



AIRLINE INDUSTRY IN INDIA

Facing the Free *Fall*

The Indian aviation industry holds a lot of promise owing to the huge population, increased affordability and making the services accessible to the common man. But, the sector is highly susceptible one. Why? Read it...



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"The safest way to become a millionaire is to start as a billionaire and invest in the airline industry" – Richard Branson, Founder, the Virgin Group

In India, the last decade showed prominent signs and a lot of promise for fast-paced growth in the airline sector. The industry, before the gloomy signs of global recession began to appear, was soaring high. But, eventually, the economic downturn impacted the aviation sector in India and dampened the spirits of the players – big and small.

India is still a new arena for private players in the airlines business and stakes are high for one and all. In the present times, there is an immediate need to formulate effective strategies to survive through the recessionary phase. It is difficult for those in business to maintain their bottom lines and therefore they should resort to restructuring and consolidation. The airline companies are gasping for breath. The factors like government policies (*Annexure I*), strategic

alliances and fuel prices etc. have a direct bearing on the industry.

This paper is an attempt to study the prevailing state of Indian airline industry and the strategies adopted by the premium as well as the low-frills airlines to sustain and survive in this downturn. In this context, the strategies adopted by a few major airlines of the world are also discussed.

The history of civil aviation in India dates back to February 18, 1911 when a small voyage was made from Allahabad to Naini by a French Pilot, Monseigneur Pigué scaling a distance of merely about 10 kilometers. The first domestic air route between Karachi and Delhi was opened in December 1912 by the Indian State Air Services in collaboration with the Imperial Airways, UK as an extension of London-Karachi flight of the Imperial Airways. Since then the

airline industry in India has evolved witnessing many phases. Few phases of them are very sluggish.

Phase I – Pre 1953

The air transport scenario pre-1953 was beleaguered by lack of regulatory and operational procedures. There were nine private airlines functional at the time out of which many were sick beyond recovery and there were a number of war-surplus aircrafts. The year 1953 became a landmark year in the history of Indian Aviation when Indian Airlines was nationalised and the sector was brought under the purview of Indian Government.

Phase II – Post Nationalisation

The air transport scenario changed post nationalisation (1953 onwards) with monopoly of national carriers and their associates and the scheduled services reserved for corporations by Air Corporation Act. Though the phase witnessed substantial growth of Indian Airlines till late eighties, there was no competitive environment.

Phase III – Commencement of Air Taxi Operations

Till 1991 there was a monopoly of Indian Airline Corporation (*domestic*) and Air India (*International*) and then private airlines were offered 'air taxi scheme'.

There was a dawn of new era with commencement of Air Taxi Operations in 1991. This phase witnessed the extensive expansion in operation though confined to highly profitable routes.

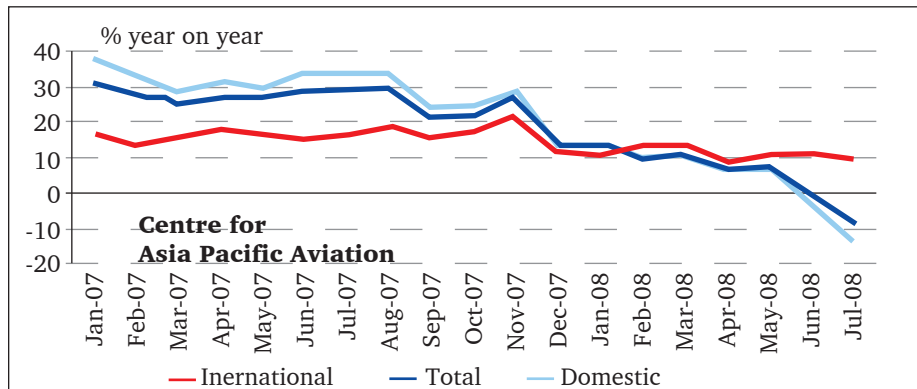
Consolidation seems like the most logical step in the civil aviation industry that demands lofty capital investment and...

Phase IV – End of Monopoly

Air Corporation Act 1953 was repealed with effect from March 1, 1994 with the following objectives:

- to remove monopoly of air corporations on scheduled services
- to enable private airlines to operate scheduled service
- to convert Indian Airlines and Air India to limited company

Fig. -1: Growth rate of Indian Airport Passengers (% change year on year) Jan-07 to Jul 08



Source: Centre For Asia Pacific, "The Monthly Essential India: Airport, Airlines & Tourism" Issue 53, Oct 08

- to enable private participation in the national carriers

Phase V – Fierce Competition and impact of economic upheavals

Indian Aviation Industry witnessed a major change in 2003, when Air Deccan introduced budget flying by lowering down the fares to mere 17% of what the other airlines were charging. The airlines distinguished themselves on various bases from business class to low frills to those with most extensive geographic coverage. The open skies policy, implemented at the end of 2004, further revolutionized the industry. Under this policy, the government established agreements with other countries to allow air transportation between the nations.

