



Requirements for this paper/Benodighede vir hierdie vraestel:				Resources/Hulpmiddels:
Answer Scripts/ Antwoordskrifte:		Multi-choice cards (A4)/ Multikeusekaarte (A4)		
Attendance Slips (Fill-in Paper)/ Presensiestrokies (Invulvraestel):		Graph Paper/ GrafiekPapier		
Scrap Paper/ Rofwerkpapier		Calculators/ Sakrekenaars		
Multi-choice cards (A5)/ Multikeusekaarte (A5)		Laptop (Power not provided)/ Skootrekenaar (Krag word nie voorsien nie)		

Type of Assessment/
Tipe Assessering:

Duration/
Tydsduur:

Paper Number/
Vraestel Nommer:

Maximum Marks/
Maksimum Punte:

Module Code/
Modulekode:

Module Description/
Module Beskrywing:

Examiner(s)/
Eksaminator(e):

Date/
Datum:

Internal/Interne
Moderator(s):

Time/
Tyd:

External Moderator(s)/
Eksterne Moderator(s):

Qualification/
Kwalifikasie:

Submission of answer scripts/Inhandiging van antwoordskrifte:

QUESTION 2/ VRAAG 2:

[80]

Answer strictly according to the numbering sequence / *Beantwoord die vrae streng volgens die numeringsvolgorde-*

Develop a consultancy report to Carnival's top management detailing your analysis and actionable recommendations regarding the following issues:

1. How strong are the competitive forces confronting Carnival in their market environment? Do a five-forces analysis (5) only by means of the conventional diagram, (b) identify the key driving forces (5) and (c) key success factors (5) to support your answer.
2. Using the case study and one or more of the frameworks covered in your course (i.e. Ansoff's Matrix/Innovation Ambition Matrix), analyse the pattern of Carnival's corporate strategy to date. (8)

☞ COPY THE FOLLOWING FORMAT IN YOUR SCRIPT TO STRUCTURE YOUR ANSWERS

Date	Key Event	Analysis
		•
		•
		•
		•
		•
		•

		•
		•

3. (a) Which of the generic strategies most closely fit the competitive approach that Carnival is taking? (5)
(b) Evaluate Carnival's recent corporate strategy. Using the three tests of a winning strategy, evaluate Carnival's recent strategy by thinking about the fit issues (6)
4. (a) What choices are open to Carnival for changing the scope of its business? Use the concepts from your lectured themes, *for example, for Integration purposes you might choose a particular strategic option.* (b) Evaluate each of Carnival's options using a Red (destroy value); or –Amber(a temporary competitive advantage); or–Green (strengthening) as part of your grading system for each option (8)

☞ COPY THE FOLLOWING FORMAT IN YOUR SCRIPT TO STRUCTURE YOUR ANSWERS

(a)Corporate Strategy Choice	(a)Examples Relating to Carnival	(b)Grading colour (red/amber/green)
	•	•
	•	•
	•	•
	•	•
	•	•

5. Evaluate Carnival's CSR performance using the Triple Bottom Line (TBL) framework. (5)
6. What steps should Carnival take to improve its CSR performance? (5)
7. How well is the strategy of Carnival performing financially? (Do the applicable financial ratio analysis based on the information in the exhibit). Justify by illustrating the formulas and calculations clearly (10)
8. Advise Carnival's CEO about the new narrative of the "superstar" phenomenon and subsequent superstar companies in the context of Carnival's ecosystem? How should Carnival remain resilient? (10)
9. Based on your case analysis (findings), what recommendations would you make to Carnival's CEO going forward about the strategy? Justify! / Op grond van jou gevallestudie-analise, watter aanbevelings sal jy maak aan die HUB aangaande Carnival se strategie vir die volgende aantal jare? Motiveer! (8)

Case: Carnival Corporation & plc -Alex Janes (University of Exeter)

On 13 May 2015, Arnold Donald, the CEO and president of Carnival, was waiting for a meeting with the company's board of directors. Since he had been asked to lead the world's largest global cruise line, in June 2013, business had improved but he knew some of this was due to better economic conditions and underlying trends in the sector. To make his mark on the company and the cruise industry he would have to go further, so he planned to review the current strategy with his board and decide the next steps in maintaining and consolidating the firm's market-leading position.

Company Background

Carnival was the vision of entrepreneur Ted Arison, who founded the company in 1972 as a subsidiary of Boston-based American International Travel Service (AITS). He started running trips from Miami to San Juan on Puerto Rico with a secondhand ship, the TSS Mardi Gras. The first voyage was less than auspicious when the ship ran aground on a sandbar. After two years, the firm was still struggling to make an impact. So, when Ted offered his business partners the chance to sell their share of the company and said that he would take on the \$5 million in debt the firm had accrued, they agreed to sell for \$1. Over the next 15 years Carnival grew organically, adding a range of destinations to its portfolio and adding to its fleet of cruise ships through the purchase of more secondhand vessels. Then, in 1980, the firm commissioned its first bespoke cruise ship, the Tropicale, which entered service in 1982. Arison's business acumen and understanding of what cruise customers wanted helped the firm to grow and compete successfully with many of the older and more established players in the field. By 1987, Carnival was known as 'the world's most popular cruise line' and on the back of this reputation Ted decided to make an IPO (Initial Public Offering) of 20 per cent of the company's common stock. This raised \$400 million and led to the next phase of the company's development and a radical change in strategy.

Acquisitions

With the funds raised from the IPO, Carnival now began to grow by acquiring other cruise lines. Its first major coup was buying one of the oldest firms in the USA, Seattle-based Holland America Line (see Exhibit 1 for Carnival Corporation & plc brands/subsidiaries).

