Air Canada

Case Synopsis

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INTRODUCTION

Brief History

Air Canada is the flagship carrier and the largest airline company in Canada. Formally named Tans-Canada Airlines, the airline was established in 1936 by Canadian federal government. In 1988, Air Canada was privatized due to the deregulation of the Canadian airline market. Then Air Canada acquired its largest rival and laid the foundation as the largest airline company in Canada. Air Canada is a founding member of Star Alliance which flies to 1290 destinations in 189 countries by using a wide range model of aircrafts, such as Airbus A330, A320 and Boeing 747, 767, 777. Also, Air Canada will begin operating Boeing 787s, which will reduce the fuel and maintenance cost sharply. The largest hub for Air Canada resides at Toronto Pearson International Airport, which handled 33.4 million passengers in 2011. Air Canada has its headquarters in Montreal, and is also operating cargo transportation and providing vacation packages to over 90 destinations. All this has led to a revenue of CA $10.2 billion in 2011 (About Air Canada, 2012).

Mission and Goals

Air Canada's Mission is "Connecting Canada and the World" with its vision as "Building loyalty through passion and innovation" (About Air Canada, 2012).

In order to achieve its mission, Air Canada has the following objectives:

- To increase operating earnings and cash flow; Air Canada continues to focus its activities on improving its financial performance while increasing its productivity and improving its cost structure.
- To embrace leadership, accountability and entrepreneurship.

- To maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of 12-month trailing operating revenues regarding managing liquidity.
- To minimize the generation of waste as well as the emission of carbon dioxide and other greenhouse gases regarding Air Canada's environmental concern (Air Canada: 2011 Annual Report).

ENVIRONMENT

General Environment

As an international airline, opportunities and threats in the global environment largely affect the strategies adopted by Air Canada. After the global financial crisis in 2001, the share price of airlines and airplane manufacturers dramatically dropped due to decreased recreational spending. The sovereign debt crisis in Europe has placed pressure on banks to tighten lending conditions to households, which increased the probability of an adverse shock to the income of Canadian. In addition, political unrest in the Middle East has caused oil prices to increase steadily. Over the last 10 years, Canada has become a multicultural country because of increased immigration. Cultural differences have created a variety of innovative ideas for businesses, but have also increased management difficulty. Since more than 69.1 percent of Canada's population reside in metropolitan areas (2011 Census: Population and dwelling counts, 2012), Air Canada has chosen to have landing spots in big cities in order to obtain more passenger traffic, and consequently, market share. The Government of Canada has integrated regulations for the airline industry, including the allocation of allowable fuel emission, and safety policy and the regulations about advertising ticket price; but price competition is left to the discretion of the industry. Moreover, the Federal corporate income tax rate has decreased from 19% in 2009 to 15% in 2013, which provides an opportunity for the expansion of domestic businesses (Corporate

Income Tax, 2012). Oil price is one of the most significant factors affecting airline companies business. Since fuel cost occupy one third of the total operating cost, the continuing high prices will greatly affect Air Canada's costs. Meanwhile, an increase in interest rate will sharply increase the operating cost, since Air Canada has $3906 million in long term debt, which means 1% increase in interest rate will cost about $4 million payable to the creditors (Air Canada: 2011 Annual Report). By comparing the financial performance between Air Canada with its primary competitor WestJet, even though Air Canada holds more than 80% market shares in Canada, it has lost $249 million in 2011 while WestJet has made a profit of $148 million in 2011(Air Canada: 2011 Annual Report).The employees in Air Canada is unionized which sometimes probably will make protests, for example, they had a strike in 2012(Cassese, 2012). Efficiency and customer satisfaction are important factors for the airline industry. Therefore, technological innovation that can improve efficiency and customer satisfaction has the potential to better the company's profitability. Air Canada now uses Boeing 737 next generation planes for short-haul routes and Boeing 777 and 787 for long-haul route, while its competitors still use older planes. The new fleet is fuel efficient; require low maintenance cost, and low training cost. Thus, technological improvement will provide Air Canada with sustainability. In terms of customer satisfaction, Air Canada has developed technologies that increase customer convenience, such as providing online check-ins and online purchases.

Industry Environment

Porter Five Forces analysis can provide a comprehensive understanding of the uncertain aviation industry. The threat of new entrants is low because of economies of scale, likelihood of retaliation, and high capital requirements; capital includes aircraft, and maintenance facilities. The bargaining power of suppliers, which consist of aircraft manufacturers, fuel suppliers and airports services suppliers, is medium to high due to oversupply in the aviation industry and strict airport regulations. The bargaining power of customers is medium to high because of low switching cost, undifferentiated products, and readily available information. The threat of substitution is low since flying remains the best option for those travelling long distances, as it is both faster and safer than competing modes of transportation. Air Canada's major competitors are broken into two segments, one is among traditional passenger carriers, and the other is that between transport carriers. The latter, which is fierce, centers mainly on pricing and serviceable routes.