The last ten years in aviation industry has witnessed very expeditious transition. The changing economic, demographic and political canvas of India gave a thrust to airlines business. The players that have made prominent mark are Air India, Indian Airlines, Jet Airways and Kingfisher Airlines etc. to name a few. The industry in its present times has witnessed a series of ups and downs and has been on incubator on a few occasions. The crisis in the global economy has taken its toll on the Indian airline industry with the overall passenger traffic in January-February this year falling by almost eight lakh over the year-ago period. A mere 67.61 lakh passengers flew in January –

February 2009 compared to 75.56 lakh last year during the same months for all airlines taken together.

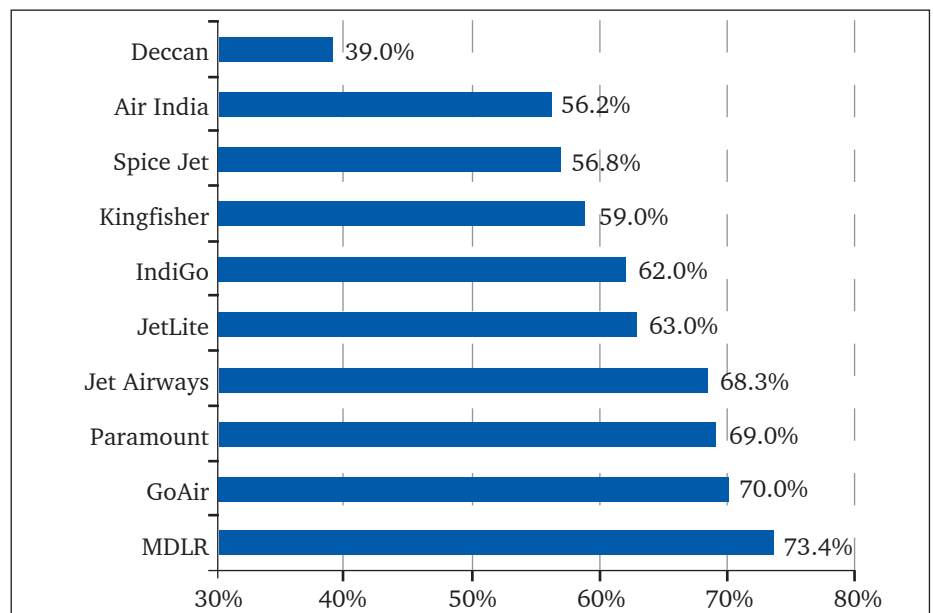
Just a couple of years ago, passenger traffic in airlines was showing a promising growth of 25 percent per year, which is amongst the highest in the world. This was attributed to de-regulation and ending the monopoly of state owned carriers. Private players found very fertile grounds to mushroom, grow and prosper in India. The picture began changing in recent past because of smaller players being swal-

lowed by bigger players & also because of the ripples of slowdown being felt in India. The underline in present time appears to be "To survive, strategise".

The Scope for Aviation Industry in India

The Indian Civil Aviation market grew at a compound annual growth rate (CAGR) of 18 per cent, and was worth US\$ 5.6 billion in 2008. Government of India is planning to improve 45 big and small airports. For Greenfield airports foreign direct investment (FDI) is allowed up to 100 percent. For improving existing airports foreign direct investment up to 74 % is allowed through automatic approvals. Indian passenger's traffic at airport is forecasted to grow six fold between 2007 and 2027. While the number of passengers reached to 600 million in 2027 from 100 million in year 2007. Every day, 250 million of Indian travelers use trains and only 40 million fly. Air India has lowest domestic passengers load factor for August 2008 signifies better reach of low cost airline(See Figure No 2). Airport Council International's prediction for next 20 years, present a rosy picture. It says that air transport has very low penetration in India. At present India has more

Annexure II Indian Domestic Passenger load Factor Aug-08



Source: Centre For Asia Pacific, "The Monthly Essential India: Airport, Airlines & Tourism" Issue 53, Oct 08



than 50 million middle class people who have propensity to travel to abroad and this figure will reach to 580 million by 2027.