This company had been in business for more than a century when Carnival acquired it. Holland America was a premium cruise operator, but also had two subsidiaries: Windstar, another cruise line, and a tour company specializing in Canadian and Alaskan holidays. Three years later, Carnival bought another Seattle-based cruise line, Seabourn. The acquisition took Carnival into the luxury sector of the industry and consolidated its leading position in the North American market.

Exhibit 1: Carnival Corporation & plc, brands and subsidiaries

This company had been in business for more than a century when Carnival acquired it. Holland America was a premium cruise operator, but also had two subsidiaries: Windstar, another cruise line, and a tour company specializing in Canadian and Alaskan holidays. Three years later, Carnival bought another Seattle-based cruise line, Seabourn. The acquisition took Carnival into the luxury sector of the industry and consolidated its leading position in the North American market.

Brand/subsidiary	Description
AIDA Cruises	AIDA cruises catered for the German-speaking market and operated 10 ships in 2015. Its cruises focused on the

	Mediterranean, Northern Europe, the Caribbean, the Arabian Gulf, and Atlantic Islands such as the Canaries. The cruises were aimed at a broad market including active younger holidaymakers as well as more mature passengers. The atmosphere on the ships was generally youthful and casual.
Carnival Cruise Lines	Carnival was the largest of the firms in the group, with 24 ships in 2015. Its cruises were aimed at a wide demographic, including families, couples and seniors. It covered destinations in the Americas and the Caribbean all year round, and in Europe on a seasonal basis. The brand had a similar casual and 'fun' feel to the AIDA line. Carnival also focused on a 'value' offering for more price-sensitive customers.
Costa Cruises	Costa was Europe's largest cruise line and had 15 ships in its fleet. The firm was based in Genoa and made much of its Italian heritage. As with the AIDA and Carnival brands, Costa cruises attempted to blend fun and relaxation, appealing to a wide demographic. The cruise line operated in the Mediterranean, Northern Europe, the Baltic, the Americas and the Caribbean, as well as the Middle East and Asia.
Cunard Line	The Cunard Line was one of Carnival Corporation's luxury brands. Operating only three ships, the firm majored on its British heritage, history dating back to the 1840s, and links to royalty and celebrities. Cunard's ships, the Queen Mary 2, Queen Victoria and Queen Elizabeth still provided a scheduled transatlantic service from Southampton to New York, but also offered seasonal cruises in Northern Europe, the Mediterranean and the Caribbean.
Holland America Line	Holland America Line was started as a shipping line between the Netherlands and North America in 1873. The firm was one of Carnival's premium brands and had a fleet of 15 mid-sized ships. The brand offered five-star dining, and a more sophisticated entertainment and activity programme. Cruises covered destinations as varied as Antarctica, Australia and New Zealand, Alaska, Mexico, the Americas and Europe, as well as offering an annual Grand World Voyage lasting 100 days.
P&O Cruises	P&O Cruises was aimed at the UK market and had seven ships (with Britannia due to enter service in 2015 to make this eight). P&O split its fleet with five vessels aimed at families and three smaller adult-only ships. The brand covered destinations around the world including the Americas, Northern Europe, the Mediterranean, Asia, the Middle East and Africa.
P&O Cruises Australia	P&O Cruises Australia operated three ships and was aimed at the New Zealand and Australian markets. Mainly focused on South Pacific, New Zealand and Australian destinations, it was the leading Australian cruise line. It was due to take delivery of a further two ships, which were currently part of the Holland America Line. The firm was another of Carnival's contemporary brands, aimed at a wide demographic with 'fun' as a central theme for its cruises. Karaoke and game shows were two of the most popular entertainments on its cruises.

Princess Cruises	Princess Cruises was the original inspiration for the TV series The Love Boat. The line had 18 ships in 2015 and was the third-largest cruise firm in the world. Princess Cruises aimed its product more at the adult and couples market as opposed to family segments. Destinations included Europe, Australia, Asia, Panama, Hawaii and South America.
Seabourn Cruise Lines	Seabourn was Carnival's ultra-luxury brand, and offered a more tailored and bespoke service to its passengers with unique destinations and a ratio of one staff member per guest. The line operated five smaller ships to destinations around the world in 2015.

Arison's next move took the firm into the European market with the acquisition of Italian cruise line Costa in 1997 and, a year later, the purchase of Cunard. Costa was the leading cruise line in Europe and was similar to Carnival's own line, offering what the industry termed 'contemporary' cruises aimed at a wide demographic, with a good range of on-board sports and entertainment facilities and dining options. Cunard was a very different purchase; the UK-based firm had a history going back to 1837 when it had started operating the first mail ships used to cross between Europe and America. The firm was one of the best-known and most well-regarded brands in the sector, and had strong links with royalty and leading celebrities past and present.

There was a hiatus in the firm's M&A activity following the death of Ted Arison in 1999. The firm stayed in the family with Ted's son, Micky, taking over as chairman and CEO. Micky soon proved to be as good a deal-maker as his father with the finalising of a substantial merger between Carnival and P&O Princess Cruises in April 2003. The combined companies created a truly global cruise line thanks to P&O's reach in Northern Europe, through its German cruise line, AIDA, and UK-based brands Ocean Village and Swan Hellenic (later sold to All Leisure Group plc), as well as the Princess Cruises brand and P&O Cruises Australia. There was also a brand offering river cruises, A'rosa, but this was divested from the group soon after the merger took place. Carnival was now the largest cruise operator in the world and jointly listed on both the London and New York stock exchanges as Carnival plc and Carnival Corporation, respectively.

The most recent acquisition, in 2007, was more complicated and involved an agreement between Carnival and Spain's largest travel company, Orizonia Corporation, to operate the Spanish firm's cruise line, Ibero, as a joint subsidiary of the two companies. In 2014 Ibero was absorbed by Carnival's Costa brand.

