maui/Kaui, one way fares were $44. A $99 triangle fare for Honolulu/Kauai/Maui was proposed. Certain discount fares were included as described in the timetable, such as the business or group plan including free tickets for multiple ticket purchases.

Terminal space was obtained for the airports to be serviced by Mid Pacific Air. However, space in the Interisland Terminal, housing Hawaiian Air and Aloha Airlines at the Honolulu airport, was not available. Therefore, Mid Pacific was the only interisland carrier located in the Main Terminal at Honolulu International Airport, resulting in a high degree of visibility for visitors and/or residents traveling on international or Mainland flights.

THE MARKETING PLAN AND IMPLEMENTATION

The prime target market for Mid Pacific was identified as residents of the state wishing to travel among the three islands serviced by the airlines for pleasure or for business purposes. The visitor market was also identified as viable.

The airline was to be "positioned" as the alternative to the two leading interisland aircarriers, Hawaiian Air and Aloha, to distinguish it clearly from the small commuter airlines. Flyers included the Mid Pacific theme that was particularly emphasized during the preoperative period, "Now There Are Three!" The intention was to elevate the newcomer to the ranks of the two familiar carriers so strongly identified with inter-island travel for many years.

A penetration strategy for pricing was followed, and the theme of making Hawaii's skies "affordable" again was stressed. Exhibit 4 illustrates the initial fare structure. One free ticket was offered with the purchase of a book of ten tickets, and three free tickets accompanied a purchase of twenty tickets. Advertising emphasized that the offer had no expiration date; therefore, no additional costs would be incurred at the time of ticket redemption even if fares increased. Revenues of 1.8 million dollars were derived from the discount book offerings.

Advertising and public relations, especially during the preoperative stage, indirectly addressed the risk factors inherent in the firm's operations. Virtually no business operates in a totally risk-free environment. However, Mid Pacific was in an environment characterized by risk of the highest order. In addition to the sheer economic impact of starting an airline, public consciousness of the safety factor as it impacts a new passenger airline operation was a major risk. It was a foregone conclusion that any accident occurring in the first few months of Mid Pacific's existence would literally spell the death knell of the fledgling airline. Aloha and Hawaiian Air had excellent safety records. Utility, economy and safety were keynotes in business decisions during the initial strategy sessions of the Mid Pacific founders. Pre-publicity and advertising emphasized "over 200 years experience in airline management" to overcome the safety factor.

Mid Pacific also promoted its Main Terminal location on Oahu, allowing for:

"Fast boarding and disembarking"
"Convenient adjacent covered parking"
"Fast computerized check-in, making pre-check obsolete"

Initially, Mid Pacific budgeted a quarter of a million dollars for advertising stressing the "affordable" and "Now There Are Three" approaches. Aided by an excellent advertising agency, an intense TV, print, and multimedia blitz carried the campaigns to the Hawaiian market prior to the airline's first flight in March. Advertising was supported by extensive public relations and promotion. Before a single aircraft was in operation, Mid Pacific engaged Aloha and Hawaiian Air in battle.

EVALUATING PREOPERATIVE STRATEGY AND ANTICIPATING OUTCOME

Based upon the highlights of the preoperative planning and strategies developed by Mid Pacific Air prior to launching its first flight in March, 1981, company managers evaluated the strengths/weaknesses of the preoperative stage. Also, anticipation of the impact of Mid Pacific's entry into the interisland air carrier market in Hawaii and actual study of the outcome were valuable in assessing the preoperative strategy. Such analyses also led to speculation about future strategies, if any, that could be developed by the airline.