The Signs of Peril for Aviation Industry

India has undergone dangerous inflation and global financial crisis. Indications are that India's economy growth is coming

down. India stock market has declined 57% from its peak of 21000 earlier this year. The reason behind bear phase was global financial crisis, overheated stock market, high interest rate regime. Now index of industrial production has touched -0.5% in January 2009. Indian Aviation Industry is no exception and undergoing turmoil due to global financial crisis and economic slowdowns. Indian aviation industry is bleeding and would expect to report a loss of \$1.5-2

billion on revenue of \$6 billion for the year ending 2008-09. Airport Authority of India reveals that number of passengers at India port for July 2008 has -8.7% years on year. Passenger growth rate was 32.6% in 2007 which has reached to -0.2% in June 2008. Decline in passenger's traffic is on account of withdrawal of operations by number of carriers in domestic segmentation since June 2008. International passenger traffic is still successful in maintaining positive growth rate for July 2008. (Fig: 1).

From July 2007 to August 2008, nine airlines were launched that placed order for 200 planes. These airlines have hired proficient pilots and Chief Executive Officers at exorbitant salaries. Thousands of youngsters have started spending on training at local and overseas schools to become crew member. The low cost airlines were started to grab train traveler with low fare that even went as low as Re 1 a seat. The bubble of artificial growth has immerged out in this phase only and continued.

Annexure III This is a list of now defunct airlines from India

AIRLINE	COMMENCED	OPERATIONS
Air Services of India	1936	1953
Airways (India) Limited	1945	
Archana Airways	1991	1999
Alliance Air	1996	September 2007
Ambica Airlines	1947	1949
Bharat Airways	1945	1984
Crescent Air Cargo	2000	2006
Damania Airways		
East-West Airlines	1992	~1995
Gujarat Airways		
Himalayan Air Transport & Survey Limited	1934	1935
Himalayan Aviation	1948	1953
Indian National Airways	1933	1945
Indian Overseas Airlines	1947	1950
Indian State Air Service (ISAS)	1929	1931
Indian Transcontinental Airlines	1933	
Indus Airways	2006	2007
Irwaddy Flotilla & Airways	1934	1939
Jupiter Airways	1948	1949
Kalinga Airlines	1946	1953/1965
Madras Air Taxi Service	1933	1934
ModiLuft	1994	1996
NEPC Airlines		
Orient Airways	1946	1953
Vayudoot		

The Factors Responsible for Downturn

The industry took a saw the downward trajectory in the recent past, largely owing to following reasons:

Defective Business Model of Low Cost Carriers (LCCs): LCCs which opened the skies for the average traveler, have under-pin the growth story of Indian aviation The revenue Model adopted by Indian low cost airline is market share driven rather than bottom line based. The aviation industry has suffered a loss of more than 4000 crore in fiscal year 2007-08. In order to grab the market share, low cost airlines started selling tickets at a price below cost incurred. Due to low fares, carriers fail

to break even on account of low seat occupancy rate. For example Jet Airways would break even by March 2010. At such low fare you will get traffic that would disappear at economic prices. Infrastructure crunch has added to heavy overheads. All the flights with heavy losses have been cut. Soaring crude oil price and fare war has put all low cost airlines into high cost-low revenue financial crisis.

Soaring Crude Oil Price: November 2007 onwards, rising oil prices, has caused monthly increase in aviation turbine fuel (ATF) prices by 5-17 per cent. Rocketing crude oil prices has absorbed gains and left mounting losses on the shoulders of all airlines company. Current situation has become unsustainable. For almost every airline, it is very difficult to recover fixed cost for on a large number of flights. Kingfisher flies once in day between Delhi and Mumbai with less than 100 passengers on 180 seated aircraft. Jet was losing around \$1million-1.5 million a day out of which 2/3rd is on account of international route.

Full Fare airline were still able to break even because of higher yield per seat due to inelastic revenue from premium class and can survive in turmoil. Smaller airline would least likely to survive and prone to mergers and acquisitions.

Strategies for Resurrection of Airline Industry

In the airlines business, the stakes are high and involves risks. The turbulent times have seen airline companies vying for bailouts or even exiting the industry (*Annexure III*). More than 30 airlines have

gone bankrupt across the world in last 12 months. At these tumultuous times, only effective strategies can ensure survival of the airlines. A few players have exhibited their strategies to fly through bad phases.

• **Increment in Fare:** Presently all the airlines have started increasing fares and lowering cost to augment revenue.

To cover heavy losses, minimum fare for half hour flight stands at Rs 3000. All the airlines in the industry have decided not to operate

loss making flights.

• **Reduction in overheads:** To minimise additional overheads, airlines like Jet Airways, is planning to charge for checked-in bags by weight. Air-India has stopped serving candies and churned expenses on publication and manpower travel. Jet Airways have started renegotiating contract for goods and services. Strict control has been imposed on capital expenditure, payroll and head count. Air India has started using Fuel Efficiency Program in association with IATA. Air India has reduced agent's commission to zero from 1st Nov-08.