New Ships, New Destinations

Carnival continued to expand its range of destinations separately from those that came with its acquisitions. In 2006 they were the first cruise line to enter the Chinese market after the launch of the Costa Allegra, a ship purpose built for round-trip voyages from Shanghai. From 2006, like many of its competitors, Carnival also started investing in the next generation of cruise ships – larger, more efficient, and with many more features and dining and leisure spaces on board – while 2008 saw the launch of six new leading-edge cruise ships: Carnival Cruise Lines' Carnival Splendor, Cunard Lines' Queen Victoria, AIDA Cruises' AIDAbella, P&O Cruises' Ventura, Princess Cruises' Ruby Princess and Holland America Lines' Eurodam.

Carnival now started working closely with Italian shipbuilder, Fincantieri, and signed agreements for the construction of a further three large ships for its Princess and P&O Cruises brands in 2010 and 2011. Other shipbuilders had been contracted to work on two cruise ships for the AIDA fleet and one more for the Costa brand in 2011.

Exhibit 2: Carnival Corporation & plc consolidated profit & loss accounts (USD mn)

	2014	2013	2012	2011	2010
Revenues					
Cruise passenger tickets	11,889	11,648	11,658	12,158	11,084
Onboard and other	3,780	3,598	3,513	3,357	3,104
Tour and other	215	210	211	278	281
Total	15,884	15,456	15,382	15,793	14,469
Operating costs and expenses					
Cruise commissions, transportation and other	2,299	2,303	2,292	2,461	2,272
Onboard and other	519	539	558	506	474
Fuel	2,033	2,208	2,381	2,193	1,622
Payroll and related	1,942	1,859	1,742	1,723	1,611
Food	1,005	983	960	965	869
Other ship operating	2,445	2,589	2,233	2,247	2,032
Tour and other	160	143	154	204	212
Subtotal	10,403	10,624	10,320	10,299	9,092
Selling and administrative	2,054	1,879	1,720	1,717	1,614
Depreciation and amortization	1,635	1,588	1,527	1,522	1,416
Ibero goodwill and trademark impairment charges	-	13	173	-	-
Total	14,092	14,104	13,740	13,538	12,122
Operating income	1,792	1,352	1,642	2,255	2,347
Non-operating (expense) income					
Interest income	8	11	10	11	12
Interest expense, net of capitalized interest	(288)	(319)	(336)	(365)	(378)
(Losses) gains on fuel derivatives, net	(271)	36	(7)	1	-
Other income (expense), net	4	(8)	(7)	10	(2)
Total	(547)	(280)	(340)	(343)	(368)
Income before taxation	1,245	1,072	1,302	1,912	1,979
Tax (expense) benefit	(9)	6	(4)	-	(1)
Net income	1,236	1,078	1,298	1,912	1,978

Note: For the years ended 30/11/2014, 30/11/2013, 30/11/2012, 30/11/2011, 30/11/2010.

EXHIBIT 3: Carnival Corporation & plc consolidated profit & loss accounts, 2010-2014 (USD mn)

	2014	2013	2012	2011	2010
ASSETS					
Current assets					
Cash and cash equivalents	331	462	465	450	429
Trade and other receivables, net	332	405	270	263	248
Insurance recoverables	154	381	460	30	-
Inventories	364	374	390	374	320
Pre-paid expenses and other	322	315	236	195	247
Total current assets	1,503	1,937	1,821	1,312	1,244
Property and equipment, net	32,773	32,905	32,137	32,054	30,967
Goodwill	3,127	3,210	3,174	3,322	3,320
Other intangibles	1,270	1,292	1,314	1,330	1,320
Other assets	859	760	715	619	639
	39,532	40,104	39,161	38,637	37,490
LIABILITIES AND SHAREHOLDER EQUITY					
Current liabilities					
Short-term borrowings	666	60	56	281	740
Current portion of long-term debt	1,059	1,408	1,678	1,019	613
Accounts payable	626	639	549	576	503
Claims reserve	262	456	553	97	-
Accrued liabilities	1,276	1,126	845	832	1,094
Customer deposits	3,032	3,031	3,076	3,106	2,805
Total current liabilities	6,921	6,720	6,757	5,911	5,755
Long-term debt	7,363	8,092	7,168	8,053	8,011
Other long-term liabilities	960	736	724	647	693
Commitments and contingencies					
Shareholders' equity	24,288	24,556	24,512	24,026	23,031
	39,532	40,104	39,161	38,637	37,490

Note: As at 30/11/2014, 30/11/2013, 30/11/2012, 30/11/2011, 30/11/2010

Source: Carnival Corporation & plc Annual Reports 2015, 2014, 2013, 2012, 2011 and 2010.

Available online at www.carnivalcorp.com/phoenix.zhtml?c=140690&p=irol-reportsannual.

Exhibit 4: Selected content from first-quarter (1Q) report for 2015

Key metrics for the first quarter 2015 compared to first quarter 2014 were as follows.

- On a constant dollar basis, net revenue yields (net revenue per available lower berth day, or ALBD) increased 2.0% for 1Q 2015, which was better than the company's December guidance of flat to up 1%. Gross revenue yields decreased 3.1% in current dollars due to changes in currency exchange rates.
- Net cruise costs excluding fuel per ALBD increased 2.4% in constant dollars primarily due to higher dry-dock costs and advertising expenses. Costs were lower than December guidance, up 5.5 to 6.5%, substantially all due to the timing of expenses between quarters. Gross cruise costs including fuel per ALBD in current dollars declined 9.6% due to changes in fuel prices and currency exchange rates.

- Fuel prices declined 38% to \$406 per metric ton for 1Q 2015 from \$654 per metric ton in 1Q 2014.
- Fuel consumption per ALBD decreased 3.7% in 1Q 2015 compared to the previous year.
- Changes in currency exchange rates reduced earnings by \$0.06 per share (constant currency).

