

# Foreign airlines to invest in indian carriers tourism essay

[Sport & Tourism](#)



**ASSIGN  
BUSTER**

Abhinav Kumar & Prashant Pranjali]" Allowing foreign airlines to invest in Indian carriers does not solve the problem. The tax structure is negatively impacting aviation. Why would any airline come to India unless it has a viable business model that would give a strategic advantage?" -- Paresh Parekh, tax partner, Ernst & Young.

## **Sector Overview**

Civil aviation is an important part of a country's national infrastructure. The sector is one of the prime movers for economic growth and a strategic element of employment generation. The Indian civil aviation sector is robust, with passenger traffic growing at a fast pace, at almost double the rate of the country's GDP. Domestic airlines carried 39.6 million passengers during January to April 2011, as against 33.4 million during the corresponding period of the previous year, registering a growth of 18.6%, according to statistics of the Director General of Civil Aviation. Overall, passenger traffic in both domestic and international flights, registered an increase of 18% in 2010, with the year clocking 90 million passengers. India is a fast-growing aviation market today; it is expected to be among the four to five biggest aviation markets by 2020 and third in terms of domestic market after US and China. In fact, India is expected to cross the 450-million mark of domestic passengers by 2020. During the last two decades, from a fleet of only about 100, airline companies now operate 435 aircraft, connecting India to the world. In a 2011-12 aviation industry outlook, Centre for Asia Pacific Aviation (CAPA) projects that the country's private carriers posted a combined profit of USD 350 million to USD 400 million during 2011-12. It also expects India's domestic airline traffic to post a growth of 17-20% during 2011-12. According

to revised Planning Commission estimates, around USD 7.52 billion is expected to be invested in the airports sector during the 11th Five-Year Plan, compared to USD 1.4 billion invested in the 10th Five-Year Plan (2002-07). The Airports Authority of India (AAI) earned approximately USD 1 billion and made a profit of USD 163 million in 2010-11.

## **Policy and Promotion**

The Indian aviation sector is an open, liberal and investment-friendly sector.

"Entry of low-cost carriers, higher household incomes, strong economic growth, increased FDI inflows, surging tourist inflow, increased cargo movement, sustained business growth and supporting government policies are the major drivers for the growth of the aviation sector in India,"

according to a Deloitte report on the Indian aviation sector. The Ministry of Civil Aviation is charged with the responsibility of the formulation of national policies and programmes for the development and regulation of civil aviation in the country; devising and implementing schemes for orderly growth and expansion of civil air transport; and overseeing the provision of airport facilities, air traffic services and carriage of passengers and goods by air. The responsibility of developing, financing, operating and maintaining all government airports in the country rests with the AAI, which was established in 1994 under the Airports Authority Act. AAI has also entered into operations management and development agreements with Delhi International Airport Ltd for Indira Gandhi International (IGI) Airport in New Delhi, with an objective to develop it into a world-class airport. Phase-1 of the development of IGI airport has been completed with the construction of the new integrated Terminal 3 (T3). It caters to an additional 34 million passengers per annum

<https://assignbuster.com/foreign-airlines-to-invest-in-indian-carriers-tourism-essay/>

(mppa) and can operate as a hub. AAI has announced that it will seek the government's clearance for its proposal to issue USD 1.04 billion worth of infrastructure bonds to further develop 15 airports in the country. According to estimates of the Ministry of Civil Aviation, the total investment required in the aviation sector is about USD 13.54 billion. The introduction of low-cost airlines, coupled with rising disposable incomes in the country, has resulted in substantial growth in domestic passenger traffic, which increased at a compound annual growth rate of 17.5% between 2004-05 and 2009-2010. Some of the policies and promotions being offered by Indian government to the civil aviation sector are:

### **2. 1. Automatic route:**

100% FDI under the automatic route is permissible for greenfield airports. 49% FDI is permissible in domestic airlines under the automatic route. 100% equity ownership by non-resident Indians (NRIs) is permitted. There is also a provision of 100% tax exemption for airport projects for a period of 10 years.

