Point of View
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this issue

SUMMARY

After 5 years of continuous double digit growth, India's domestic air market registered negative growth of 11% in 2009 in sync with slowdown in the global airline industry. Airlines in India were not profitable even when the air market was growing @ 25%, because supply of seats always was in excess of demand. Airlines in India have one of the highest operating costs per seat and low load factor. With liberalization of the aviation sector airlines in India are up against better placed foreign airlines, which offer better connectivity. Airlines in India have to drastically reduce their operating costs as airline industry is expected to stage slow recovery only by middle of 2010.

COMPANY PROFILE

What ails India's airlines?

- **Pankaj Narayan Pandit**

India's aviation sector is making news, albeit for the wrong reasons. First, India's national airline, Air India, is seeking massive equity injunction under a bailout package from the Government of India, running into several thousands of crores. On the other hand, private airlines under the banner of FIA (Federation of Indian Airlines) threatened to ground all flights for one day, over an old issue, namely sales tax on ATF (Aviation Turbine Fuel) levied by Indian State Governments for fuel for domestic flights. Later pilots from Jet Airways and Air India resorted to agitation, further adding to the financial woes of airlines.

Air Market in India - High growth due to liberalization

Year	International		Domestic		Total Air Market	
	No. in millions	% Growth	No. in millions	% Growth	No. in millions	% Growth
2003-04	14.62	11.2%	15.67	12.4%	30.29	11.81%
2004-05	17.26	18.0%	19.44	24.0%	36.7	21.16%
2005-06	20.16	16.8%	25.20	29.6%	45.36	23.59%
2006-07	23.37	15.92%	35.7	41.66%	59.07	30.22%
2007-08	27.17	16.26%	44.38	24.31%	71.55	21.12%
2008-09	NA	NA	39.46	-11.1%	NA	NA

Source: DGCA (*Directorate General of Civil Aviation).* International carriage includes carriage by foreign airlines

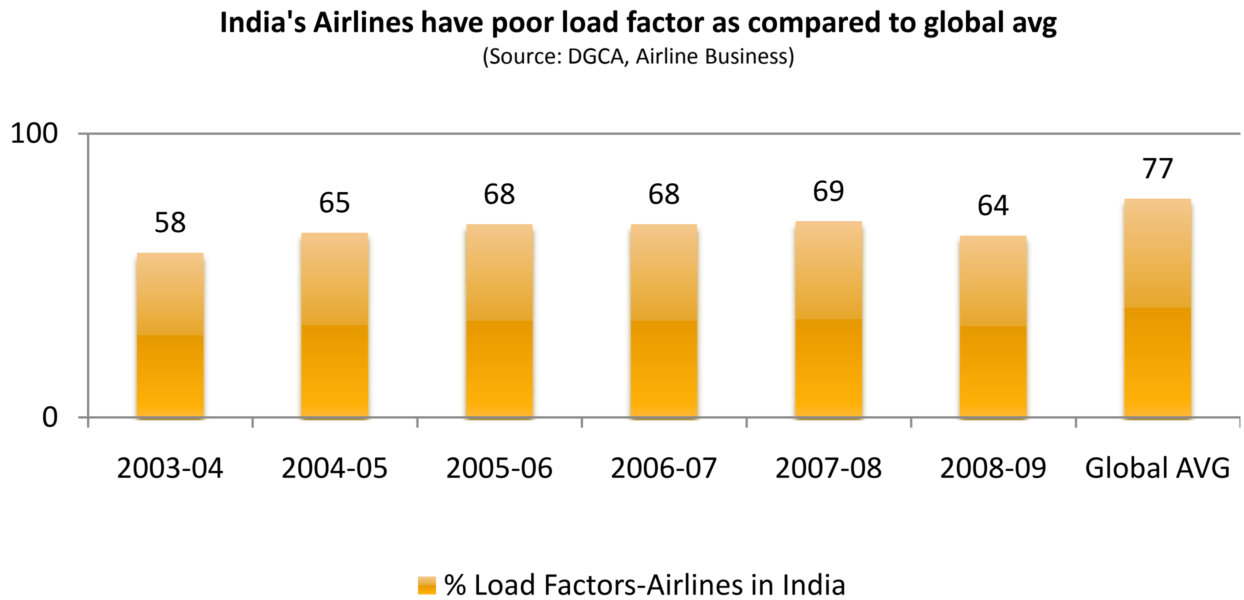
The deregulation of Indian aviation since 2003-2004, resulted in average annual growth of air market @ 27% till 2008. However, the domestic air market registered negative growth of 11.1% for the first time in the last 6 years. Today airlines in India have enviable fleet of brand new modern aircraft and new Greenfield private airports in Bangalore and Hyderabad. New airports are envisaged at several tier 2 cities under public- private partnership. However over the last two years, India's airline industry has incurred operating losses of over US$2.06 billion. Paramount Airways, which operates in niche southern sectors, remains the only consistently profitable airline.