2015 outlook

At this time, cumulative advance bookings for the remainder of 2015 were ahead of the previous year at higher prices. From January, booking volumes for the remainder of the year were running in line with the previous year's historically high levels at higher prices.

Donald noted, 'We are experiencing an ongoing improvement in underlying fundamentals based on our successful initiatives to drive demand. Our efforts to further elevate our guest experience are clearly resonating with consumers and, notably, improving the frequency and retention of our loyal guests.' Donald added, 'We are also seeing results from our ongoing public relations efforts and creative marketing campaign designed to attract new-to-cruise customers. Our multifaceted campaign built around the Super Bowl garnered 5 billion media impressions before the commercial aired and has exceeded 10 billion impressions to date.' Donald also noted that the recent delivery of Britannia, the largest cruise ship built for Britain and christened by Her Majesty Queen Elizabeth II, drew international acclaim and showcased cruising on a global scale.

Based on current booking strength, the company expected full year 2015 net revenue yields to increase 3 to 4% on a constant currency basis, which excluded translation and transactional currency impacts, compared to the previous year. This was one full point better than December guidance on a constant currency basis. On a constant dollar basis, which does not exclude the unfavourable transactional impact of currency, the company still expected yields to be approximately 2% higher than the prior year. The company expected net cruise costs excluding fuel per ALBD for full year 2015 to be up 2 to 3% compared to the prior year on a constant dollar basis, which was better than December guidance of up 3%, due primarily to the favourable transactional currency impact.

Since December, unfavourable changes in currency exchange rates (constant currency) had reduced full year 2015 earnings expectations by \$219 million, or \$0.28 per share. However, this impact was significantly offset by the improvement in the company's operating performance, resulting in just a \$0.05 reduction to the midpoint of December guidance.

Taking the above factors into consideration, the company forecasted full year 2015 non-GAAP diluted earnings per share to be in the range of \$2.30 to \$2.50, compared to 2014 non-GAAP diluted earnings of \$1.93 per share.

Looking forward, Donald stated, 'Consistent with many global companies, the strengthening of the US dollar has hampered our full year earnings expectations, masking the 3 to 4% (constant currency) yield increase our collective brands are expecting to achieve.

'Our successful initiatives to drive both ticket and onboard revenue yields have improved our financial performance and we remain on track toward our goal of achieving double-digit return on invested capital in the next three to four years.'

Source: Carnival Corporation & plc First Quarter Report 2015 on Form 10-Q. Available online at www.carnivalcorp.com/phoenix.zhtml?c=140690&p=irol-reportsother.

Stormy Seas

However, despite its many successes, by 2013 Carnival was seeing a worrying trend in its net and operating profits – both of which had declined substantially since 2010. The company's operating profit margin fell from 16.2 per cent in 2010 to just 8.7 per cent in 2013. The net profit margin had also fallen over the same period, from 13.7 per cent to 7 per cent (see Exhibits 2, 3 and 4 for more financial details: profit and Loss Account, Balance Sheet – 2010 to 2014,¹ and first-quarter performance for 2015).

Carnival's worsening financial situation was exacerbated at the beginning of 2012, when the *Costa Concordia*, carrying more than 4,000 passengers and crew, struck a rock off the coast of Italy and sank. The disaster claimed the lives of 32 people even though the ship was grounded a few hundred metres from the Isle of Giglio.² The events of 13 January resulted in a loss of confidence among the cruise lines' customers and travel agents, and damaged Carnival's reputation as the details of the event became clearer. The captain of the ship was alleged to have left his post before all the passengers were rescued and had been sailing too close to the coast without authorization. The company was hit by a series of lawsuits in the wake of the disaster and, as the investigations and salvage continued into 2013 and then 2014, the affair attracted further negative publicity. Then, in February 2013, the company suffered a further setback as a result of a major fire on-board the Carnival Triumph, which left more than 4,000 passengers and crew stranded in the Gulf of Mexico. By the middle of 2013 it was clear that a radical change was needed to bring Carnival back on course. Micky Arison stepped down as CEO in June of that year and the board appointed one of its non-executive directors, Arnold Donald, as the new president and CEO.³

Cruising's Evolution

Although cruising in its current format has been in existence since the 1960s, the idea of combining transport and hotel facilities is not a new idea. In the 19th century, many of the cross-Atlantic steamship lines and North American Railroad firms, such as Canadian Pacific, offered vertically integrated services to their customers, including sea passage, hotel accommodation at departure and destination ports, and onward rail travel. One of the first businessmen to pioneer cruises was Henry Flagler, a director of Standard Oil and the 'father' of Miami and Palm Beach. He built railways to serve his resort hotels in Florida in the late 1800s, and established sea links to further destinations on the Bahamas as part of a vacation package for his customers.

The biggest change and the genesis of modern cruising came about in the 1950s and 1960s as air travel began to impact on the North Atlantic passenger services. Passenger numbers sailing across the Atlantic fell by 90 per cent between 1960 and 1975, and this led many of the operators to change their business model from transport to tourism. While the passenger liners of the early to mid-20th century had been the equivalent of floating hotels, the cruise ships became floating resorts, offering a much wider range of activities and facilities for their guests.

