



**Department of Business Administration**

# **The Connection Between External Environment and Internal Strategy**

**-A Case Study of Scandinavian Airlines System**

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## **Abstract**

A variety of factors are the reasons for adjusting or changing company's strategy, such as the change of customer demand, company's internal financial factors, the influence of external environment and so on. This research is to find out the link between the change of external environment and the adjustment of internal strategy. Choose the suspension of one flight in SAS as the case to state this point. Show the strategy change of SAS when they were facing the serious impact of financial crisis.

SAS as the biggest airline in North Europe it could be a typical firm to investigate this kind of situation. A deep-interview and reading the published reports of SAS are the main data collection approached. Some resources were from the internet because it is real-time news and the reports from the company are published on their website. The interviewee is from the top of the company who is familiar this area and has full experience in international business. The study used lots of theories from different books and journals to integrate the information that we collected to analysis and achieve our final conclusion.

After analyzed the study it found the SAS used the retrenchment strategy as their new international strategy to reverse the negative situation. The financial crisis affected the customer demand badly not just in China also around the world and forced them to change the strategy. The report ultimate believed there were still a lot of other factors, beside the financial crisis, caused the adjustment of strategy in SAS.

**Key Words:** financial crisis, retrenchment strategy, Scandinavian Airlines System (SAS), customer demand, suspension of Stockholm-Beijing flight

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# **1. Introduction**

*In this chapter, a general view of the background, the research question will be given. There are some limitations existing in the research process and be stated in this chapter. Readers also can get preliminary assumption about the topic in this chapter.*

## **1.1 Background**

The financial crisis of 2007-2009 began in July 2007, it was brewing for a while and really started to reveal its influences in the middle of 2007 and into 2008. The financial crisis impacts the world stock markets deeply, some large financial companies collapsed, bankrupted or was merged even was bought out. The governments in every country even the wealthiest nations have had to institute rescue plans to bail out their financial systems.<sup>1</sup>

**Scandinavian Airlines System (SAS)** is a multi-national airline for Denmark, Norway and Sweden, and the leading carrier in the Scandinavian countries, based in Stockholm, Sweden and owned by SAS AB. As same as other multinational company, the financial crisis has a serious implication on SAS. Since the global economic crisis intensify continuously, as a large transport company, the firm annual performance report of 2008 shows negative, its net loss of up to 6.32 billion SEK and compare to the 0.636 billion kronor of net income in 2007. Loss only in the fourth quarter reached to 2.77 billion SEK. This is the largest annual loss in the company history.<sup>2</sup> They are seeking 6 billion capital injections and want to lay off 3000 employees all over the world to try to reverse the serious loss.<sup>3</sup>

SAS launched two direct flights between Nordic cities to Beijing in 2007. One is Stockholm to Beijing, the other one is Copenhagen to Beijing. Recently, SAS announced as the earning performance of the direct flight between Stockholm to Beijing wasn't achieve the expectation

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<sup>1</sup> (<http://www.globalissues.org/article/768/global-financial-crisis>, 2009-4-5)

<sup>2</sup> ([http://www.chinadaily.com.cn/bizchina/2009-02/13/content\\_7473443.htm](http://www.chinadaily.com.cn/bizchina/2009-02/13/content_7473443.htm))

<sup>3</sup> (<http://layofftracker.blogspot.com/2009/02/sas-cuts-8600-jobs.html>)

continuously that the board decided to suspend the route from May 1 in 2009. Expecting the move will reduce the financial risk in such depressed airline market. Since the global economic contraction, SAS as a foreign airline is the first company that reduces their services to China.<sup>4</sup>

SAS considered the earning performance, the reducing market demand and the growing operating costs, in order to enhance the core competitiveness, SAS decided to implement "Core SAS" (the core SAS) new strategy to enhance the competitiveness. SAS will concentrate on the Nordic market and the business travelers group, and will withdraw the capital from the subsidiary companies which are not belong to the core business. Via focus on operate the best and the most crucial product and service to enhance their competitiveness and independence.<sup>5</sup>

## **1.2 Research Question**

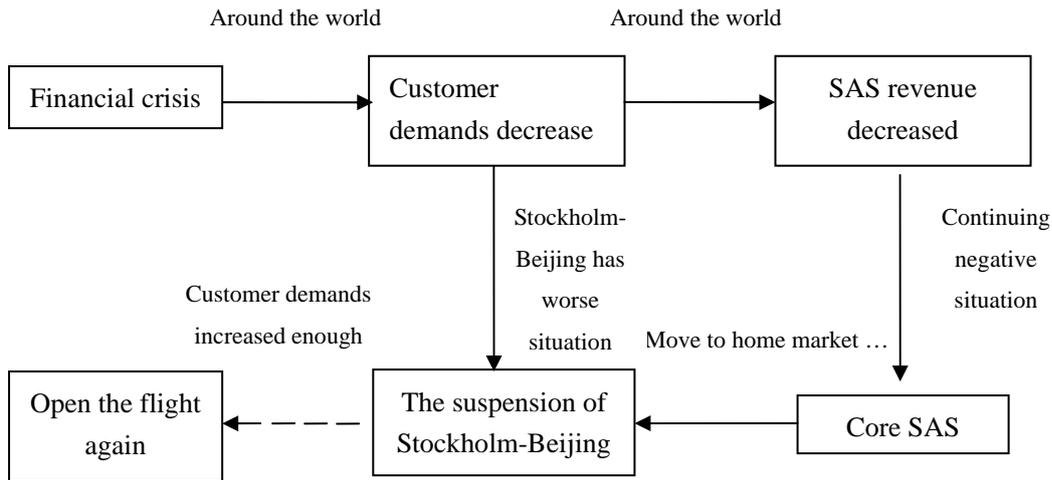
International business strategy always is adjusted by the change of external environment. In this study, we focus the adjustment of international business strategy of SAS after financial crisis. We conduct an interview and collect relevant information to make an in-depth investment, using the suspension of non-stop flight Stockholm – Beijing as the point of penetration to extend the problem to new international business strategy of SAS. We summarize and analyze the information that we collect, moreover, give our conclusion and recommendations at the end. This paper is focus on the connection between the financial crisis (external environment) and the adjustment of business strategy of SAS (internal strategy).