Competitive Environment

Traditional carriers, Transat and Cathay Pacific, and cargo carrier, WestJet are among Air Canada's top competitors. Transat employs a vertical integration strategy, which has been successful in making the airline the leader in the international tourism industry (Transat: 2011 Annual Report). Its goals are achievable because of its strength in distribution and cost management, but weakened by its lack of alliances, and industry seasonality. Another competitor, Cathay Pacific, is currently focusing on its Asia/Pacific growth with future emphasis on sustainable air travel (Cathay Pacific: 2012 Annual Report). The ability to offer excellent customer service abilities, and the creation of One World alliances are among Cathay Pacific's capabilities. Last, WestJet, a competitor in the cargo transportation segment, is focused on profitable growth, and partnerships with future plans to expand in an environmentally friendly manner. WestJet believes that its success in the past will be carried into the future. Its success was and will be achieved by the airlines ability to offer low cost fares and enthusiastic customer service (WestJet: Investors Relations, 2013). Although, it has made a trademark of its services, it does acknowledge the lack of premium services.

Internal Resources & Capabilities

Air Canada's resource can be separated into tangible resource and intangible. Physical resource includes a mainline fleet of 205 aircraft comprise of 89 Airbus narrow-body aircraft, 56 Boeing and Airbus wide-body aircraft and 60 Embraer regional jets, and aircraft fuel and spare parts. Financial resource consists of fuel derivatives; share forward contracts, interest rate swaps, and Air Canada shares jump after pension extension on March 13, 2013. Technological resource comprise of trademarks such as Air Canada's logo and slogan. An intangible resource, HR, is quite weak; employ relations have been stressful since IAMAW, which represents 8,600 ground crew and mechanics at Air Canada, began labour dispute with Air Canada. Air Canada has been very innovative; it has generated ideas that have quickly been transformed into products, such as its mobile booking apps. Although, the airline has had a reputation for reliability and quality, it has been decreasing due to its attempt at cutting cost. Air Canada has effective logistic management techniques; the airline effectively controls the services provided to consumers in an efficient manner that meets or exceeds customer expectations. Its information system allows customers to check their flight status online, and through the use of Advanced Passenger Information Systems (APIS), Air Canada can readily obtain customer data. Its Marketing department effectively promotes deals, price-matching on the same routes, and advertises through traditional and social media outlets. It also has excellent customer service. Furthermore, Air Canada has an organizational structure that promotes efficiency, which results in reduced cost. The organization is also highly innovative; it has transformed technological ideas into products and services, such as lie-down beds, which was first offered by Air Canada. The airline's marketing; management and longstanding brand are among its core competencies.

CURRENT SITUATION

Financial Performance

Table 1 illustrates the financial performance of Air Canada over the past three years. Its financial picture looks increasingly toxic. Operational costs are rising, with fuel charges increasing by 27% in 2011 alone. Air Canada lost $249 million in 2011, compared with $24 million in 2010. Moreover, free cash flow has fluctuated dramatically over the past three years, which could jeopardize the company's sustainability.

Table 1: Three Years Financial Performance of Air Canada, 2009-2011

Financial Performance	2009	2010	2011
Operating Revenues	$9,739M	$10,786M	$11,612M
Net Operating Income (Loss)	(24M)	(24M)	(249M)
Free cash flow	(399M)	746M	366M
Adjusted net loss per share – Diluted	$ (0.18)	$ (0.58)	$ (0.72)

Source: adapted from Air Canada 2010 Annual Report and Air Canada 2011 Annual Report. Retrieved from: http://www.aircanada.com/en/about/investor/reports.html

Current Strategy

Air Canada has been pursuing a business strategy that aims at improving its revenue performance while increasing its productivity and improving its cost structure with the objective of increasing operating earnings and cash flow. Specifically, Air Canada makes an effort to leverage its strengths internationally, reducing costs, generating incremental revenues, focusing on business travellers, and transforming its corporate culture with an emphasis on leadership, accountability and entrepreneurship. Also, Air Canada has adopted an international powerhouse strategy, which reflects its geographic advantage in the world with its hubs well-situated at global crossroads used by travellers crossing both the Atlantic and Pacific (Air Canada: 2011 Annual Report).

STRATEGIC CHALLENGES

Maintain Cost Control

In order to offer the lower fares, Air Canada must be able to create cost effective contracts with its suppliers and operate productively. Currently, there appears to be issues with cost controls, since the airline has been experiencing negative profits for the past three years. The challenge is whether or not Air Canada has the financial strength to invest in cost cutting techniques, and whether it can do this while investing in environmental sustainability plans similar to that of its competitors.

Increase Efficiency

In order to be the lowest price carrier, Air Canada has to develop a strategy that helps to improve the efficiency of each value chain activity and to largely cut its costs. It is necessary to focus on marketing and management activities, since both will contribute Air Canada's success.

Manage Risks of Uncertain Interest Rate and Fuel Price

In addition to controlling cost by improving efficiency, a proper strategy of risk management is important and challenging for Air Canada. The continuous increase in fuel prices affects Air Canada's ability to offer low prices; and uncertain interest rates largely affects interest expense and the debt repayment.

Maintain Market Shares

Air Canada cannot relax their vigilance just because they have more than 80% market shares in Canadian aviation business (Air Canada: 2011 Annual Report). Air Canada needs to keep up with the latest technology and innovation in the aviation field. Also, strengthening R&D will make it more competitive than other airline company.

Improving Financial Performance

By comparing the financial performance between Air Canada with its primary competitor WestJet, even though Air Canada holds more than 80% market shares in Canada, it has lost $249 million in 2011, while WestJet has made a profit of $148 million in 2011(Air Canada: 2011 Annual Report). Therefore, trying to make a positive number on their income statement is the first thing need to do in their future operation.

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