As the industry developed in the 1970s and 1980s, niche offerings and substantial investments in marketing (on top of the capital invested in the ships) led to a rapid expansion and development of a wide range of destinations. In the late 1980s and 1990s the industry was beginning to mature and a wave of mergers and acquisitions took place that established an oligopoly of three firms, who continued to dominate the industry in 2014: Carnival, Royal Caribbean and Norwegian Cruise Lines. In 2015 these three firms controlled more than 80 per cent of the share of passengers and a similar proportion of the revenues generated. Carnival Corporation's 48.1 per cent share was twice that of Royal Caribbean's (23.1 per cent), which was more than twice that of Norwegian's market share (10.4 per cent). Although the industry had largely consolidated by 2015, there were still changes in ownership⁴ and deals going on – Genting Hong Kong, the owner of the largest cruise firm in Asia, Star, had bought luxury cruise firm Crystal in March 2015 for \$550 million, having previously sold its 28 per cent share of Norwegian Cruise Lines (see Exhibit 5 for details of the main competitors to Carnival).

Exhibit 5: Significant competitors

Competitor	Description
Royal Caribbean Cruises	The second-largest cruise line in the world behind Carnival. Royal Caribbean had a 23.1 per cent market share by volume (passengers) and 22.1 per cent market share by value in 2015. The firm had five brands: Azamara – a small-ship luxury style cruise line with two vessels; Celebrity Cruises, with 11 mid-sized liners and a more contemporary ambience; Croisières de France – aimed at the French-speaking market with two mid-sized vessels; Pullmantur – the leading Spanish cruise firm, which had 45 per cent of the market and operated three ships; and the flagship brand, Royal Caribbean International, which operated some of the largest cruise ships in the world and had a fleet of 21 liners, with the first smartship – the Quantum of the Seas – recently added to its portfolio. Royal Caribbean's revenues were \$7.96 billion in 2013, with an operating income of \$855.1 million – up from \$7.69 billion with net income of \$432.2 million in 2012.
Norwegian Cruise Lines	Until March 2015, Norwegian was part owned by Genting Hong Kong, the firm behind Star Cruises. The firm was the third-largest cruise line, with market share of 10.4 per cent by volume and 12.4 per cent by value in 2015. Norwegian had a fleet of 13 vessels but also recently purchased two smaller operators, Oceania and Regent Seven Seas, from Prestige in November 2014 for just over \$3 billion. Both operated in the higher-premium sector of the cruise market.

Source: Tutt, L. (2014) Key Note Market Report, 'Cruise Market'.

A Cyclical Industry

Like much of the shipping and tourism industry, cruising was affected by changes in economic conditions. The year after the 2007/08 financial crisis the global travel and tourism industry declined by between 4.0 per cent and 4.8 per cent, with an estimated loss of 5 million jobs. However, as the world economy recovered, the sector bounced back relatively quickly with growth of 6.2 per cent and 8.2 per cent in 2010 and 2011, respectively. The value of the sector at the end of 2012 was \$631.1 billion (€490.9 billion), which meant that it had grown 2.8 per cent overall between 2008 and 2012. Cruise lines accounted for about 5 per cent of the sector with the rest taken up by hotels and resorts. Forecasts by Key Note to 2017/18 were predicting overall growth of hotel, resorts and cruise lines sector by 5 per cent a year, with the ocean cruise element of this growing at just under 2.8 per cent per year (see Exhibits 6 onwards for further details).

Exhibit 6: Forecast for the Number of Ocean Cruise-Holiday Passengers Worldwide by Region, 2014–2018 (in millions)

Region/year	2014	2015	2016	2017	2018	%change 2014-2018
North America	12.05	12.23	12.41	12.59	12.78	6.1
Europe	6.97	7.26	7.56	7.87	8.19	17.5
Rest of the world	3.29	3.43	3.58	3.74	3.91	18.8
Total	22.31	22.92	23.55	24.20	24.88	11.5

Source: Tutt, L. (2014) Key Note Market Report, 'Cruise Market'.

Exhibit 7.1: Ocean Cruise-Holiday Passengers Worldwide by region, 2009–2013 (in millions)

Year	North America	Europe	Rest of the world	Total
2009	10.40	5.04	2.15	17.59
2010	11.00	5.67	2.40	19.07
2011	11.44	6.15	2.91	20.50
2012	11.64	6.23	3.03	20.90
2013	11.82	6.40	3.09	21.31
% change 2009–13	13.7	27	43.7	21.1

Source: CLIA (2014) 'Global economic contribution report'. Available online at www.cliaeuropa.eu/media-room/clia-europe-economic-contribution-report.

Exhibit 7.2: Number of Cruise Passengers Globally 2013 – Top 10 Countries (in millions)

Country	Number
USA	10.92
UK	1.73
Germany	1.69
Italy	0.87
Australia	0.83
Canada	0.77
Brazil	0.73
People's Republic of China	0.73
France	0.52
Spain	0.48

Source: CLIA (2013) 'Global cruise impact analysis'. Available online at www.cruising.org/about-the-industry/research.

According to the Cruise Line International Association (CLIA), European market growth rates fell from a high of 10.2 per cent in 2010, to 1.2 per cent in 2012, rallied in 2013 to 3.5 per cent, but saw a further stall in 2014 with growth rates of just 0.4 per cent.⁴ Spain, Italy and the UK had fewer people taking cruises in 2014 than the previous year, and the UK was overtaken by Germany as the largest market for cruises. In 2014, 1,771,000 Germans went on a cruise as opposed to 1,644,000 UK citizens. The most popular destinations for European passengers in 2014 were the Mediterranean and Atlantic Islands, such as the Canaries, which attracted 54 per cent of the market, Northern Europe, which accounted for 21 per cent, and the Caribbean and the rest of the World, which made up the remaining 24 per cent of the market.⁵ One of the other factors that had a major impact on cruise lines was fluctuations in the price of fuel, which accounted for up to 12.8 per cent of the operating costs of a ship. When fuel prices were high, operators often had no choice other than passing the increased costs on to passengers in the form of higher ticket prices. However, when oil prices fell, the largest operators could make substantial savings – for example, Carnival made savings of \$128 million as a result of lower fuel prices in 2014. The larger cruise lines had typically managed this risk using a range of financial instruments, including derivatives and hedging activities.

