Profitability of indian airline industry essay

Environment, Air

The Wright brothers brought to life one of the greatest dreams of mankind – sustained, powered flight. It did not take long for this invention to proliferate worldwide. The British brought it to India between the World Wars and the aviation juggernaut has been rolling since then. Post independence, India had nine airlines transporting both passenger and cargo traffic. The Indian government nationalized all the existing airline assets in 1953 as it was following the Soviet economic patterns.

Indian Airline was set up to serve the domestic market, while Air India was set up to cater to the International sector. Both Indian Airline and Air India enjoyed monopoly over the Indian skies as during the License Raj, it was unimaginable for private players to set up and successfully run airline businesses. Due to this unhindered monopoly enjoyed by the two airlines, service was not up to the mark, flight delays were frequent and fliers had to face many hardships, especially in transit flights.

Liberalization brought about the change which came as a booster for the Indian aviation industry. The Aviation industry has witnessed phenomenal growth for both domestic and foreign passenger and cargo sector since the ‘ Open Skies’ policy which resulted after globalization. The entry of private players (like Kingfisher, Jet) and low cost carriers (like Air Deccan, Spice Jet) took away the monopoly of Air India and Indian Airlines. The prices, which were hitherto prohibitively expensive, were brought down to levels where the middle class consumers could afford them.

As a result, the number of first time fliers increased substantially. Since then, the Government of India has provided some initiatives for the promotion of

the aviation sector. Foreign Direct Investments in Domestic Airlines have gone up from 40% to 49%, with Non Resident Indians and Persons of Indian origin being allowed 100% of the same. International routes have been freed for entry to Private players provided they had 5 years of experience in the domestic sector and owned a fleet size of more than 20 aircraft.

There had been wide swings in the rofitability with the fluctuating prices of Aviation Turbine Fuel, wide variations in Load Factor, ageing fleets of Air India/Indian Airlines, low cost airline price wars. The industry was in the limelight regarding mass layoff policies at Jet, a Rs. 4000 Core Liability for Air India and many more incidents. However, the industry has evolved over the years to become more customer-centric and lean. In the following pages, we will delve into the specifics of the profitability (and non-profitability) factors of the same.

History of Aviation Industry in India: The first Indian, or maybe even Asian, to have an airplane was the young Maharaja of Patiala, Bhupinder Singh, who had a keen interest in aviation. He sent his British Engineer CW Bowles to Europe to look at the new art or science of flying and bring a couple of planes back with him. Bowles returned to India in December 1910 with a Farman biplane made in England and a Gnome-Bleriot monoplane fitted with two seats. Fortune did not favour Patiala and neither of these aircraft became the first to get into the air.

In early December 1910 a party from Belgium and two from England also came to India with several aeroplanes. The first of these to land in India was from Coventry’s Humber Motor Company, famous for its cars especially used

by the police in UK. It included a leader, Capt WG Windham, two pilots, and two mechanics. The group arrived on December 5 at Allahabad. The first actual flight was successfully attained by Mr. Davies in a ‘ Bleriot’ on the 10th of December.

The second aircraft flew the next day, December 11, 1910, under the control of the French pilot Henri Pequet and carried the first air passenger in India, who was one of the sons of the Maharaja of Benares. Pequet flew the biplane over the confluence of the Ganges and the Yamuna and also over Allahabad Fort. In 1912, the first air flight between Karachi and Delhi was started by the Indian State Air Services in collaboration with the UK based Imperial Airways. It was an extension of London-Karachi flight of the Imperial Airways.

The Imperial Airways extended its Empire Routes to India, connecting India with the outside world for the first time through an air network. A de Havilland Hercules flew the Cairo-Basra-Karachi-Jodhpur-Delhi route. It was also the first domestic passenger flight to be operated in India. On February 10, 1931 JRD Tata was awarded India’s first pilot licence, Pilot Licence No. 1 by Federation Aeronautique International signed by Sir Victor Sasoon on behalf of the Aero Club of India and Burma. In 1932 Urmila K Parikh becomes the first woman to get a pilot licence when she was given a licence by the Aero Club of India and Burma.

With the distinctive honour of being India’s first pilot, JRD Tata was instrumental in giving wings to India by setting up the first Indian airline company, Tata Aviation Service in 1932. On 15th October 1932, Tata Son’s Limited, later Air India International, commenced weekly airmail service with

a Puss Moth aircraft between Karachi and Madras via Ahmadabad and Bombay, covering over 1, 300 miles. In its very first year of operation, Tata Airlines flew 160, 000 miles, carrying 155 passengers and 10. 71 ton of mail.