Figure 1.1 Preliminary assumption of the connection between external environment and internal strategy

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<sup>4</sup> ([http://www.chinadaily.com.cn/bizchina/2009-02/13/content\\_7473443.htm](http://www.chinadaily.com.cn/bizchina/2009-02/13/content_7473443.htm))

<sup>5</sup> (<http://www.flysas.com/en/it/Press-center/Press-releases/SAS-Group-launches-Core-SAS---renewed-strategic-approach-for-a-competitive-and-profitable-airline-including-a-rights-issue-of-SEK-6-billion/?vst=true>)



### 1.3 Limitations

Due to it is a piece of real-time news that we caught from internet at the beginning, lots of information we only could get from recent journal or network comments. At the same time, as a research topic focus on a big airlines which is existing with the current market, that would be hard for authors to update all survey data or company business activities and ensure they are always accurate. Because the newest activities are always published in Swedish, as we are international students that would be hard to update. The limitation of collecting information from interview also cannot be ignored. Since in the research process we only interview with a relative responsible person, it might be bring some subjectivity and one-sidedness. During the interview process we haven't discuss with the responsible person about whether SAS has any financial system to perceive and make some countermeasures before the Financial Crisis broke out. Some special reasons lead to the answer are different from what we expected, especially when the questions involve their business strategy secret, the information which we got perhaps hard to guarantee its absolutely truth and comprehensiveness cover. After the study, we found there are many affecting factors influence the strategy adjustment of Scandinavian Airlines, this paper only focus on the aspects of Financial Crisis, but the coverage area not to explore all the factors.<sup>6</sup>

<sup>6</sup> Overhead picture from lecture in methodology(Fec339, Växjö University)

## **2. Methodology**

*In this part, we present the method and tool that we use in our information collection. Some details about interview process and the validity and reliability are also stated in this chapter.*

### **2.1 Methodology approach**

According to Blumberg's perspective,<sup>7</sup> in qualitative study, words, sentence and narratives constituted the qualitative information, while the quantitative information, such as numbers and figures, are the basic of quantitative study. In this study, the main information from different channels, through communicate with the top manager of SAS to understand the details about the adjustment of strategy; the time-news and published policy from internet to know the newest situation of the company; and our own experience will supplement the conclusion. Most of these materials and data were qualitative and the descriptions of the information throughout the study.

### **2.2 Data collection**

#### **2.2.1 Research design**

A research design is a process or a plan of investigation that is adopted by the researchers to answer the research questions.<sup>8</sup> After the research questions was decided (See Chapter 1), we followed the aim of research to review existing theories.

There were two main data collection approaches in this study, which are primary data and secondary data. Based on the information that we collected and integrate the related theories from the lectures to analyze and provide our ideas for SAS.

#### **2.2.2 Primary Data**

For the researchers the primary information is first-hand and new, which can be collected by

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<sup>7</sup> Blumberg Boris (2005) et al, Business research methods, McGraw-Hill Education

<sup>8</sup> Kumar Ranjit, 2005, Research Methodology – A step-by-step Guide for Beginners, 2<sup>nd</sup> edition, Sage Publications, P 84

three kinds of approaches: observation, interviewing and questionnaire.<sup>9</sup> Interviewing was the main collection approach of primary data. We think the interviewing is more appropriate in this study. Questionnaire and observation is more appropriate to collect the external data, such as customer/employee satisfaction survey, users popularizing rate, validity investigation and so on. But the topic in this research is about the inside strategy of a company. The group that the questionnaire and observation focus is harder for us to collect the real and deep information. Hence, we think the interviewing is more appropriate.

### **Interviewing**

The choice of interviewee in this research should meet some requirements. 1. working in headquarter in Sweden. 2. High position in strategy related department. 3. Has enough experience with this area. Finally, we contact vice president of sales & marketing SAS International named Mr. Roberto Maiorana, who has more than 20 years experience in SAS. We designed 6 main interview questions and send them to him. According to Cooper and Schindler<sup>10</sup>, sending questions and ideas to the interviewees previously can provide more time to them to think about and motivate the questions. The questions also will be clear for the interviewer to read and analyze. Through telephone interview, besides asking the main questions, according to the manager's replied we asked the branch questions to obtain the more exhaustive detail explanation. It could be more convenience to supplement forward relevant questions. The communication carried on approximately 40 minutes and whole of the process was recorded in order to enhance the accuracy of information extraction.

### **2.2.3 Secondary Data**

Via access to a research library and use method to get relevant official documents can be the resource for the secondary data, such as government publications, service records, earlier research and client history, and so on.<sup>11</sup> The published policy and reports from SAS homepage

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<sup>9</sup> Saunders M, Lewis P, Thornhill A., 2007, *Research Methods for Business Students*, Prentice Hall, Pearson Education, London, England

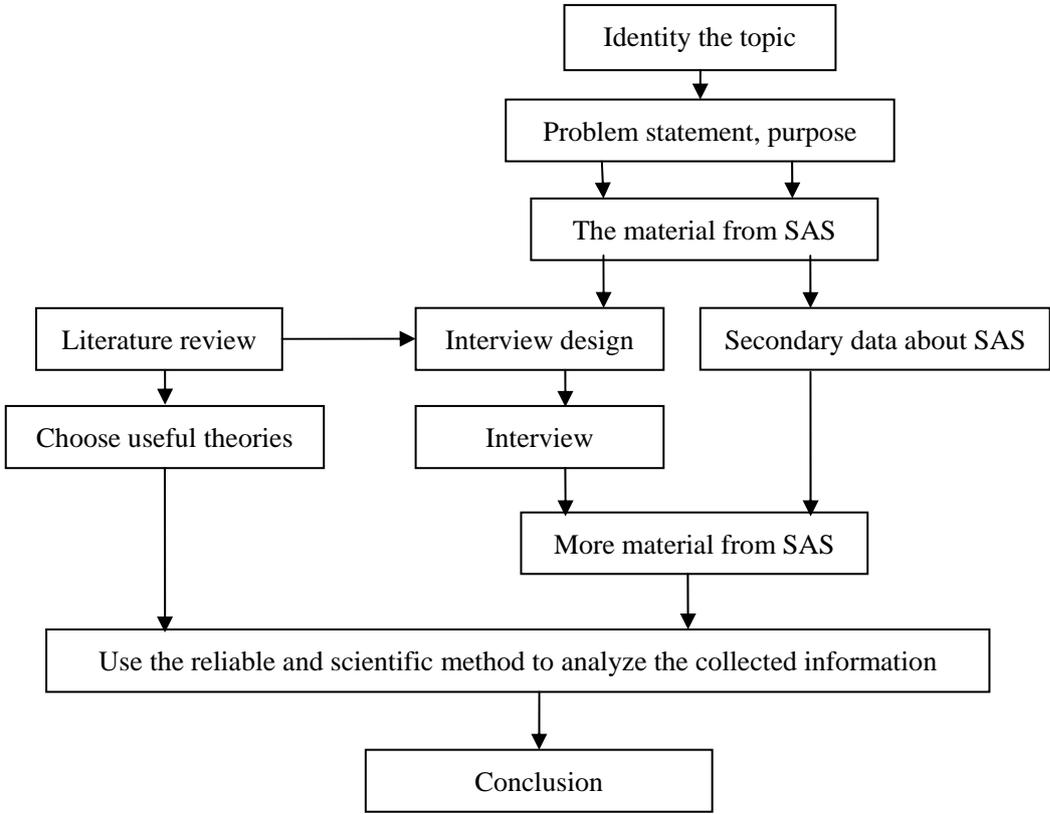
<sup>10</sup> Cooper and Schindler, 2003, *Business Research Methods*, Boston: Mc Graw-Hill, cop, P324

<sup>11</sup> Don Erwin Ethridge, 2004, *Research methodology in applied Economics.*, Blackwell publishing

were the main secondary source. Reading some real-time news comments from various authoritative website were the help for considering the direction of analysis. Moreover, as the topic is real-time that imply us should pay attention to the newest tendency and try to assure the accuracy of the research.