Global cruise lines also had to manage exposure to a range of other financial risks. These included both operational and investment currency risks, especially if they operated in a number of locations and had a

wide range of destinations. However, one of the substantial areas of risk for cruise lines was as a result of the construction of new ships. Depending on where the ships were built and whether the company had taken out loans to fund the capital investment, it would need to manage changes in currency exchange rates and interest rates.

Scanning the Horizon

The cruise industry also had to deal with a range of other changes in its environment. Cruise lines and their ships had to take account of regulations and standards laid down by the International Maritime Organization (IMO), which represented 170 member states. The IMO regulations covered areas such as safety and security. However, the country whose flag the cruise ship was registered under would also have regulations that the ship must comply with and, finally, in territorial waters and in port, the ship would be subject to the laws and regulations of the host country – which in the case of the United States could be substantial and comprehensive in nature. Many shipping firms registered their vessels with countries such as Liberia and Panama, whose laws and regulations were not as stringent as those of other, developed world countries such as the UK and the United States. Cruise companies, such as Carnival, also based their operations in some of these countries in order to avoid paying higher US taxes. Carnival plc was registered in the UK, but Carnival Corporation was incorporated in Panama. The financial crisis and subsequent government austerity programmes in many developed countries had highlighted loopholes used by companies to avoid tax in the countries from which most of their income was derived. In 2013, Jay Rockefeller, a United States senator, began pushing for an exemption that allowed cruise lines to avoid paying tax on revenue derived from US citizens to be eliminated. The exemptions Carnival had received under Section 883 of the Internal Revenue Code would be under threat if Rockefeller's legislation were enacted and this would mean far higher tax bills for the company's US operations.

Rockefeller was also behind moves to develop a Cruise Passenger Protection Act to give the US government and federal agencies more powers to oversee the cruise industry in terms of protecting consumers' rights, on-board security and passenger safety.

The Era of the 'Smartship'

Technology was starting to play an increasingly prominent role in the value proposition of cruise ships in a similar way to other forms of tourism and travel. Customer expectations had risen, with the growth in the use of smartphones and the Internet. Cruise lines had to find ways of offering services like high-speed broadband on a moving vessel in the middle of the ocean. The new ships that the major players were commissioning contained many new technology-enabled and enhanced features. Royal Caribbean's Quantum of the Seas was billed as the 'world's first smartship' at its launch in late 2014 and cost \$1 billion to build. With a maximum capacity of 4,900, the newest ship in Royal Caribbean's fleet, the Quantum of the Seas, provided passengers with an app for reserving meals in its 18 restaurants and navigating the 16 decks, plus high-speed Internet via satellite, robot bar tenders, a 1,300-seat theatre, and a range of other facilities, from a skydiving simulator to the North Star observation tower, a crane-like structure that could suspend guests over the sea or above the deck. The Quantum of the Seas laid down a new standard for large-scale cruise ships, but other firms were also developing new and larger vessels for their fleets with an upswing in planned launches for 2015, 2016 and 2017 (see Exhibit 8 for further details). Royal Caribbean based the Quantum of the Seas in Bayonne, New Jersey, but planned to operate the ship and the second Quantum-class vessel, Anthem of the Seas, from Chinese ports such as Shanghai in the long term.

Exhibit 8: Major Planned Ship Launches, 2015–2017

2015 new ships

Cruise line	Ship	Launch	Passengers
P&O	Britannia	Mar-15	3,611
Compagnie du Ponant	Le Lyrial	Apr-15	264
Viking Ocean Cruises	Viking Star	Apr-15	930
TUI Cruises	Mein Schiff 4	Apr-15	2,500
Royal Caribbean International	Anthem of the Seas	Apr-15	4,180
Norwegian Cruise Line	Norwegian Escape	Oct-15	4,248
Total			15,733

2016 new ships

Cruise line	Ship	Launch	Passengers
Holland America Line	Koningsdam	Apr-16	
AIDA	AIDAprima	Apr-16	
Royal Caribbean International	Harmony of the Seas	Apr-16	
Royal Caribbean International	Ovation of the Seas	Apr-16	
Carnival Cruise Lines	Carnival Vista	Apr-16	
Viking Ocean Cruises	Viking Sea	May-16	
TUI Cruises	Mein Schiff 5	Jul-16	
Regent Seven Seas	Regent Seven Seas Explorer	Dec-16	
Seabourn	Encore	Dec-16	
Total			24,240

2017 new ships

Cruise line	Ship	Launch	Passengers
Viking Ocean Cruises	Viking Sky	Feb-17	930
Norwegian	Norwegian Joy	Apr-17	4,200
Princess	Majestic Princess	Apr-17	3,600
MSC	Seaside	Nov-17	4,140
Viking Ocean Cruises	Viking Sun	Dec-17	930
Total			13,800

Sources: CLIA Cruise Ship New Build Delivery Schedule: Q2 2015. Available online at www.cruising.org/about-the-industry/research; Viking Cruises Cruise Ship Overviews.

Green Ocean Strategy

The cruise industry has had a controversial past when it comes to sustainability and the environment. Each cruise ship was the equivalent of a small town or very large hotel and produced large amounts of sewage as well as other pollutants from the fuel the ships burn, and the waste from food and other consumables. Environmental monitoring and regulations had increased steadily in the industry but the growth in sustainable tourism and changes in customer opinions had also driven many of the large operators to look at this aspect of their operations. In 2009 the industry started working with environmental charity Friends of the Earth in producing ratings for each cruise line and the ships it controlled: sewage, air pollution and, for those ships that operated in Alaskan waters, a water quality measure.⁶ Each element was rated from A to F, with A being the best environmental performance and F the worst (see Exhibit 9 for a comparison of cruise lines' performance over time).