### **2. 2. Appointment of Airport Economic Regulatory Authority:**

To monitor the quality of services rendered by various airports and their tariff, an independent regulator, the Airport Economic Regulatory Authority (AERA) has been appointed. AERA is a statutory body constituted under the Airports Economic Regulatory Authority of India Act, 2008. The AERA was established by the government in 2009. The statutory functions of the AERA are to determine the tariff for aeronautical services and to determine the amount of development fees in respect of major airports.

## **2. 3. Setting up of Air Navigation Services Corporation:**

Air traffic control (ATC) operations have started to function as a new entity from April 2012. Earlier, the air navigation service was under the AAI, the state-owned airport operator. The new company is called Air Navigation Services Corporation of India. Revenues coming from ATC operations include charges for route navigation facilities, terminal navigation and instrument landing, among others. Also, every time an international flight uses India's airspace, it pays a fee for ATC services.

### **Major Players**

At present, India has 136 airports, of which 128 are owned by the AAI. The Government of India has recognized the need to involve private players in developing world-class airport infrastructure, based on the high growth of traffic handled at airports over the last few years. With changing government policies, the involvement of private players is increasing rapidly in the sector. With business activity growing, the demand for non-scheduled airline services is increasing. In 2008-09, the country was home to 99 non-scheduled airline operators with a combined fleet of 241 aircraft, compared with 65 operators with a combined fleet of 201 aircraft in 2007-08. Until recently, the AAI was the only major player involved in developing and upgrading airports in the country. However, private sector players are now becoming increasingly involved in the sector. Some major private sector players include GMR Infrastructure Ltd, GVK Power and Infrastructure Ltd, Siemens, Larsen & Toubro (L&T), Unique Zurich and Maytas Infrastructure Limited, etc. Air India and Indian Airlines are public sector airlines that operate both domestic and international flights. Apart from these, a plethora

<https://assignbuster.com/foreign-airlines-to-invest-in-indian-carriers-tourism-essay/>

of private airlines operate in the Indian sky, prominent among which are: GoAir, IndiGo, Jet Airways, Jet Konnect, JetLite, Kingfisher Airlines, SpiceJet, Deccan, Paramount Airways, Jagson Airlines, etc. Jet Airways/JetLite had a combined passenger level of 1.2 million passengers, or around 26%, of the market as of July 2011. IndiGo has started international air services from September 1, 2011, after completing the mandatory five years of wholly domestic operations. The low-cost carrier (LCC), the largest in the domestic Indian market, marked its foray into international markets with direct services to Dubai, followed by Singapore and Bangkok, in the first phase. Dubai's first low cost airline, Flydubai, has started flights to Ahmedabad in Gujarat from August 2011. The Bangalore-based National Aerospace Laboratories (NAL) and Mahindra Aerospace have been working on manufacturing a small plane for three years. Mahindra's Australian subsidiary GippsAero built the prototype in 10 months at its facility and has conducted the first flight. Teams from NAL, Mahindra Aerospace and GippsAero are involved in the C-NM5 programme.

## **Present FDI Limit**

Recently, Indian Govt. allowed foreign airlines to buy stakes of up to 49 percent in local carriers in a long-awaited policy move, providing a potential lifeline to the country's debt-laden airlines by opening up a fresh source of funding. Removing the existing restriction on investment by foreign airlines would assist in bringing in strategic investors into the civil aviation sector. Higher foreign investment inflows are necessary at the present juncture, in order to strengthen the sector. Introduction of global best practices, concomitant with the induction of FDI from foreign airlines, is expected to