**2.3 The structure of study process**

Figure 2.1 the structure of study process



**2.4 Validity and Reliability**

Validity can be defined as the degree of a research method’s accuracy that the researchers use in solving the research problem.<sup>12</sup> According to Cooper & Schindler (2003)<sup>13</sup>, three mainly forms of validity are used to evaluate the research method. 1) Content validity. The more appropriate reflection of the topic that the method provides, the higher extent of content validity exists. 2)

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12 Saunders M, Lewis P, Thornhill A., 2007, Research Methods for Business Students, Prentice Hall, Pearson Education, London, England  
 13 Cooper and Schindler, 2003, Business Research Methods, Boston: Mc Graw-Hill, cop

Criterion-related validity. It means the capability of predicting some results or estimating some current condition's existence. 3) Construct validity. It means whether the method conform to the predicted correlations from other theoretical propositions. This study conducted multiple evidences from different aspects. The interviewee was from the top manager in SAS, who has a lot of experience and knowledge in this topic. The perspective of him was high valid. The process of interview was recorded. We paid lots of attentions to understand the opinion of interviewee and repeated listen to the record for information extraction, which in order to ensure a high level validity. The useful information from SAS's homepage also was fully used. The main questions are relevant to the aim and the questions of interview and questionnaire are link to the main questions. All of these are in order to establish the validity of this study.

A method is reliable if the later researchers use an instrument under the same or similar conditions to the same population as earlier researchers and they arrive at the same or similar results and conclusions.<sup>14</sup> In this research, read literatures and official news previously and integrate them into the case to design interview questions. We send the questions to interviewee previously in order to provide more time to him to motivate and express his opinion fully and the interview process was recorded which also can re-check the accuracy of the material. Moreover, the true experience of us was reliable. So, the reliability exists in our study.

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14 Cooper and Schindler, 2003, Business Research Methods, Boston: Mc Graw-Hill, cop

### **3. Theory**

*The theoretical background of the study is presented in this chapter. All these theories are the foundation and the evidence of the following chapter content. The theories include financial crisis, international business strategy, facilities location planning, co-operation and competition between companies and customer demand.*

#### **3.1 Financial Crisis**

When financial crises emerge, all or most of the financial indicators of a country or several countries will be impacted seriously. A large part of value of financial organization or assets will lose because the deterioration of financial indicators.<sup>15</sup> Financial crisis always include an exchange rate crisis, a banking crisis or a crisis combines both. A large number of bankrupt enterprises, the unemployment rate increased, and the general economic depression always accompany with the financial crisis, even some times social unrest or political instability will emerge in some countries.<sup>16</sup>

In the middle of 2007, a financial crisis started to reveal its influence, which has already brewing for a long time and from the survey of semi-official organization the economy recession was showed in December 2007 and was intensified in September 2008. The Wall Street turmoil which is aroused sub-prime mortgage crisis now has evolved into a global financial crisis. The speed of development, the size and the impact are far beyond the expectation of experts and ordinary people.<sup>17</sup> The U.S investment bank provide the loans to the people who are insolvent to purchase real estate, that is what we said the sub-prime mortgage. In theory, the people can repay the loan and the interest by the price difference when the prices of their house increase. But in reality, after the U.S housing price fall, the people who with the sub-prime mortgage are unable to repay the loan after for a short while, that cause the sub-prime mortgage crisis.<sup>18</sup>

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15 Gernot K. & Emilio J. C., 2003, Globalization: Critical Perspectives, New ork: Nova Science Publishers

16 James G., 2002, International economics, Boston: Addison-Wesley

17 Charles I. Jones, 2009, The Global Financial Crisis of 2007-20??, A supplement to Macroeconomics

18 Charles I. Jones, 2009, The Global Financial Crisis of 2007-20??, A supplement to Macroeconomics

Some European countries didn't pay much attention to the financial crisis as they thought it only will influence America that the control can't be implemented at once when the economic activity in Europe declined rapidly. Making matters worse, global trade declined sharply, the European exports were cutting output which was a safety valve for domestic industries. The financial crisis hit Europe much harder than expected. Almost all banks are on the brink of collapse. The currency was devaluated with an unbelievable pace, a large number enterprises are going bankrupt, rising rates of unemployment at a fast pace, the public protests, the financial and economic turmoil that brought a tough and difficult problem for European governments.<sup>19</sup>

### **3.2 International Business Strategy**

#### **3.2.1 Formulate the International Business Strategy**

A clear strategy can help a company to increasing its efficiency in such competitive international markets. Formulation the strategy is one of the most important processes to keep the organization operates normally. Appropriate strategy focuses on the suitable activities that can help the company to avoid the future of mediocre performance or failure. On the contrary, the consequence of an inappropriate strategy is often failure which cause internal tensions even will pull the firm in an opposite direction or take the company into its unfamiliar industries. A victory always starts with a successful strategy.<sup>20</sup>

The highly dynamic and competitive business environment force the organizations have to concern the fast changing circumstances constantly to avoid the unexpected loss.<sup>21</sup> Utilizing a dynamic approach to formulate and implement the business strategy frequently according to the environment uncertainty to reduce the company's risk which is a common way for organization

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19 Dick K. Nanto, 2009, The Global Financial Crisis: Analysis and Policy Implications, Congressional Research Service Report for Congreve.

20 Wild J, Wild K& Han J, 2008, International Business – an integrated approach, New Jersey: Prentice - Hall

21 Rainer F. & Kazem C., 1995, Strategy Formulation: a Learning Methodology, Benchmarking: An International Journal, Vol. 2, 38-55

access to success.<sup>22</sup> Organizations formulate the strategies to achieve a more favorable position.<sup>23</sup> When drawing up the new strategy, managers try to manage everyday activities to give the enterprise or the industry current or future direction a new view.<sup>24</sup>

### **3.2.2 Retrenchment Strategy**

When a company is operating more than one line of business, a corporate – level strategy need to be formulated. The corporate-level strategy includes four key approaches, which are growth strategy, retrenchment strategy, stability strategy, and combination strategy. Strategy decision is depended on different market and different business environment.<sup>25</sup> In this study, we focus on the retrenchment strategy.