Exhibit 9 : Cruise lines' performance on CSR according to Friends of the Earth

Cruise line	Final grade / Year				
	2009	2010	2012	2013	2014*
Holland America Line	B	B-	B-	B	C
Norwegian Cruise Lines	B-	B-	B-	B	C
Princess Cruises	B-	C+	B+	B	C
Cunard Cruises	C-	C-	C-	C-	D
Regent Seven Seas Cruises	C-	C-	C	D+	D
Celebrity Cruises	D+	D+	C-	C+	D+
Carnival Cruise Lines	D-	D-	D+	C-	D
Silversea Cruises	D-	D-	D	C	D
Royal Caribbean International	F	D+	D+	C	D
Disney Cruise Line	F	C-	A-	A	C+
Crystal Cruises	-	F	F	F	F
Costa Cruises	-	-	F	F	F
Seabourn Cruise Line	-	-	C-	C-	D
Oceania Cruises	-	-	D	D-	D-
P&O Cruises	-	-	F	F	F
MSC Cruises	-	-	-	-	F

** Final grades for 2014 affected by the lack of data supplied to Friends of the Earth from the cruise lines – the Transparency element, which hadn't featured in previous scorecards skews the results down as all cruise lines were given an F for this element of their operations.*

Cruise lines were also given an overall rating. In 2014, the industry decided that it would no longer work with Friends of the Earth after concerns were raised over the measurements the charity used to come up with its ratings. The cruise lines disputed that installation of the most advanced treatment systems for waste water was a fair proxy for sewage treatment, or that plugging in to dockside electricity facilities was an accurate measure of air pollution reduction (ships typically had to keep their engines running to provide electricity if they did not do this). Friends of the Earth added a Transparency rating to its scorecard.

Relations deteriorated further when Friends of the Earth began a lawsuit in 2014 designed to force US federal body the Environmental Protection Agency (EPA) to take action against cruise ships discharging sewage in US waters. Cruise lines already had to comply with the International Convention for the Prevention of Pollution from Ships (MARPOL), which placed limits on the amount of sulphur in the fuel used in the Baltic, the North Sea and the English Channel, and North American waters. In 2014 this was extended to Puerto Rico and the US Virgin Islands. From 2015 the amount of sulphur in fuels used by ships in these Emission Control Areas (ECAs) would have to be further reduced by 0.1 per cent from the current allowance of 1.0 per cent. This was likely to increase cruise lines' fuel costs, despite the fall in oil prices in 2014.

Complex Supply Chains

Apart from the fuel to power their ships, most cruise lines managed a substantial network of suppliers covering several different areas of operation.⁷ The four main streams covered fuel, which would include lubricants and other oil-based products needed for the ship; technical equipment, such as parts for engines and permanent fixtures and fittings on-board, such as carpeting; corporate purchasing, which covered most onshore and headquarters requirements; and, finally, hotel supplies, which covered all the consumables, such as food and drink, as well as all those other items that would be found in a hotel – such as bed linen, towels, and so on. Cruise lines also spent heavily on advertising and, perhaps most critically, the purchase/fitting out of new or secondhand ships to build and develop their fleets. Global sourcing was a reality for most large cruise lines, although quality and standards were usually not negotiable – especially when it came to food preparation and processing, so local producers were not always chosen.

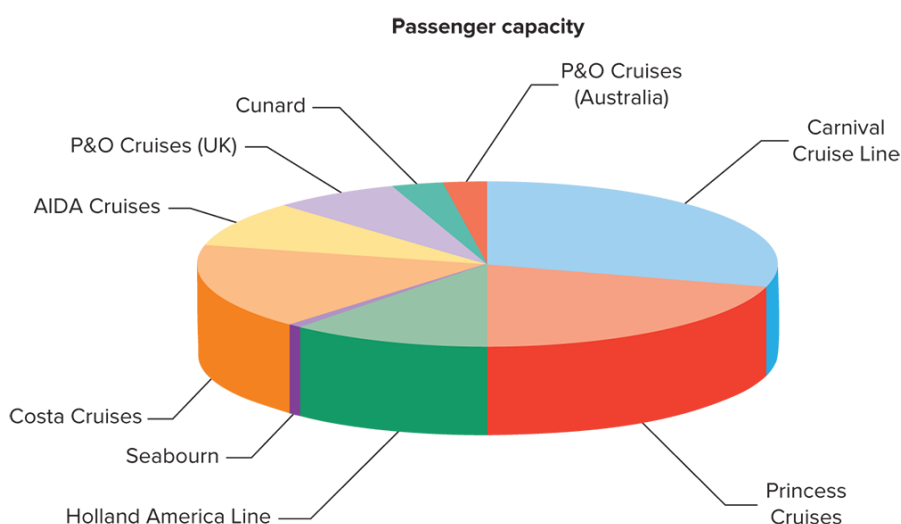
The largest cruise firms had to manage operations at a wide range of destinations, which involved the rapid loading and unloading of large amounts of luggage, passengers, crew, liquids, sewage and other waste, fuel oil and solids, including food. Fleet and ship-based purchasing managers had to anticipate passenger and crew needs for up to seven days if the ship was at sea for a substantial period of time. The logistical challenges also meant that the development of destinations was a key task too. Ports not only had to have the infrastructure to cope with the increasingly large vessels and their thousands of passengers, they had also to be capable of supplying the wide range of consumables needed to keep a large cruise liner running. Cruise lines treated destination development very seriously and worked closely with local governments and officials as well as a range of businesses, from fresh produce suppliers to excursion organizers, to ensure that their ships could resupply, and the passengers and crew had a good range of activities to choose from onshore. For example, Carnival's operations in China began in 2006 with its Costa brand the first to enter the market. In 2014, the firm relocated its Chief Operations Officer, Alan Buckelew, to the region to work on forming a range of strategic alliances.