From Honolulu

6:40 am	7:11 am	2
7:25 am	7:56 am	20*
8:10 am	8:41 am	22*
8:35 am	9:06 am	12
10:10 am	10:41 am	4
11:00 am	11:31 am	24*
11:40 am	12:11 pm	26*
12:05 pm	12:36 pm	14
1:50 pm	2:21 pm	6
2:45 pm	3:16 pm	28*
3:20 pm	3:51 pm	30*
3:50 pm	4:21 pm	16
5:05 pm	5:36 pm	32*
5:25 pm	5:56 pm	8
6:20 pm	6:51 pm	34*
7:20 pm	7:51 pm	18

From Kauai

7:15 am	8:41 am	22* (1)
7:40 am	9:06 am	12 (1)
9:15 am	10:41 am	4 (1)
10:10 am	11:31 am	24* (1)
10:45 am	12:11 pm	26* (1)
11:10 am	12:36 pm	14 (1)
12:45 pm	2:21 pm	6+ (1)
1:45 pm	3:16 pm	28* (1)
2:25 pm	3:51 pm	30* (1)
2:55 pm	4:21 pm	16 (1)
4:25 pm	5:56 pm	8 (1)
5:25 pm	6:51 pm	34* (1)
6:25 pm	7:51 pm	18 (1)

\+ Effective: March 30, 1981
* Effective: April 15, 1981

From Honolulu

6:25 am	6:56 am	21*
6:50 am	7:21 am	11
8:25 am	8:56 am	3
9:20 am	9:51 am	23*
9:55 am	10:26 am	25*
10:20 am	10:51 am	13
11:55 am	12:26 pm	5+
12:55 pm	1:26 pm	27*
1:35 pm	2:06 pm	29*
2:05 pm	2:36 pm	15
3:35 pm	4:06 pm	7
4:35 pm	5:06 pm	31*
5:35 pm	6:06 pm	17
7:10 pm	7:41 pm	9
8:05 pm	8:36 pm	37*

From Maui

7:30 am	8:56 am	3 (1)
8:15 am	9:51 am	23* (1)
9:00 am	10:26 am	25* (1)
9:25 am	10:51 am	13 (1)
11:00 am	12:26 pm	5+ (1)
11:50 am	1:26 pm	27* (1)
12:30 pm	2:06 pm	29* (1)
12:55 pm	2:36 pm	15 (1)
2:40 pm	4:06 pm	7 (1)
3:40 pm	5:06 pm	31* (1)
4:40 pm	6:06 pm	17 (1)
6:15 pm	7:41 pm	9 (1)
7:10 pm	8:36 pm	37* (1)

From Maui

7:30 am	8:01 am	3
8:15 am	8:56 am	23*
9:00 am	9:31 am	25*
9:25 am	9:56 am	13
11:00 am	11:31 am	5
11:50 am	12:21 pm	27*
12:30 pm	1:01 pm	29*
12:55 pm	1:26 pm	15
2:40 pm	3:11 pm	7
3:40 pm	4:11 pm	31*
4:10 pm	4:41 pm	33*
4:40 pm	5:11 pm	17
5:55 pm	6:26 pm	35*
6:15 pm	6:46 pm	9
7:10 pm	7:41 pm	37*
8:10 pm	8:41 pm	19

From Kauai

7:15 am	7:46 am	22*
7:40 am	8:11 am	12
9:15 am	9:46 am	4
10:10 am	10:41 am	24*
10:45 am	11:26 am	26*
11:10 am	11:41 am	14
12:45 pm	1:16 pm	6+
1:45 pm	2:16 pm	28*
2:25 pm	2:56 pm	30*
2:55 pm	3:26 pm	16
4:25 pm	4:56 pm	8
5:25 pm	5:56 pm	34*
6:25 pm	6:56 pm	18
8:00 pm	8:31 pm	10
8:55 pm	9:26 pm	36*

Fares

Honolulu-Maui-Honolulu
Honolulu-Kauai-Honolulu
$33 Adults, each way
$21 Children 2 thru 11, each way
Adult discount fare—on flights before 8 AM or after 2:59PM—$27

Kauai-Maui-Kauai
$44 Adults, each way
$26 Children 2 thru 11, each way

Triangle Fare
Honolulu-Kauai-Maui
$99 Adults
$66 Children 2 thru 11

Businessman or Groups
Buy a book of 20 tickets and get 3 tickets FREE.
Buy a book of 10 tickets and get 1 ticket FREE.
Tickets have no expiration date. No additional cost even if rates increase.