It is nearly impossible for the company to maintain growing revenue forever. When the enterprise realize their brand is entering or maintaining a recession period, such as either enterprise's inside or outside environment are always in a disadvantageous situation, the keeping decrease of customer demand, or the management level reduces seriously, which all will affected the revenue or the market share that they should consider how to reverse the situation. Retrenchment strategy becomes the necessity. There are three general strategic approaches for declining market which are retrenchment, harvesting, and consolidation.<sup>26</sup> Retrenchment Strategy is a strategy that the corporations need to adjust some aspects or even change the whole old strategy to adapt the unstable external environment, which is exact opposite of a growth strategy. The external environment includes the economic recession, the industrial recession, or the demand of products or service is reducing. Under these circumstances, via retrenchment strategy the enterprise can save a lot of losses and still can retain their basic distinctive competence.<sup>27</sup> A retrenchment strategy involves the company gives

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22 Rainer F., Kazem C. & John W., 1995, Analysis of Strategy Formulation and Implementation at Hewlett-Packard, Management Decision, Vol. 33, 4-16

23 Rainer F. & Kazem C., 1995, Strategy Formulation: a Learning Methodology, Benchmarking: An International Journal, Vol. 2, 38-55

24 Wild J, Wild K& Han J, 2008, International Business – an integrated approach, New Jersey: Prentice - Hall

25 ibid

26 Thomas T. N. & Reed K. H., 2002, The Strategy and Tactics of Pricing, China: Tsinghua University Publishers

27 Howard S., 2005, Turnaround Strategies for Declining SmALL Business: the effects of performance and resources. Journal of Developmental Entrepreneurship, 239-252

up in some market segments or removes them to other market where the firm has a more profitable position. The essence of a retrenchment strategy is withdrawing or liquidating the assets from the markets where is representing weakest that make the company is more defensible.<sup>28</sup>

In retrenchment strategy, the scale or scope of a corporation's business will be reduced and it is also a reduction of expenditures to confirm the financial stability.<sup>29</sup> When the economic conditions worsen or competition increases that the profits of the organization are declining, the corporation often cut back the scale of their operations. They may shrink, adjust or withdraw the current market field, such as close some unprofitable factories or lay off workers or withdraw from offering some products and serving in some markets. The scale of the operation is reduced and the benefit index, for example, profit rate, market share, will decline obviously at the same time. The corporation can via selling unprofitable business units or the units which are no longer directly related to their overall aims to reduce the scope of their business.<sup>30</sup>

When the national business environments become more competitive, retrenchment strategy is a common approach for the weaker competitors.<sup>31</sup> The strategy can reduce the loss in a maximum way. In many cases, insist to save irreversible business blindly and stubbornly will lead the company to an irretrievable situation. The losses won't be saved even be created. This kind of firm only can use the existing and limit resource to invest when they have a new business opportunity, which definitely will affect the business prospects to expand the business area. On the contrary, adopting the retrenchment strategy, enterprises can transfer the resource from unprofitable market to the better market on more profitable business and thereby achieve the maximization of long-term interests.<sup>32</sup> If the operations become out of control and can't be reversed in any move that in some cases, enterprises will choose bankruptcy, which is also a type of retrenchment strategy.<sup>33</sup>

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28 Thomas T. N. & Reed K. H., 2002, *The Strategy and Tactics of Pricing*, China: Tsinghua University Publishers

29 <http://en.allexperts.com/q/Marketing-1090/2009/1/strategic-management.htm>

30 Wild J, et.al, 2008, *International Business – and Integrated Approach*, New Jersey: Prentice-Hall

31 *ibid*

32 Thomas T. N. & Reed K. H., 2002, *The Strategy and Tactics of Pricing*, China: Tsinghua University Publishers

33 <http://en.allexperts.com/q/Marketing-1090/2009/1/strategic-management.htm>

### **3.3 Facilities Location Planning**

A hundred-mile move to a new location, and millions of dollars saved. Selecting the location for production facilities is an important aspect in international business strategy, which called facilities location planning. Different kinds of aim will have different potential locations around the world for multinational companies to select, production, research, development, for instance. The business environment is important for facilities location planning. The cost and availability of labor and management, raw materials and energy are the aspects that should be considered in the business environments. Other factors such as political stability, local culture, the regulation and bureaucracy, economic development in that place also can't be ignored. For the majority of service companies, the choice of company's address should not only the geographical position need to near their customers, moreover the category and quantity of customer's need are also the center for facilities location planning.<sup>34</sup>

John T. Mentzer mentioned there are sever key factors should be considered when the company choosing the facilities location.

1. Land: Whether this area is wide enough for the facilities.
2. Labor: It is a key factor for a company to choose the location.
3. Capital: Different economic incentives in different countries to attract multinational company decide to invest or locate there.
4. Sources of Supply: Make sure the distance between the company and regular suppliers from a potential location.
5. Production: Via the value, weight, volume or other factors change to compare the supplies to the final product.
6. Markets: Inexpensive location and close to customers need an optimal balance.
7. Logistics: How close between the nearest transport area and the facilities location.<sup>35</sup>

Location economies can be obtained by selecting a right location, which the benefits originate

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34 Wild J, et.al, 2008, International Business – and Integrated Approach, New Jersey: Prentice-Hall

35 John T. Mentzer ,2008, 7 keys to Facility Location, Supply Chain Management Review, 5/1/2008

from locating production activities in optimal locations. Selecting a highly favorable location can enhance the competitive advantage for a company. In order to get the advantage of location economies, the customs, demands, traditions and the environment are the considerations need to be familiarized for the firms.<sup>36</sup>

### **3.4 Co-operation and Competition Between Companies**

Nowadays, the international environment is much more competitive than before. The companies have to face different kinds of competition depend on different environment, which varies by products, companies, strategies and countries. For instance, the rival companies which are producing homogenous products, such as rolled steel, the price will be the most important competitive factor. The cost saving would be the main purpose for strategy formulation. Some other rival companies will compete to the innovation and differentiation. Regardless which type the company is, the competitors from international or local ones in home or foreign markets need to be concerned.<sup>37</sup>

Co-operation exists in the activities when a business cooperates with its competitors in order to gain mutual gain. There are two approaches for co-operation, which are joint venture and strategic alliances.<sup>38</sup> When companies choose to cooperate with one or more enterprises, which have the mutual strategic benefit or the similar management strength to achieve the common strategies called strategic alliances.<sup>39</sup> According to Ford (1997) defined the strategic alliance is a way to achieve individual and partnership strategic advantages by establishing synergistic combination of individual and mutual goals that encourage their partners willing to invest time, effort, resources to create a long-term collaborative relationship.<sup>40</sup>

In the strategic alliance, the participators bring its unique or particular skill or resource to share

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<sup>36</sup> Wild J, et.al, 2008, International Business – and Integrated Approach, New Jersey: Prentice-Hall

<sup>37</sup> John D. Daniels, Lee H., 2004, International Business: Environment and Operations, Upper Saddle River

<sup>38</sup> Robert L. 2004, Strategic Partnerships: an Entrepreneur's guide to joint ventures and alliances, Chicago, IL: Dearborn, cop.