<https://assignbuster.com/foreign-airlines-to-invest-in-indian-carriers-tourism-essay/>

lead to higher service standards, international best practices and induction of state-of-the-art technologies, in the air transport sector. Until now, foreign airlines were allowed to participate in the equity of companies operating cargo airlines, helicopter and seaplane services, but not in the equity of an air transport undertaking operating scheduled and non-scheduled air transport services. The Government has now permitted foreign airlines to invest, under the Government approval route, in the capital of Indian companies operating scheduled and non-scheduled air transport services, up to the limit of 49 percent of their paid up capital. The 49 percent limit will subsume FDI and FII investment. The investments so made, would need to comply with the relevant regulations of SEBI, such as the Issue of Capital and Disclosure Requirements (ICDR) Regulations / Substantial Acquisition of Shares and Takeovers (SAST) Regulations, as well as other applicable rules and regulations. Such investment would further be subject to the conditions that:(i) A Scheduled Operator's Permit can be granted only to a company: a. That is registered and has its principal place of business within India, b. The Chairman and at least two-thirds of the Directors of which are citizens of India, c. The substantial ownership and effective control of which is vested in Indian nationals.(ii) All foreign nationals likely to be associated with Indian Scheduled and Non-Scheduled air transport services, as a result of such investment, shall be cleared from security view point before deployment, and(iii) All technical equipment that might be imported into India, as a result of such investment, shall require clearance from the relevant authority in the Ministry of Civil Aviation.[1]The issue of permitting FDI by foreign airlines in the equity of an air transport undertaking operating Scheduled and Non-

Scheduled air transport services has been under consideration of Government for some time. There has been a need to consider financing options available for private airlines in the country, for their operations and service upgradation, and to enable them to compete with other global carriers. Denial of access to foreign capital could result in the collapse of many of our domestic airlines, creating a systemic risk for financial institutions, and a vital gap in the country's infrastructure. Aviation analysts and experts said the move will benefit only if the sector fundamentals are changed and no foreign carrier can change that with any amount of investment. According to GoAir, an Indian low-cost airline pays about \$4, 000 in fuel per block hour, which is 25% higher than any other low-cost airline in the world. This lands Indian carriers in a situation where their fuel costs are higher by at least 45% on a comparative basis globally. Airlines are negatively impacted by steep increase in airport tariffs (more than 350% hike by Delhi Airport) and increased ground handling charges (straight 40% increase announced recently). These, coupled with a southward-biased fare structure, does (fares in China more than 187% of the Indian fares) not support a high operating cost environment. The move will benefit the industry in a medium to long-term as the problem of the industry right now is of profitability and not investment-related. The profitability-related issues need to be addressed, which clearly cannot be done by foreign carriers as they cannot change the tax or the fare structures here. But yes, in terms of investment required in adding capacity or expansion that capital will work well for Indian carriers.



## Questions arising out of this decision

The Government's recent decision to allow 49 per cent foreign direct investment (FDI) in the aviation sector has given rise to two sets of questions. The first has to do with what this will mean for airlines like Kingfisher. Will Kingfisher be able to get the much talked about monies to keep its operations afloat? Analysts are not very optimistic as they feel that the Government's decision has probably come too late to help the airline. The other, more significant questions, include, will this decision to allow foreign airlines to invest in India benefit existing airlines? Will it see the birth of new airlines promoted by foreign capital? How will the flying experience for passengers change? There is near unanimity among analysts that SpiceJet and GoAir are likely to be the two most preferred airlines for FDI. The reasoning — both are promoted by those who are not hard-core airline professionals but entrepreneurs who invested in the business to exit at the correct time and with a profit, which they are likely to get from a foreign airline buying a stake in their businesses.

### 5. 1. Positive Move

While most international airlines have declined to comment on whether they will look at investing in an Indian carrier post the Government changing the policy, analysts say airlines from the Gulf, South East Asia and some European carriers are likely to take maximum advantage of the change in policy. Already, Etihad Airways is in the news, with media reports stating that Jet Airways is in talks with the Gulf carrier. Many in the industry feel that the policy change is also likely to see some new airlines take wings. This could be the route that Tony Fernandes, the promoter of the low-cost airline, Air <https://assignbuster.com/foreign-airlines-to-invest-in-indian-carriers-tourism-essay/>