In the next few years, Tata Airlines continued to rely for its revenue on the mail contract with the Government of India for carriage of surcharged mail, including a considerable quantity of overseas mail brought to Karachi by Imperial Airways. The same year, Tata Airlines launched its longest domestic flight – Mumbai to Trivandrum with a six-seater Miles Merlin. In 1945, India's second domestic airline, Deccan Airways, was founded with seventy-one per cent ownership by the Nizam of Hyderabad and balance 29 per cent by Tata Sons.

Deccan Airways, one of the first domestic airlines, flew in the Hyderabad region, using a fleet of 12 Douglas DC-3s. Its first service began in July 1946. At the time of independence, the number of air transport companies, which were operating within and beyond the frontiers of the company, carrying both air cargo and passengers, was nine. It was reduced to eight, with Orient Airways shifting to Pakistan. These airlines were: Tata Airlines, Indian National Airways, Air Service of India, Deccan Airways, Ambica Airways, Bharat Airways and Mistry Airways.

In early 1948, a joint sector company, Air India International Limited, was established by the Government of India and Air India, erstwhile Tata Airline, with a capital of Rs 2 crore and a fleet of three Lockheed constellation aircraft. Its first flight took off on June 8, 1948 on the Bombay – London route. At the time of its nationalization in 1953, it was operating four weekly

services between Bombay –London and two weekly services between Bombay and Nairobi. This joint venture was headed by J. R. D. Tata and had himself piloted its inaugural flight.

The Indian Government nationalised the airlines industry in 1953, with enactment of Air Corporation Act. Assets of eight existing air companies viz. Deccan Airways, Airways India, Bharat Airways, Himalayan Aviation, Kalinga Air Lines, Indian National Airways, Air India, Air Services of India, were merged to form the national carrier. This included Air India International for the international routes and Indian Airlines Corporation for domestic sector under the control of the Director-General of Civil Aviation and the regulations set out in the Air Corporation Act (1953).

A large fleet of 74 DC-3 Dakota, 12 Viking, 3 DC-4 and various smaller aircraft were part of this large airline. Thus Air India and Indian Airlines started to establish a monopoly in the aviation industry. India enjoyed more success in the airline industry than most other developing countries for a number of reasons. Whereas others had to rely on foreign pilots to fly their planes, Air-India used mostly native-born pilots. Similarly, skilled Indians were plentiful enough to maintain India’s fleet as well as to train and supervise its personnel; many other countries had to go outside for this kind of expertise.

Air-India benefited from these advantages along with its sister carriers. In 1960, India entered the jet age when Air India began operating its first Boeing 707-437. It also marked the year when USA was connected to India by an Indian airliner. The framework remained unchanged until the late

1970’s when there was mounting criticism that Indian Airlines was not promoting tourism and industrial development at the regional level. The reform process in India commenced in 1986 as a direct result of complaints from the tourism sector that there was insufficient capacity on some key routes.

The Minister of Tourism and Civil Aviation took the initial step by permitting private sector airlines to operate as ‘ air taxis’. Though fifteen licences were issued continuing criticism led to the Government’s announcement in 1989 that it was implementing an ‘ Open Skies’ policy with a progressive relaxation of restrictions on the air taxi operators and eventual approval to provide scheduled services. The immediate outcome was the granting of five new licences, but the largest of these discontinued services after only five months.

By 1991 the policy was regarded as a failure. The fatal crash of an Indian Airlines A320 aircraft in 1990 was a major setback, especially since the carrier’s A320 fleet was grounded during a lengthy investigation. The loss of a substantial share of the incumbent’s capacity created an opportunity for the private sector to expand its role and the commencement of East West Airlines in February 1992 marked the start of a new era. This airline was owned by one of India’s largest travel groups and it had a major impact on the market with its seven B737- 200’s and three F27’s.

Its entry was assisted by a pilots’ strike at Indian Airlines and East West carried more than one million passengers in 1992-93. One of the significant policy developments was that the air taxis were permitted to obtain up to

40% of their equity finance from foreigners. Jet Airways, also backed by a travel group, took up this option in 1993 with 20% funding from Kuwait Airways and 20% from Gulf Air. In the same period, the other significant airlines to introduce jet aircraft were Damania Airways and ModiLuft.

By the end of 1993, 17 operators had been granted air taxi licences, another 20 had obtained preliminary approval, and new entrants were serving 54 routes. Indian Airlines and Vayudoot were weakened as a result of losses in traffic, but they also suffered when pilots and engineers defected to the new carriers. At one point, Indian Airlines had six of its 10 A31O’s unserviceable, and 12 of its 19 B737-200 and one-third of its A320 aircraft could not be used. Vayudoot was reported to have made a loss of US$5 million in the first five months of 1994 and it was folded into Indian Airlines.

However, these start-up carriers had to comply with the traffic allocation rules set by the government. The operating routes were divided into three categories * The first category identified by the Government included all of the main trunk routes * The ‘ social’ routes included the remote areas in the northeast, Jammu and Kashmir and the Andaman Islands * The third category covered all of the other non-trunk routes. Each scheduled carrier flying Category I routes were required to deploy an additional minimum of 10% of that capacity (in terms of available seat kilometres) on Category II routes.