<sup>39</sup> Wild J, et.al, 2008, International Business – and Integrated Approach, New Jersey: Prentice-Hall

<sup>40</sup> Ford.D, 1997, Understanding Business Markets: Interaction, Relationships and Networks various: Harcourt Brace & Company

and expecting the relationship can bring the benefit from the other's co-operation company, which always involves know-how, technology transfers instruments, or production mode.<sup>41</sup> The partners also can share the cost of an international investment project and tap into competitors' specific strengths.<sup>42</sup> A successful strategic alliances strategy can provide a dramatic improvement to the operations and competitiveness of a company.<sup>43</sup>

### **3.5 Customer Demand**

Wild J *et.al* (2008) mentioned demand is the quantity in which the buyers are willing to purchase a product or service at a specific selling price. The quantity of demand in potential market is the key factor for the enterprise to consider when they want to expand its business into a new market. The market demand insufficiency will cause the business loss the value that force every company research the market demand before entering a new market.<sup>44</sup>

Customer focus nowadays is become an important strategy for a company, which implies the company formulates its strategy or its activities and products depend on the consumer demands. There are three approaches can achieve this: the customer-driven approach, the product innovation approach and the sense of identifying market changes. In customer-driven approach, what the customers' wants is the key for the strategic marketing decisions. All the strategies will be continued after they pass the test of consumer research. The needs of potential consumers are the drivers of every aspect of a market offering.<sup>45</sup>

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41 Jeannet and Hennessey, 1995, *Global Marketing Strategies*, Boston: Houghton Mifflin Company

42 Wild J, et.al, 2008, *International Business – and Integrated Approach*, New Jersey: Prentice-Hall

43 Frida W. H., 2003, *How Co-operation Can Deliver Added Value to Customers: From the customers vies*, *Teknisk fysik* 2003:336

44 Wild J, et.al, 2008, *International Business – and Integrated Approach*, New Jersey: Prentice-Hall

45 Joseph P. Guiltinan, Gordon W. Paul, 1996, *Marketing Management: Strategies and Programs*, McGraw Hill/Irwin

## **4. Empirical**

*This part is about the empirical data. There are three parts in this chapter. Firstly, the overview of SAS will be presented. Second part is about the recent strategy tendency of SAS. In the last part, the details of the interview will be given.*

### **4.1 Overview of SAS**

SAS is the leading Scandinavian airline company which was founded in August 1946. It is a multi-national airline 50% owned by the Norwegian, Danish and Swedish states. Focus area of the company is short-and medium-distance flights in Europe and the company headquarters located in Stockholm, Sweden, and owned by SAS AB. Scandinavian Airlines is as well as one of the founding members of Star Alliance, which is the world's leading airline alliance.<sup>46</sup> There are three primary centers are operating by SAS: Copenhagen-Kastrup Airport, Stockholm-Arlanda Airport, and Oslo-Gardermoen Airport.<sup>47</sup>

During these years, SAS always tend to grow up to be an innovation, pioneering airlines. And strive to offer the market's most sought-after products which are based on giving customers flexible, value-for-money air travel. It precisely follow the promise what they approved—"we give you the opportunity to fly on your terms". The further explanation they give like "It does not matter where, how or why our customers travel—we must always be able to offer the alternative with the best value. That is when we keep our promise."<sup>48</sup>

SAS attaches great importance to environmental protection and it is the forefront of the industry in relation to environmental concerns and in order to be seen as the most environment-conscious airline in Europe.

SAS is a customer-focused company since its management mode decided it should attach important to listen respectfully suggestions and criticisms from customers. Jens Ericsson, who is the manager of analysis and systems in Scandinavian Airlines' Customer Relations Department, said the customers speak out their experience for avoiding the same problem

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<sup>46</sup> Jyske Markets, August. 2009, *Equity Research, Industry*

<sup>47</sup> <http://www.flysas.se>

<sup>48</sup> Ibid

happen again, but not for compensation.<sup>49</sup>

Competition amongst airlines for customers is very tough. It is essential for companies to do their best to meet customers' requirements through listening what they say and adapting what they want. Concurrently ensure their services equal to their price.

#### **4.2 Recent strategy tendency of Scandinavian Airlines**

After the serious influence by financial crisis, SAS Group had a comprehensive consideration regarding to corporate earnings, reduction of market demand and increasing operating costs. In order to enhance the core competitiveness of company and base on the cost, two intercontinental flight routes they decided to temporarily suspend.<sup>50</sup>

As a response to the current global environment, as well as the internal challenges, and with the purpose to strengthen SAS Group's competitive advantage and profitability in long term, SAS management and Board of Directors have decided to use "Core SAS" as the new strategic direction to instead of the old one.

The renewed SAS strategy is intended to through establish a new, streamlined and effective organization to support a new competitive SAS. They reduced lots of activities and started to focus on their core market—Scandinavia. The new rescue plan is SAS' final chance to survive. The implementation of Core SAS will commence in 2009, aiming to create a new SAS that generates long-term value for shareholders, and fix the current industry dynamics, internal challenges and the global recession.<sup>51</sup>

Core SAS—SAS's new strategic approach is built on specific targeted areas:

**(1) Move the center market to Nordic home market.** Sale or withdrawn the non-core business and unprofitable sub-companies. Focus on operating SAS Ground Services, SAS

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<sup>49</sup> <http://www.sas.com/success/scanair.html>

<sup>50</sup> <http://www.sas.com>

<sup>51</sup> <http://www.sas.com>

Technical Services and SAS Cargo are intended to be discontinued or outsourced to third parties

- (2) **Concentrate on business traveler groups and strengthened commercial product and service.** Reduce 10% fleet and 40% flight routes, launch of service and simplicity concept.
- (3) **Improve cost base.** Propose in 2009-2011, cost reduction program of approximately SEK 2.7 billion will be carry out; via collective agreement negotiations to save approximately SEK 1.3 billion each year.
- (4) **Enhance efficiency of organization and customer oriented culture.** Operations of national subsidiaries to be streamlined that transferred into new organizations. All operations will be enhanced efficiency.
- (5) **Strengthened capital structure.** Approximately SEK 6 billion right issue in order to facilitate the implementation of Core SAS; Extension of some debt facilities.<sup>52</sup>