Asia is likely to adopt. Terming the decision as "excellent" Dhiraj Mathur, Executive Director and Head of National Aerospace and Defense Practice, PricewaterhouseCoopers (PwC), said that with the coming in of international airlines things can only get better for the sector and lead to a better flying experience for passengers. "Service will only improve," he added. Other important aspect of allowing foreign airlines into the Indian aviation sector is the benefit of alliances that these international carriers can bring for an Indian carrier. International airlines that are said to be keen to invest in India carriers include Singapore Airline, which is a key member of Star Alliance. FDI in aviation was long overdue and it was only a question of 'when' and not 'whether' it will happen. It has probably got highlighted so much as currently the industry is going through a rough phase. India has allowed FDI in banking, telecom, insurance, information and broadcasting and these are sensitive sectors as well.

## **5. 2. Heading Out**

Apart from international passengers, it is also the faster growing domestic traffic which could be of interest to foreign airlines. Sushy Shyamal, Partner (Infrastructure Practice), Ernst & Young, adds that this could also provide a good opportunity for domestic airlines to go international as this can become a good integration strategy for local players, who are eligible to leap frog into the international arena. An international aviation analyst feels that with the policy change aviation will finally be treated at par with other sectors. "The sector is undergoing a monumental shift and finally this policy change will allow the Indian aviation sector to participate in a fast changing industry rather than be a silent bystander," he said. Taking the argument further, <https://assignbuster.com/foreign-airlines-to-invest-in-indian-carriers-tourism-essay/>

Amber Dubey, Partner and Head (Aviation). KPMG, added, " It will also pave the way for Indian carriers to buy stake in global carriers some day, though it sounds unimaginable today. Just like no one imagined that iconic brands like Arcelor, Novelis, Tetley, Blackburn Rovers or Jaguar-Land Rover could be owned by Indians some day."

### **5. 3. Who Benefits?**

Critics of the policy, however, feel that it lacks focus. On the one hand the Government has put bilateral exchange with foreign countries on hold. On the other it has allowed airlines to invest in domestic carriers. What is the message being sent... come invest in our carriers, get them to collect passengers and bring them to one point from where the foreign airline, which has invested in an Indian carrier, will carry them to the four corners of the world? How will this help Indian carriers? The other issue that some are critical about is the timing of the decision. Analysts point out that with the industry awash in the red, domestic carriers will become cheap assets for foreign airline to invest in. Of course, according to analysts, this will not stop Indian players from eyeing foreign partners. The inherently high-risk and volatile business makes it a very restrictive industry for a majority of the financial investors to even consider investing in the sector. In the current market there won't be many financial investors evaluating this sector. Cash crunch is definitely there. However, whether international carriers will pay heed to the interests of Indian carriers is something that one will have to wait and see.

### **5. 3. 1. Benefits for Common Indians**

Irrespective of the intentions of the government and opposition parties, the decision of 49% FDI in retail will prove to be beneficial for the Indian middle class and upper middle class people. Currently, number of Indian passengers using various airlines for travelling is increasing at a rate of 11% per year, with the advent of FDI; this rate will increase to better ratio. Furthermore, upcoming investment will increase competition and that will not only improve services and security, but will also reduce cost of air travelling and hence, more Indians will be able to use airlines. However, the State still owns the Air India Limited and unless the State disinvests the Air India Limited completely, we cannot expect much progress in aviation industry because, by holding Air India, Indian government immorally controls the market and this intervention creates losses for private aviation companies and the Air India too. While the loss of Air India Ltd. is the loss of tax-payers and it attains bailouts and subsidies that results in inflation and then general price rise, the private companies fail to get any bailout to compensate their losses. Governmental intervention will keep the possible growth of aviation industry and benefits of Indian consumers at a reduced rate.

### **Conclusion**

FDI in Aviation sector is a good sign with not so-good intentions and it will create further economic bubble and will provide chances for government to create more socialistic programs which will further increase more fiscal deficit and national debt. Also, more than aviation industry, Indian Railways Industry is more in need of disinvestment and FDI. However, government has

opted for the easier option while Indian Railways is still proving to be a great burden on tax-payers.