Another 10% of the capacity on these routes is to be operated within those regions that have some of the least economic fares. In addition, the carriers have to provide a further 50% of their capacity on Category III routes. As

expected, few survived the experience and today only Jet Airways and Air Sahara remain. Current Scenario of Airlines industry in India The Indian Aviation Sector has witnessed tremendous growth in the recent past which is driven by sound demographic, macroeconomic, government aided reforms ; market dynamics.

The rising disposable income, booming aviation sector, burgeoning middle class, increasing business travel, government reforms, entry of low cost carriers, increasing competition, etc. have positioned the Indian Aviation Sector in a high growth trajectory. The open sky policy of the government has helped a lot of overseas players entering the aviation market in India. Thus, with the increasing competition among the major players in the industry, the market can be described as an oligopolistic market.

From then, it has only been growing in terms of players and the number of aircrafts. At present, private airlines account for around 75% portion of the domestic aviation market. The demand of people travelling in plane increased to a greater extent over the years and considerably the price decreased as several low cost carriers entered the market. The market share and the capacity-demand trend of the Indian aviation industry for the year 2009-2010 are shown in the graph below.

The passengers carried by domestic airlines from Jan-Jul, 2010 were 298. 1 lakhs as against 247. 48 lakhs in the corresponding period of year 2009 thereby registering a growth of + 20. 7%. Analysis of Capacity (ASKM) and Demand (RPKM) data on Year-to-Year basis indicates that trend of increase in both the capacity and demand continued in the month Jul 2010 also. The 9th

largest aviation market in the world is India. The Airport Authority of India (AAI) manages a total of 127 airports in the country, which include 13 international airports, 7 custom airports, 80 domestic airports and 28 civil enclaves.

With a compound annual growth rate (CAGR) of 18 per cent and 454 airports and airstrips in place in the country, of which 16 are designated as international airports, the aviation sector in India is expected to witness a revival by 2011. Passengers carried by domestic airlines from January-February 2010 stood at 8, 056, 000 as against 6, 761, 000 in the corresponding period of 2009—a growth of 19. 2 per cent, according to a report released by the Ministry of Civil Aviation. Aviation Policy in India The policies of the Indian government encourage foreign participation.

Government allows 100% FDI via the automatic route for the green field airports. Also, foreign investment up to 74% is permissible through direct approvals while special permissions are required for 100% investment. Private investors are allowed to establish general airports and captive airstrips while keeping a distance of 150 km from the existing ones. Complete tax exemption is also granted for 10 years. About 49% FDI is allowed for investment in domestic airlines via the automatic route. However, this option is not available for foreign airline corporations.

Complete equity ownership is granted to NRIs. Foreign direct investment up to 74% is allowed for non-scheduled and cargo airlines. Thus, all these policies promote foreign investment in this industry. The Response to Economic Crisis In response to the crisis, the industry has embarked on a

cost-cutting spree. Most full service carriers have chosen to outsource ancillary functions like ground handling, reservation, aircraft maintenance, catering, training, accounting, IT infrastructure, loyalty programme management to reduce their operational costs.

Air lines are now paying more attention to the air cargo segment and develop its revenue potential by maintaining a dedicated fleet of aircraft for handling air cargo. To cut down their labor costs, airlines have also resorted to hiring contract labor for cabin crew, ticketing and check-in functions and retired personnel from Air force and PSU’s have been engaged at senior management positions as part of the cost – cutting exercise. The government on its part is acutely conscious of the crisis and has stepped in to avert an implosion in the aviation space.

By keeping the tax on jet fuel at a low rate of four percent for smaller planes, it has offered an olive branch for regional carriers that typically use smaller aircrafts. It wants to aggressive promote regional aviation and has chosen not to cut the tax rate on aviation fuel for full service carriers which currently hover at around 30-40%. The Ministry of Civil Aviation has advised air – carriers to consume less engine power and reduce their operations on routes attracting lower load factors.

The government is also contemplating several fiscal and monetary incentives to make India a major hub for Air craft Manufacturing and MRO (Maintenance and Repair Operations) in Asia. It is expected that these strategic moves will give the much needed fillip to the industry and propel it to a new trajectory of growth. Recent Air India Strikes Since government takeover in 1953,

strikes at Air India are frequent. The recent strike was during the Mangalore plane crash. About 25, 000 employees of Air India have gone to strike protesting a gag order issued by the Air India management.

Air India for once has the entire country on its side as it reportedly dismissed at least 40 employees, suspended 17 others and derecognized the irresponsible Air Corporation Employees Union and Air India Aircraft Engineers Association for having gone on a flash strike. Over 13, 000 passengers, including small children, were left stranded at airports across the country, and some had harrowing stories. The national carrier had to cancel at least 130 flights, incoming and outbound, and suffer a loss of nearly Rs. 12 crores during the 48-hour strike.