On Sep 30<sup>st</sup> SAS Group has reached an agreement with Lufthansa and LHBD Holding Ltd. (LHBD) , they are going to sell out a 20% stake in the UK based British Midland PLC (“bmi”) to LHBD which is a UK-based company held by Lufthansa of a 35% stake. After this transaction, SAS will receive a cash allowance which resulting in a capital gain that’s about approx 420 million SEK. In addition, if the further value of bmi can be achieved in the two-year period SAS will receive excess payment from Lufthansa. SAS has been the shareholder of in bmi from 1989 until now, but they will keep cooperation through its Star Alliance membership.<sup>53</sup>

According to the Jyske Markets (2009)<sup>54</sup>, some risk factors and vested interest are classed as following:

**“Risk factors in the future might be faced by SAS’ rescue plan:**

- The new savings strategy will increase earning, but it’s hard to convince that SAS will reach its rival’s cost level.

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<sup>52</sup> <http://www.sas.com>

<sup>53</sup> <http://finance.yahoo.com/news/>

<sup>54</sup> Jyske Markets, August. 2009, *Equity Research, Industry*

- Due to the economic slowdown caused the weaker demand phenomenon which has pushed more customers to the discount segment and thus away from the expensive seats in the SAS aircraft.
- Lower economic growth resulted in weaker-than-expected development in traffic figures (falling airfares, lower capacity utilization).
- Increasing competition from discount airlines.
- The rising of oil prices.
- Terrorist attacks will affect people's willingness to travel.

**Vested interest in the future might be gained of SAS' rescue plan:**

- Due to the realization of the expected cost-cuts which could positive push good traffic figures and ensure a strong-than-anticipated development in earnings in 2009 and 2010.
- The respect of airfares has a strong-than-anticipated development.
- The declining of oil prices and USD.
- The fast turn of world economic resurgence will increase the demand from business travelers. ”

### **4.3 Interview with SAS**

On May 1<sup>st</sup> 2009, we did a telephone conference interview with the vice president of sales & marketing SAS International named Mr. Roberto Maiorana. The process of the interview took half an hour. We appreciated our supervisor Dr. Ernst Hollander also participated into the interview.

The purpose of the research is tending to find out the reasons why SAS terminated the non-stop flight route Stockholm-Beijing. According to the questions, the answers were given in detail. He mentioned in 1998, SAS was operating the flight Copenhagen-Beijing which made SAS become one of the earliest airlines who connected Euro and China. The route was very

profitable and in 2005 SAS started non-stop flight Stockholm- Beijing since they got a great Swedish market demand. The number of the flight from 3 frequencies a week in March 2005 increased to 6 frequencies in summer 2008, which was linked to the Olympic Games in Beijing.

Everything was well until the earthquake happened in China in 2008 and Scandinavian public opinions were questioning traveling to China. Plus the influence of Tibet problem broke out in China, because of the different politic systems and different culture background between European countries and China that caused some European customers doubt about human rights issues in China and also take a wait-and-see attitude to travel to China. Then Scandinavian public is much more than SAS learned before. Two SAS operators who organized travel groups to China that found the first decline sign was in the early spring, 2008. Earthquake influenced the traveling and in addition, from China side, after Chinese government published a new rule for facility trip, which refers prohibit strictly the employees who work for the government or the public sector use excuses to utilize the government budget for personal travelling, SAS lost a lot of customers. These facts affected on the development of the route. At the beginning SAS thought Olympic Game might create more traffic that they double the flight frequency, but the result out of their expectation since all these happened. During the period the global financial crisis broke out, SAS found the traffic decline all over the world not only Beijing route.

When we ask the process of making the decision, the interviewee said it is complicate to explain all the steps. They have a plant of calculation, look into four costs, research average revenue on each passenger kilometers, and look into a lot of key performance indicators to conclude the decision but we didn't have the time to ask the further explanations of these key performance.

Whether SAS will rebuild the route again, Roberto told us they will consider the possibility to open up the route again when the demand return to the level of 2007. Although the route had been terminated, SAS still remain the connection with China since they keep the route from Copenhagen to Beijing. Regarding to why SAS select Copenhagen but not Stockholm he explained the most important reason is location advantage—compare with these cities, Copenhagen has a better location. Because of Sweden and the south of Euro are easy for SAS to

offer product via Copenhagen and it has a stronger captured area that is considering south of Sweden, Denmark, and north of Germany and so on. SAS has a large number destination of Copenhagen that they offer all Scandinavian markets with good collection. When they try to design a new route, they first operate the route from Copenhagen then build that the same product in Stockholm when the demand is enough. Base on the data survey from SAS, they found the same destination, the Stockholm route always weaker. He mentioned when they choose which route should be retained, they consider Copenhagen preferentially since it is always the most profitable route.

In the interview he emphasized the cooperation with Air China is very important and they also have a good cooperation relationship with many local air companies. Such as when the customers buy the ticket from SAS, sometimes they travel by Air China's flight. At the same time both of these airlines are the members of Star Alliance. They can share the information and the facilities each other.

## **5. Analysis**

*In this part we integrate the relevant theories are mentioned above and the information that we collect from different channels to analyze and find out the answer of the research question.*

In 1998, SAS was operating the flight between Euro and China. The flight Copenhagen - Beijing made SAS becomes one of the earliest airline companies in this market. This flight was very profitable and soon after the company found the customer demand in Sweden is enough to open the non-stop flight Stockholm – Beijing. This flight was profitable and the frequencies were reached 6 in a week in 2008, which SAS believed the Olympic Games in Beijing will create the more customer demand. But after the financial crisis and some emergencies occurred in China, the flight received a heavy blow.

The financial crisis of 2007-2009 was created by the USA and immediately spread to all over the world with an alarming rate. Till to 2008, the financial crisis become out of control and it causes collapse of many large financial institutions or are taken over by the government. At the beginning, some European countries didn't pay attention to it until they found the economic activity in Europe has declined rapidly in a short period of time, the negative impacts as we mentioned before. The financial crisis has hit Europe much harder than expected. According to a variety of data collection and business interview we are told that the SAS as one of the first largest airlines in North Europe unavoidably has received considerably negative influence. Since the global economic crisis intensify continuously, as a large transport company, the firm annual performance report of 2008 shows negative, its net loss of up to 6,320,000,000 SEK and compare to the 636 million kronor of net income in 2007. Loss only in the fourth quarter reached to 2.77 billion SEK. This is the largest-- ever annual loss in the company history. During the crisis period, thousands of layoffs and huge pay cuts are in store for employees of Scandinavian Airlines (SAS) after the company posted losses of more than 1.3 billion kronor from the first six months of 2009.