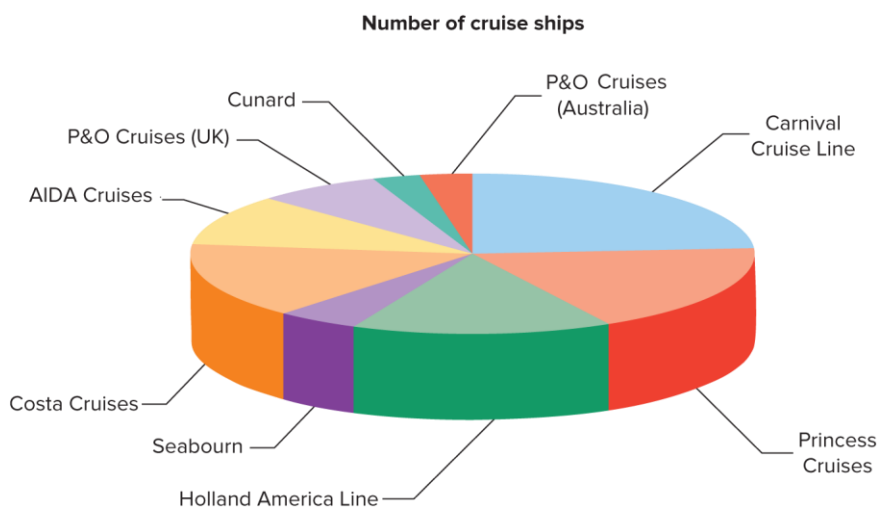
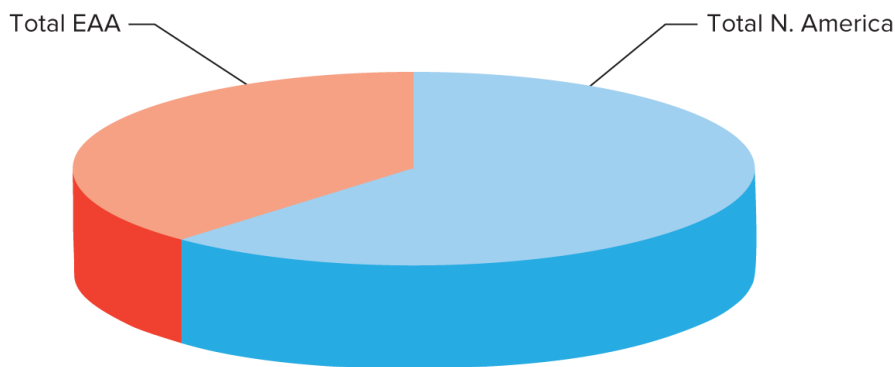
At the other end of the chain were the travel agents and websites that acted as intermediaries for the cruise lines. While some firms had tried to go direct in the past, the lack of knowledge and perceptions potential customers had about cruising meant that it was very expensive and difficult to educate and acquire new customers. Travel agents were a more concentrated group, which made this task easier, and they also added good value in terms of marketing the idea of a cruise to their clients. Cruise lines spent a large amount on advertising – Carnival took ads in the Winter Olympics and the Superbowl as part of a \$600 million spend in 2014/15.

The New Strategy

Penetrating further into Asian markets was one of Donald's key aims for Carnival. In 2014, four of the firm's ships had their home ports in mainland China and these were supported by 12 marketing offices. Carnival had developed strategic alliances with the China State Shipbuilding Corporation for it to work alongside Fincantieri in building the next generation of Cruise liners, and also with the China Merchants Group to look at joint ventures aimed at developing ports and destinations in the region.

The different brands and subsidiaries at Carnival had always been given a large degree of independence from the parent company. Some of this was due to the long history that many of the firm's acquisitions had, and the need to ensure their brand identity wasn't diluted. However, Donald realized that there needed to be more co-ordination between the different parts of the business. He began a series of global leadership team meetings with the 65 most senior managers in 2014, with the aim of improving the firm's use of its scale and also to develop a series of supporting initiatives to help align the different brands (for further details of the relative size of the brands see Exhibit 12





The need to bring the firm's Return on Invested Capital back into double figures meant that new initiatives were needed on both cost savings and revenue generation. The accounts for 2014 and first quarter's results for 2015 had shown a move in the right direction, but much more was needed to return the firm to its 2010 level of performance. (8)

New ships were also part of the equation. The latest vessels were more efficient and larger than their predecessors, with more high-value cabins (normally those with balconies). 2014 had seen the launch of the *Costa Diadema* and the *Regal Princess*, and early in 2015 the *P&O Britannia*.

The Board Meeting

Arnold Donald went through his notes one more time before the meeting with the board. He knew that the overall direction of the firm was yielding better results – at least in the short term. However, the detail and the delivery of many of the options the firm had still needed some work. This was what he wanted to discuss with the other directors and his very experienced Chairman, Micky Arison. There were many questions to debate: Were the new ships sufficiently 'smart' for the new generation of cruise passengers – especially in the light of the *Quantum of the Seas* and planned sister ships? Was China the right focus for developing new markets? The average Chinese cruise customer was much younger and had a very different profile to the US and European passengers the firm had built its reputation serving. Given the popularity of the Mediterranean with European customers should penetrating this market be more of a priority? Was there still scope to grow through acquisition? Norwegian and Genting had recently shown that there were still deals to be made. Or

was the answer to control more of the supply chain or channels to market. As had been the model of operating in the past? Donald's PA knocked on his door: '

The other directors are here now – can I tell them you're on your way?' ...

TOTAL/TOTAAL: 100

File reference: 8.1.7.2.2