Some of the reasons behind these frequent strikes are the delay in salaries to Air India employees. But several airlines have been paying salaries a little later than usual due to financial constraints. Another important reason mentioned by the union is Air India’s losses, which mounted from six to seven thousand crores due to several wrong decisions taken by the management and the ministry of civil aviation. The financial bungling by the management could be seen from the fact the balance sheet of the National Aviation Company of India Ltd (NACIL) for the year 2008-09 could not be finalized till the end of September 2009.

Progress and Future Scope of Indian Aviation industry The Indian aviation industry is forecasted to grow phenomenally in the coming years. The Vision 2020 announced by the Civil Aviation Ministry conceives of building infrastructure to support 280 million customers. Investments to the extent of

US$ 110 billion are envisaged by 2020. About US$ 30 billion for development and sprucing up of existing airports and US$ 80 billion for building new fleets is being estimated. The aerospace giant Boeing projects that the Indian aviation industry will require about 1, 000 commercial jets in the coming 20 years.

Some of the other progress and Future scope of Indian Aviation Industry are mentioned below. * Indian aerospace companies are growing too. Hindustan Aeronautics Limited (HAL) was ranked 40th in Flight International's list of the top 100 aerospace companies last year. * Aircraft manufacturing major, Boeing, is in the process of setting up the US$ 100 million proposed Maintenance Repair Overhaul (MRO) facilities in Delhi. Air India is also in the process of launching a Cargo Hub in Nagpur while Deccan Aviation has already started one from the city.

GE Aviation and Air India will jointly invest US$ 90 million to set up a maintenance, repair and overhaul (MRO) facility in Mumbai. * Indocopters Private Ltd, distributor for Eurocopter helicopters in India, is planning to set up a helicopter maintenance, repair and overhaul (MRO) facility in Bhubaneswar, the company's fourth service center in the country. Now that we have an idea of the past and present scenario of the Indian Aviation Industry, let us analyze the factors which positively and negatively affect the profitability of airline firms in the country.

Factors Which Have Had A Positive Impact On The Indian Airline Industry There are a number of positive factors which have had a positive influence on the profitability of the firms in the Indian Aviation sector. These factors

have not only been responsible for helping the growth of airline services in the country over the past few years but have also helped the industry survive the difficult times during the recent economic recession. In this report we will analyse few of the important positive factors.

Improvement in Airport Infrastructure: Realizing the huge amount of resources needed to develop the airport infrastructure across the country and the shortage of time available to provide for the same, the Indian government made the seemingly correct decision of promoting public-private partnerships (PPPs) in the airport infrastructure space. The speedy upgradation and modernisation of the Delhi and Mumbai airports (in collaboration with DIAL and the GVK group respectively) are prime examples of the benefits of the PPP model.

The newly inaugurated T3 terminal at the Delhi airport is in fact the 8th largest passenger terminal in the world. The terminal by itself would triple the total passenger capacity at the Delhi airport. The development of the Greenfield airports at Hyderabad and Bengaluru are further proof of the success of the PPP model. The Rajiv Gandhi international airport at Hyderabad has been rated as the 5th best airport globally by the Airports Council international.

India’s first airport constructed under the PPP model was at Cochin and this has made profits since opening in 1999. However, it is not only the PPP model at work, The Airports Authority of India is also currently in the process of upgrading the Chennai and Kolkata airports. It is not only the metro airports which the AAI is targeting. Last year alone, the AAI completed the

modernization of 10 non-metro and 12 other airports across the country. It has drawn an action plan to modernize 35 selected non-metro airports and develop 23 other airports.

The government is also in the process of expanding the airport network to more Tier II and Tier III cities. The larger the capacity of the high traffic airports more the flights possible from those locations and more the passengers that can be ferried between the two locations quickly. This would help in reducing the average total cost per flight as the fixed costs for the airline companies at most of the airports would remain the same. Thus, companies would profit from economies of density.

Moreover the same plane could be utilized more efficiently if the take-off and landing times are reduced. Airline companies used to unnecessarily waste a lot of fuel circling the congested airports, awaiting their turn to land or spend extra time on the runway awaiting their turn to take off. With the considerable improvement in airport infrastructure, these extra expenses have been reduced to some extent and will continue to do so in the future as infrastructure keeps improving.

The more the number of airports, the more the number of passengers in the catchment area that would start using air services for their transportation need. The Tier II and Tier II cities are witnessing rapid economic progress. Thus, these areas will see a tremendous growth in the demand for air travel due to the increase in incomes in those areas. Also as airlines expand their fleet, the economies of scale will help further reduce the costs associated with air travel.