Because the change of external global environment and increasing of internal challenges that force SAS make some adjustments for their strategy to make the business more profitable. Plus the competition from other companies is larger than before especially from the low price airline since the price becomes a more sensitive factor for considering air ticket after the change of external environment. A strategy called Core SAS which the managers believe it is more appropriate for current situation. According to the theory that we research, Core SAS can be classed as retrenchment strategy of corporate-level strategy. When the external circumstances include recession of economy, financial crisis, or reducing of demand, retrenchment strategy can help the company to resist this change even may reverse the negative segments of the company. SAS via forgoes some unprofitable markets to locate itself in a better position. SAS decide to withdraw their capital from some airlines, Spanair, airBaltic, Spirit, Air Greenland, for instance. Narrow their target customers to business travelers and streamlined their organization in order to reduce the cost and efficient the operations.

Before the interview with Mr. Roberto Maiorana, we conjectured that they decide to suspend the route from Stockholm to Beijing because of the implementation of the renewed strategy—"Core SAS". Since the new tactics is focus on Nordic home market for enhance the competitiveness - through monographs on what they do best, the core business products and services to promote the competitiveness and independence of the company. Also from the recent strategies of SAS show that it signed an agreement and going to sell out its 20% stake in bmi to Lufthansa and LHBD, it is also reflect the Core SAS strategy with focus on the Nordic home market this stake has been set out for divestment. But base on the interview and reference analysis we found that the carry out of" Core SAS" is not the decisive reason for flight cancellation, but the size of customer demand is the most important reason for them to consider whether to offer or close a flight route.

The new strategy "Core SAS" is built on the basic of "streamlined organization and customer oriented culture". We could interpret as "customer focus". Many companies today have a customer focus (or market orientation). This implies the potential consumer demands are the pillar for the company to carry out its activities and products. In the theory part mentioned that

there are three ways of doing this, one of the ways is “consumer-driven approach”- all the strategic marketing decisions, market offering and the nature of the product itself that is driven by the need of potential consumers.

Selecting the location for production facilities always is a crucial factor to impact the success of business. For SAS, there were two direct flights from North Euro to Beijing and SAS decide choose to terminate the Stockholm flight instead of Copenhagen flight because the managers believe the location environment advantage of Copenhagen is much better than Stockholm. The cost, labor, management, market demand and raw materials are the aspects that should be considered in the business environments, which is important for facilities location planning. In SAS’ survey, the market demand in Copenhagen is higher than in Stockholm and also the profit. Copenhagen is the hub of Scandinavia airline that it is easy to offer product via Copenhagen and it has a better stronger captured area. SAS already has a large number destination of Copenhagen to offer good collection to all the Scandinavia market. The market potential of Copenhagen is stronger.

In a strategic alliance, members bring their unique or particular competences or resources to share with, and via the relationship expect to gain experiences from the others’, which always involves distribution access, technology transfers instruments, or production modes. The members also can share the cost of an international investment project and other competitors’ specific states. A successful strategic alliance can bring effective improvements to the operations and competitiveness to member companies.

SAS and Airchina are both the members of Star Alliance, for instance we can see the phenomenon that customers buy tickets from SAS but usually travel from Sweden to China by Airchina’s plane. Such kind of co-corporation also exists among other Star Alliance members , that we can see as a resource sharing, the partners can share the cost of international operation and use competitors’ specific strengths to carry out the operation of the company’s.

Although the manager didn’t mentioned there is a link among the financial crisis, the core SAS,

suspension of the flight, from the outside information, the occurring time of financial crisis, the financial report of SAS and the promulgation time of core SAS, we have reason to believe there is a connection between the external environment change and their internal strategy. Financial crisis is a main reason to decrease the customer demand seriously that force SAS has to consider another new strategy to reverse the loss. Moving their focus market cause the flight outside the home market need to be reduced that promote cutting one of the connection between Euro-China, which has a weaker geography position and less profit --- Stockholm-Beijing.

## **6. Conclusion and Ideas**

*This chapter, firstly we will state the conclusion after we analyze the data and theories. Then we have some ideas base on the situation for the company. We also will give the suggestions for the further study in the last part.*

### **6.1 Conclusion**

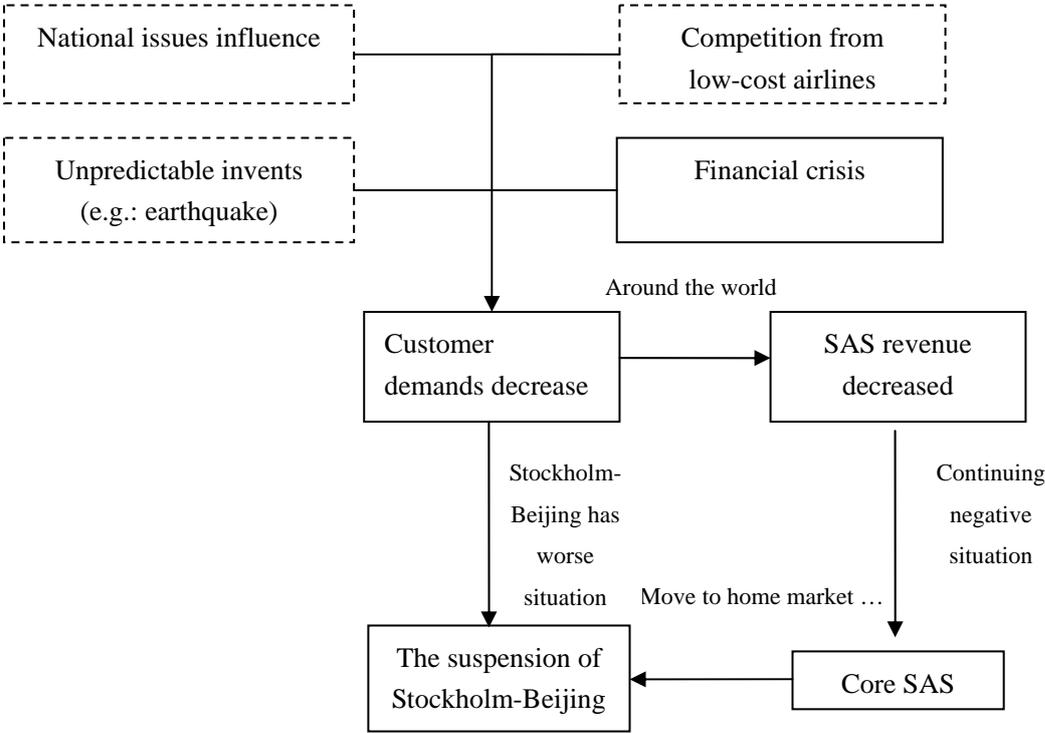
Since the financial crisis happened in 2007, the negative influence was brought rapidly spread to whole Europe. SAS as one of the largest airlines in North Europe, it reported that in 2008 the net losses of 6.32 billion kronor which compared with net income 636 million kronor it earned in 2007, at the same time the company would cut back on about 40 percent of its routes and sell its stakes in a number of airlines. In order to enhance the core competitiveness of company, SAS implemented a retrenchment strategy called “Core SAS” to try to reverse the negative situation. “Core SAS” is built on specific targeted areas, like focus on Nordic home market and cut the operation of some unprofitable intercontinental flights to reduce cost, focus on the business group. SAS can gain future vested benefit by this new strategy but the risks also exist which should be paid close attention on.

