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 significant risks. We have maintained a focus on mitigating those risks although many remain outside of our control – for example changes in governmental regulation, acts of terrorism, adverse weather, pandemics and the availability of funding from the financial markets.

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

The Group carries out detailed risk management reviews to ensure that the risks are mitigated where possible. You can find a more detailed summary of our internal control and risk management processes on pages 48 and 49. The sections on ‘Our strategy and objectives’ and ‘Running a responsible business’ also include additional information on how we manage and mitigate risk.

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

The management team regularly monitors customer satisfaction through the global monthly Think Customer Survey alongside ongoing research and development of the BA product to mitigate this risk.

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.

Our strong global market positioning, our network and alliances and diverse customer base continue to address this risk.

Consolidation/deregulation
As noted above, the airline market is fiercely competitive and will need to rationalise given current market conditions. This will involve further airline failures and consolidation.

Mergers and acquisitions amongst competitors have the potential to adversely affect our market position and revenue.

The merger with Iberia and the Joint Business Agreement with American Airlines and Iberia for transatlantic routes, may introduce planning risks such as sub-optimal design and set-up processes and delivery risks such as realising planned benefits. The management team have a robust integration and Joint Business Agreement programme which addresses these risks.

Some of the 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 that will need to be repaid or refinanced. Our ability to finance ongoing operations, committed aircraft orders and future fleet growth plans are vulnerable to various factors including financial market conditions. Although most of our future capital commitments 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.

The Company’s Treasury Committee regularly reviews the Group’s financial position. The results of these reviews are discussed with management and the appropriate action taken.

Economic conditions
Our revenue is highly sensitive to economic conditions in the markets in which we operate. Deterioration in the global economy may have a material impact on our financial position.
Principal risks and uncertainties continued

The Revenue Projection Group regularly reviews the Group’s revenue forecast. The results of these reviews are discussed with management and the appropriate action taken.

Employee relations
We have a large unionised workforce. Collective bargaining takes place on a regular basis and a breakdown in the bargaining process may disrupt operations and adversely affect business performance. Our continued effort to manage employment costs increases the risk in this area.

Event causing long-term network disruption
Several possible events may cause a long-term network disruption. Example scenarios include a significant failure of the public transport system, the complete or partial loss of the use of terminals at Heathrow, adverse weather conditions (such as snow, fog or volcanic ash), war, civil unrest or terrorism. A long-term network disruption may result in significant lost revenue and additional cost. The management has robust business continuity plans to mitigate these risks to the extent feasible.

Failure of a critical IT system
We are dependent on IT systems for most of our principal business processes. The failure of a key system may cause significant disruption to our operation and/or lost revenue. System controls, disaster recovery and business continuity arrangements exist to mitigate the risk of a critical system failure.

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.

The Group is exposed to risk to the extent of non-performance to financial contract by counterparties for activities such as fuel and currency hedging. Failure of counterparties may result in financial loss.

The Company’s Treasury Committee regularly reviews the Group’s fuel and currency positions. The results of these reviews are discussed with management and the appropriate action taken.

Fuel supply
The Heathrow jet fuel supply is critical to the operation. Biofuel and jet fuel use the same pipeline infrastructure and with increased use of biofuel, the risk of contamination is increased. Any contamination of the fuel supply will have a significant operational impact. The fuel supply is not released to Heathrow until significant testing is completed.

Government intervention
Regulation of the airline industry is increasing and covers many of our activities, including route flying rights, airport slot access, security and environmental controls. The airline industry is becoming increasingly regulated. Our ability to both comply with and influence any changes in these regulations is key to maintaining our operational and financial performance.

Government plans to significantly increase environmental taxes with the introduction of a per flight tax, the European Union Emissions Trading Scheme and the potential for other environmental taxes 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 main runways since it opened over 60 years ago. As a result, we are vulnerable to short-term operational disruption and there is little we can do to mitigate this. The 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. The failure of a key supplier to deliver contractual obligations may cause significant disruption to our operation. We describe the supplier risk in more detail on page 42.

Pandemic
If there is a significant outbreak of Swine Flu or other infectious disease, staff absence will increase which may seriously impact the operation. Key corporate clients may discourage travel, significantly impacting sales. As part of the recent outbreak of Swine Flu we fully rehearsed our contingency plans.

Pensions
Negative movements in pension asset values and financial returns from these assets may increase the size of the pension deficit. Management regularly review the status of the pension funds and remain committed to appropriate action. Discussions are ongoing with the Trustees, the Pensions Regulator and other stakeholders to determine a strategy for funding the existing deficit in line with business objectives.

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. Our Operations Control Incident Centre responds in a structured way, in the event of an incident.