• **Reduction in flights:** Airlines have started leasing out idle flights and cancelled the delivery orders. Jet Airways has slashed the number of seats for Delhi-Singapore and Delhi-Brussels routes. Flight between Mumbai-Delhi and Chennai-Bangalore has been cancelled. For all 180-seater aircraft lease agreement which is about to renew, carrier can go for 70-seater fuel efficient Embraer jet like paramount. Curtailing loss making routes is required at present unsustainable situation. Air India has terminated 50 year old London-New York service from 10

Sep-08.

• **Manpower Retrenchment:** To slash manpower overheads, most of airlines have given pink slips to the employees there by creating atmosphere of apathy. Air India is planning to reduce Productivity linked Incentive of 34000 employees comprising up to 50% of salary in some cases. It may send some employees on leave without pay.

• **Closure of station:** To augment revenue, loss making station could also be closed down. Like Spice jet has bunged Port Blair and Cochin stations. In such circumstances, carriers can linked up several city pairs where they do not have direct flights.

• **Reduction in tariffs:** To inject fresh blood in bed ridden India aviation industry, Government of India has taken some positive steps by slashing custom duty on fuel from 10% to 5% and excise duty on petrol. Due to which Indian oil companies have reduced Aviation Turbine Fuel (ATF) by 4.4 percent.

• **Hedging:** Reserve Bank of India has been decided to permit domestic crude oil refining companies to hedge their commodity price risk on crude oil imports in overseas exchanges/markets. Oil refiner would now be able to hedge domestic purchase of crude oil and down stream companies could hedge oil imports. These have helped in oil companies in slashing ATF. Government of India can further extend help by sanctioning more subsidies to upstream oil companies.

• **Bailout Package:** Indian airlines are seeking financial assistance from Indian Government in form of bailout packages of worth \$ US 963 million to adjust losses because of rising cost. Air India alone has been seeking approval of \$ US 220 million bailout package from Civil aviation Minister.

• **Consolidation and Strategic Al-**

The low-frills airlines have a promising future compared to the premium counterparts...



liances: Survival of fittest will hold true. Many airlines with heavy losses unwind international operation and seeking consolidation. Jet airways have already entered consolidation phase for gulf region by pursuing alliances, with no plans for future expansion. Jet Airways and Kingfisher have joined hands for a strategic alliance. The strategic operational alliance will witness using each other's strength in the most prudent manner so as to curb losses (*of the order of Rs.10 Crore daily for each airline*).

- Financial Assistance and Concession: Concession requested includes the followings;
 - a. Interest Free loan with one time payments after three years
 - b. Putting Jet fuel in declared good category for sales tax relief
 - c. Reduction in Custom and Central Excise duty
 - d. 50% drop in airport landing, route and terminal navigation charges for 24 months
 - e. No further enhancement in airport service charges

Conclusion and suggestions

The Indian aviation industry holds a lot of promise owing to the huge population, increased affordability and making the services accessible to the common man. But, the sector is highly susceptible to turbulence in economy.

The low-frills airlines have a promising future compared to the premium counterparts. There is a high possibility that Indian aviation industry will go back to 1990s where only few players with high economy class fares existed. Indian aviation industry has undergone turmoil and to overcome this unsustainable situation enhancement of fare would not suffice. It has negative impact on number of passengers. The customer base has to increase rather than sharing old customer base. The pie has to be enlarged rather slicing same one. Also, consolidation seems like the most logical step in the civil aviation industry that demands lofty capital investment and increased pressure on revenue. But, consolidation move should take place only after a very pru-

dent analysis and where the players can effectively derive synergies. The mergers and acquisitions should make logical sense and should not be taken up for the sake of it.

Annexure

Annexure I

The recent policies that have been implemented are:

- Revised Air Service Agreement with USA – Both countries can have any number of airlines fly to each other with full intermediate and beyond traffic rights
- Liberalisation of entitlements with UK, Australia and France – The number of services and seats allowed to fly between these countries has been increased, along with permission to foreign airlines to fly to new destinations in India
- International operations by private airlines – All airlines having at least 20 aircraft and having at least 5 years of domestic experience can fly to all international destinations except the Gulf
- Signing of new Air Services Agreements with Slovenia and Morocco – The current number of ASAs with India stands at 100
- Policy on Commercial Agreement – Commercial Agreements between carriers will not be mandated by the government
- Removal of restriction on photography – Passengers are now permitted to take photographs inside terminals and aircraft
- Open Sky policy during peak seasons – Designated foreign airlines can operate extra services to India during peak seasons

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