The non-stop flight route Stockholm-Beijing which started to operate in 2005 and it was very profitable. According to the anticipation of SAS, the customer demand will increase rapidly during the Olympic Games time in Beijing 2008 that prompt they raise the frequencies to 6 per week. But because the influence of financial crisis and the effect of China domestic affairs, such as the earthquake happened in May, 2008, the ban of official employees travel by government expense, and the influence of Tibet problem, the customer demand decreased at a fast pace. The profit not only didn't achieve the expectation average but also created the loss. As a flight outside the home Nordic market, these phenomena strengthened the necessary of suspension. SAS chose to retain the flight which is more profitable and have a better location advantage, Copenhagen-Beijing, and cut the weaker flight, Stockholm-Beijing.

The official announcement said the suspension is temporary. The customer demand is the determinant of whether the flight should be operated that when the market demand return to the level of 2007, the route will be opened up again. But from our perspective, according to the current situation of SAS it will be very tough to re-operate this service.

This is a new and general figure after we modified, which compare with the original one in question part (See Chapter 1). Because during the research, we found there are some other more components affect the customer demands decreasing, which in the dotted frames.

Figure 5.1 the connection between the external environment and internal strategy



**6.2 Ideas**

As international students from China who are studying business, after approximate 10 weeks research and we collected lots of relative information through many approach. We have some ideas which as following:

### **1. Target marketing strategies**

The negative impacts brought from financial crisis in China are less than Western countries. China is one of the few countries where the GDP still keeps growth; meanwhile the income of residents has not been affected too much. Additionally, today's China has a strong momentum of development that citizens are chasing more high expectation for life quality. They are not merely satisfied with demand of food, clothing and lodging, but they put sight on transportation which could offer them swift and comfortable service during whole travelling process. So the general demand of these customers is gradually becoming a vital potential market. If SAS is going to resume the route from Stockholm to Beijing in the future, we suggest the company might appropriately adjust tactics just focus on the market of China, tend to pay attention on the potential market we mentioned before, but not only business travelers.

### **2. Via price advantage to promote high-quality service of SAS**

We have some experience of travelling between Sweden and China by SAS and also other airlines; through compared with them we found that service of SAS is the best, whatever the cabin comforts, food, entertainment facilities or service attitude. But we commonly found that the price of SAS always higher than other competitors. It would be a barrier for potential customers to try out their service. So in our opinions, suppose SAS can appropriate adjust the price of flights, in the circumstances of maintaining profitability try to minimize the price gap with other airlines, then the high-quality services of SAS could be the competitive advantage to attract more potential customers.

### **3. Set up the limited urgent seat**

It is a tough challenge for sell out all tickets of every flight. Therefore, SAS can set up a new service for as possible increase the sale-out rates of each class flights. For example, a short period before plane takes-off; it can be 72 hours, 48hours, or within 24 hours, and the company could according to the sales condition select a limited number of remaining seats for sale with a preferential price. The approach can reduce the cost of vacant seats and at the same time it satisfies some customers who are anxious to travel but have expense of consideration. The "Last Minute" Service of SJ can be used as a reference data.

#### **5.4 Suggestion for further studies**

Although this study exist some disadvantages and limitations, we think it still has its useful aspect. This study is valuable for the service industry when they are facing the external environment change to adjust their international business strategy. When we collected relevant theories we found the theories about retrenchment strategy is limit and the relevant case is rare. So this paper also is helpful for the researchers who want to understand or research retrenchment strategy.

It will be more comprehensive and interesting if supplement some aspects in the further studies, as following:

1. Because we only from the Swedish side to investigate that we suggest in the further studies can complete the investigation from Chinese side or interview the supervisor of China. We think the manager may have more information about the real situation about China and may have different thinking about this issue because culture in China and Sweden are different.
2. To do the comparison with other airlines or other service industries what are their strategy when they under the same or similar external condition. Find out the differentiation can decrease the limitation of this study that can enhance the value for other services industries not just value for Airlines Company.
3. Before the financial crisis serious impacted the global economy, many companies had already realized the change of economic environment and establish some prevention measures. But from the influence that SAS was affected and the adjustment of strategy the possibility of no prevention measures is larger. It would be interesting for the further researcher to investigate SAS as a leader of airline in Europe, have they predicted the financial crisis and instituted the corresponding countermeasure to resist it.

4. There are also other multinational airline implement the retrenchment strategy for resist the influence of financial crisis, such as Japan Airline, Air France and so on. We think although the retrenchment strategy was implemented by these airlines, the geography location difference, target customer difference, catchment are difference that the detail of retrenchment strategy in each airline will be different. Compare the difference among different retrenchment strategy can help the airlines to absorb the advantage of the strategy from other airlines.

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## **Appendix**

### **The interview question**

#### **Questions:**

1. As we have learnt, Scandinavian Airlines (SAS) will suspend its Beijing-Stockholm service

from May 1 due to declining traffic on that route. As Chinese business students in Sweden we feel sorry about the news. We would like to know how SAS arrived at the decision.

2. SAS statement said that “Removing capacity from the long-haul fleet is vital to reduce the risk and financial exposure of SAS operations in this downturn” We want to ask which arguments there were against the decision.
3. We think it must be tough to make the decision, could you please tell us how the analysis was done. Please describe some steps briefly.
4. Majorities of the Chinese students feel it is a pity about cancellation of this flight since they love SAS. Then, after the flight stop, have you make any further plan to help the customers who need the service on this route?
5. We noticed that SAS will carry out the “Core SAS” new strategy, could you please tell us the background of this strategy? What kind of achievement that SAS want to gain from the strategy?
6. As far as we have understood SAS will maintain the flight routes “Copenhagen-Beijing”. Are there other considerations behind those priorities than the short term financial matters mentioned above? When we ask for other considerations we refer inter alia to future growth estimates, priority for business passengers, Copenhagen/ Stockholm balance etc.