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Practice exam questions

The rapid transformation of the aviation industry

Mark Hage

Check your answer to the question on pp. 10–13 of the magazine. This question relates to the Edexcel specification.

Sample answer

One major reason why inorganic growth is important to airlines like IAG is the ability to generate significant cost reductions through economies of scale. By merging British Airways with Iberia to form IAG, the airlines were able to integrate their operations and build more efficient booking platforms. The article highlights that these larger groups can use their increased size to negotiate better deals with suppliers, such as catering companies, which directly reduces their variable costs. This reduction in average costs is critically important in an industry currently facing high labour cost pressures and pilot shortages. If IAG can lower its unit costs while maintaining revenue, its profitability will improve, providing the funds needed to invest in new aircraft to meet sustainability targets.

However, the importance of this growth strategy depends heavily on successful integration, as poor management can lead to diseconomies of scale. The article notes that while consolidation aims to streamline operations, it often leads to trade unions arguing that job security is 'under threat'. This friction recently resulted in industrial action by British Airways pilots and ground staff, which cost the airline £120 million and potentially damaged its reputation. If inorganic growth leads to internal conflict and expensive strikes, the financial importance of the merger is undermined, as the costs of disruption may exceed the savings gained from purchasing economies.

A second factor highlighting the importance of inorganic growth is its role in ensuring financial survival and market dominance during external shocks. The aviation industry is vulnerable to events like the covid-19 pandemic, international conflicts and supply chain disruptions. The article suggests that for struggling carriers like KLM, merging with Air France was essential as it provided the 'capital needed to survive' after years of losses. Furthermore, inorganic growth allows airlines to create an oligopolistic market structure. This results in reduced competition, giving groups like IAG greater power to set prices to recover costs. This financial stability is vital when airlines are facing rising prices for 'essential commodities' like jet fuel and parts.

On the other hand, the importance of inorganic growth can be questioned if it leads to regulatory backlash or fails to solve supply-side issues. Consumer groups are concerned that these large groups prioritise shareholders above passengers. If IAG exploits its important market position to raise ticket prices too high, it risks driving customers away or inviting government intervention. Additionally, becoming a larger entity does not solve industry-wide supply constraints. For instance, Airbus has a backlog of nearly 9,000 jets. Therefore, while inorganic growth is important for capital and market share, it is not a cure-all for operational challenges like equipment shortages.

In conclusion, inorganic growth is of critical importance to airlines like IAG, primarily as a defensive mechanism to ensure survival in a capital-intensive industry. As shown by the KLM/Air France example, the financial resilience gained through mergers is essential to withstand external shocks like the pandemic. While there are significant risks of diseconomies of scale, such as the £120 million lost to strikes, these are operational challenges that can be managed, whereas a lack of capital during a downturn is a threat to the business' very existence. Therefore, given the persistence of inflation and global instability, the financial security provided by inorganic growth outweighs the operational risks.

Sample examiner comment

Mark: 12/12 (level 4 – an excellent response, fully focused on the question)

Knowledge and understanding (AO1) are excellent. The response demonstrates a clear grasp of inorganic growth, economies of scale, oligopoly and diseconomies of scale.

Application (AO2) is strong and consistently applied. The answer utilises specific evidence from the text to demonstrate importance, such as the IAG/BA merger, the negotiation with catering suppliers, the £120 million cost of strikes, and the capital necessity for KLM/Air France.

Analysis (AO3) is well-developed. The candidate provides logical chains of reasoning, explaining *why* inorganic growth is important (e.g. lowering unit costs to fund sustainability investments) and analysing the consequences of failure (e.g. strikes negating cost savings).

Evaluation (AO4) is highly effective. The response assesses the 'importance' by offering balanced counter-arguments within the main body. Crucially, the **judgment/conclusion** clearly prioritises the arguments. The candidate justifies that financial survival (defensive importance) is more critical than operational efficiency (diseconomies of scale) because of the existential nature of external shocks in the aviation industry. This clear weighing of arguments secures top marks.

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