Principal risks and uncertainties

The operational complexities inherent in our business, together with the highly regulated and commercially competitive environment of the airline industry, leave us exposed to a number of risks. Many of these risks – for example changes in governmental regulation, acts of terrorism, pandemics and the availability of funding from the financial markets – can be mitigated to a certain degree but remain outside of our control.

The directors of the Group believe that the risks and uncertainties described below are the ones that could have the most significant impact on the long-term value of British Airways. The list (presented in alphabetical order) is not intended to be exhaustive.

The Group carries out detailed risk management reviews to ensure that the risks are mitigated where possible. A more detailed summary of risk management and internal control corporate governance processes are included on pages 58 and 59. Clear plans for mitigating many of our principal risks and uncertainties that we face are included in the section on ‘Our strategy and objectives’ and ‘The way we run our business’ on pages 24 to 28 and pages 34 to 52 respectively.

Brand reputation
Our brand is of significant commercial value. Erosion of the brand, through either a single event, or series of events, could adversely impact our leadership position with customers and ultimately affect our future revenue and profitability.

Competition
The markets in which we operate are highly competitive. We face direct competition from other airlines on our routes, as well as from indirect flights, charter services and from other modes of transport. Some competitors have cost structures that are lower than ours or have other competitive advantages such as being supported by government intervention.

Fare discounting by competitors has historically had a negative effect on our results because we are generally required to respond to competitors’ fares to maintain passenger traffic. A particular threat in the current economic environment is cash rich competitors growing market share and acting irrationally to force other airlines out of the market.

Consolidation/deregulation
As noted above, the airline industry is fiercely competitive and will need to rationalise to meet current market conditions. This will involve further airline failures and consolidation. As in all consolidations, a merger with Iberia, and the joint ATI application with Iberia and American Airlines, would introduce integration risks such as a failure to realise planned benefits, brand erosion and other execution risks.

Mergers and acquisitions amongst competitors have the potential to adversely affect our market position and revenue. Certain markets in which we operate remain regulated by governments, in some instances controlling capacity and/or restricting market entry. Relaxation of such restrictions, whilst creating growth opportunities for us, may have a negative impact on our margins.

Debt funding
We carry substantial debt which will need to be repaid or refinanced. Our ability to finance ongoing operations, committed aircraft orders and future fleet growth plans may be affected by various factors including financial market conditions. Although most of our future capital requirements are currently asset-related and already financed, there can be no assurance that aircraft will continue to provide attractive security for lenders in the future.

Employee relations
We have a large unionised workforce. Collective bargaining takes place on a
regular basis and a breakdown in the bargaining process could disrupt operations and adversely affect business performance. Our continued effort to reduce employment costs, through increased productivity and competitive wage awards, increases the risk in this area.

Environment
Failure to adopt an integrated environmental strategy could lead to deterioration in our reputation and a consequential loss of revenue. An increased focus on corporate responsibility and a published emissions reduction target will help deliver the refocused strategy.

Fuel price and currency fluctuation
We use approximately six million tonnes of jet fuel a year. Volatility in the price of oil and petroleum products can have a material impact on our operating results. This price risk is partially hedged through the purchase of oil and petroleum derivatives in forward markets which can generate a profit or a loss.

The Group is exposed to currency risk on revenue, purchases and borrowings in foreign currencies. The Group seeks to reduce foreign exchange exposures arising from transactions in various currencies through a policy of matching, as far as possible, receipts and payments in each individual currency and selling the surplus or buying the shortfall of its currency obligations.

Fuel supply
The infrastructure that provides jet fuel to Heathrow is critical to the operation. Any breakdown in this infrastructure and/or contamination of the fuel supply will have a significant operational impact.

Global economic slowdown/credit crunch
Our revenue is highly sensitive to economic conditions in the markets in which we operate. Further deterioration in the global economy may have a material impact on our financial position. The financial services sector is one of our key customer segments and continued difficulties in the banking industry represent a significant risk to our revenue.

Government intervention
The airline industry is becoming increasingly regulated. The scope of such regulation ranges from infrastructure issues relating to slot capacity and route flying rights, through to new environmental and security requirements. Our ability to both comply with, and influence any changes in, these regulations is key to maintaining our operational and financial performance.

UK Government plans to double APD from 2010, and the European Union Emissions Trading Scheme, may have an adverse impact upon demand for air travel and/or reduce the profit margin per ticket. These taxes may also benefit our competitors by reducing the relative cost of doing business from their hubs.

Heathrow operational constraints
Heathrow has no spare runway capacity and operates on the same two runways it had when it opened 60 years ago. As a result, we are vulnerable to short-term operational disruption and there is little we can do to mitigate this. In February 2008, public consultation on the UK Government’s conclusion that its environmental conditions could be met to allow full use of these two runways and the construction of a third, short runway, ended. This expansion of the airport would create extra capacity and reduce delays, enabling Heathrow to compete more effectively against European hubs such as Paris, Amsterdam and Frankfurt.

Key supplier risk
We are dependent on suppliers for some principal business processes. In the current economic environment our suppliers are at increased risk of business failure. The failure of a key supplier may cause significant disruption to our operation. We describe the supplier risk in more detail on page 46.

Pensions
If the financial markets deteriorate further, our pension deficit may increase, impacting balance sheet liabilities, which may in turn affect our ability to raise additional funds.

Safety/security incident
The safety and security of our customers and employees are fundamental values for us. Failure to prevent or respond to a major safety or security incident could adversely impact our operations and financial performance.