Name of Airline	**Operating losses (2007/08) (US $ Mill)**	**Operating losses (2006/07) (US $ Mill)**
National Airlines	-527.08	-558.33
Air Deccan	-263.95	-73.75
Kingfisher	-170.41	-111.04
Jet Airways	-120.20	-10.83
Jetlite(Air Sahara)	-85.20	-115.83
SpiceJet	-55.0	-34.79
Indigo	-44.16.	-36.25
Go Air	-31.04	-44.79
Paramount	+4.79	+5.0 (Profit)
Total Operating losses	-1292.29	-980.62

Source: DGCA

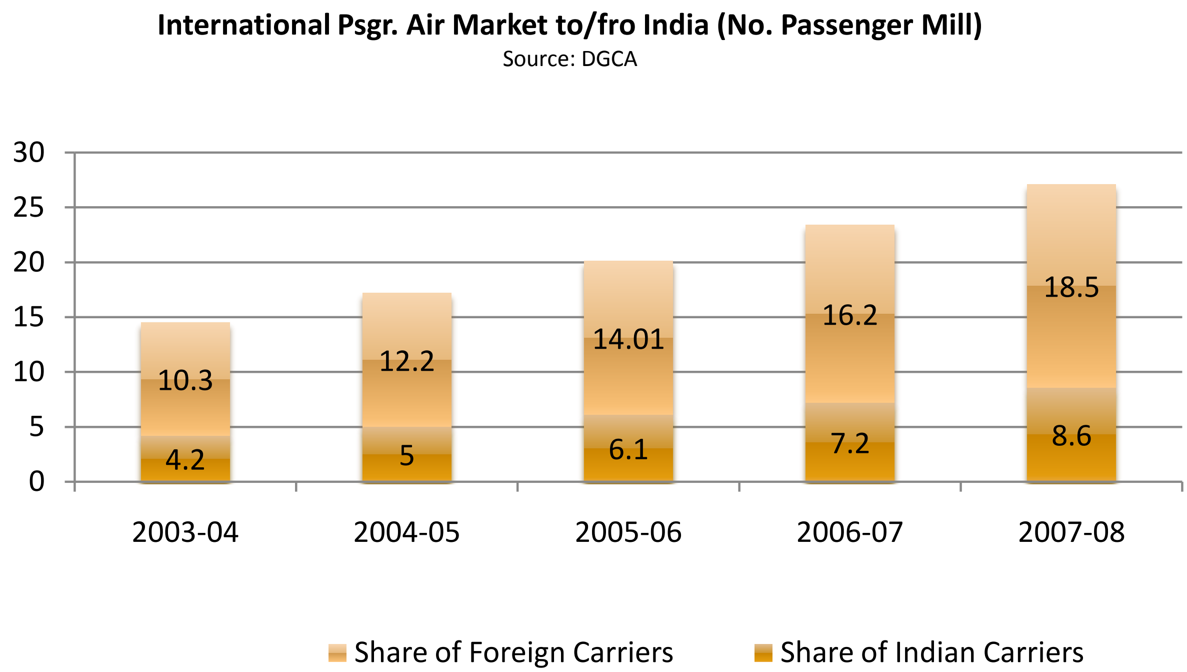
Asset bubble in Indian aviation

Following liberalization of the Indian aviation sector, commercial aircraft fleet in Indian skies went up from 121 nos. in 2003 to 381 nos. in 2007-2008. Orders for 300 new aircraft have been placed but the industry is likely to stagger these deliveries. As part of deregulation, the Ministry of Civil Aviation has increased bilateral entitlement to several international destinations, heralding "almost Open Sky Policy". However, India's airlines have not benefited from such quantum growth in air market. Poor Seat Factor continues to haunt India's carriers, which clearly indicates more supply than demand, even though their load factors improved from 58% in 2003 to 63.7%. Yet this is much below 77% load factor, which was the global average for top 150 airlines in 2008.



Indian carriers face formidable competition from international peers

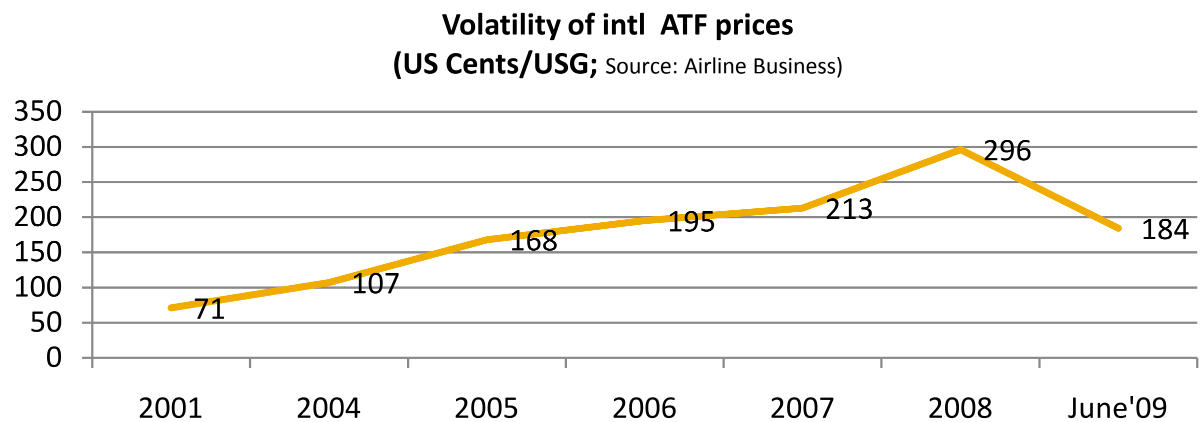
In 2004-2005, Government of India liberalized ASA (Air Service Agreements) with many countries allowing private airlines like Jet, Sahara, Air Deccan (Kingfisher), to touch international shores. However increase in such bilateral entitlements also rendered equal flying rights to foreign airlines from developed economies like Lufthansa, Emirates, Singapore Airlines, British Airways, Air France and Northwest. These airlines have unmatched resources including surplus balance sheets built over many years, fleet strengths and loyalty program membership of global airline alliances, all of which have enabled them to develop a wider base of international travelers. In fact, it is the international airlines like Lufthansa, Singapore Airlines, Emirates, etc which have reaped the benefits of opening up of the Indian skies as their share of India's international air market increased by 8.2 million after liberalization, while airlines in India could add 4.2 million passengers.



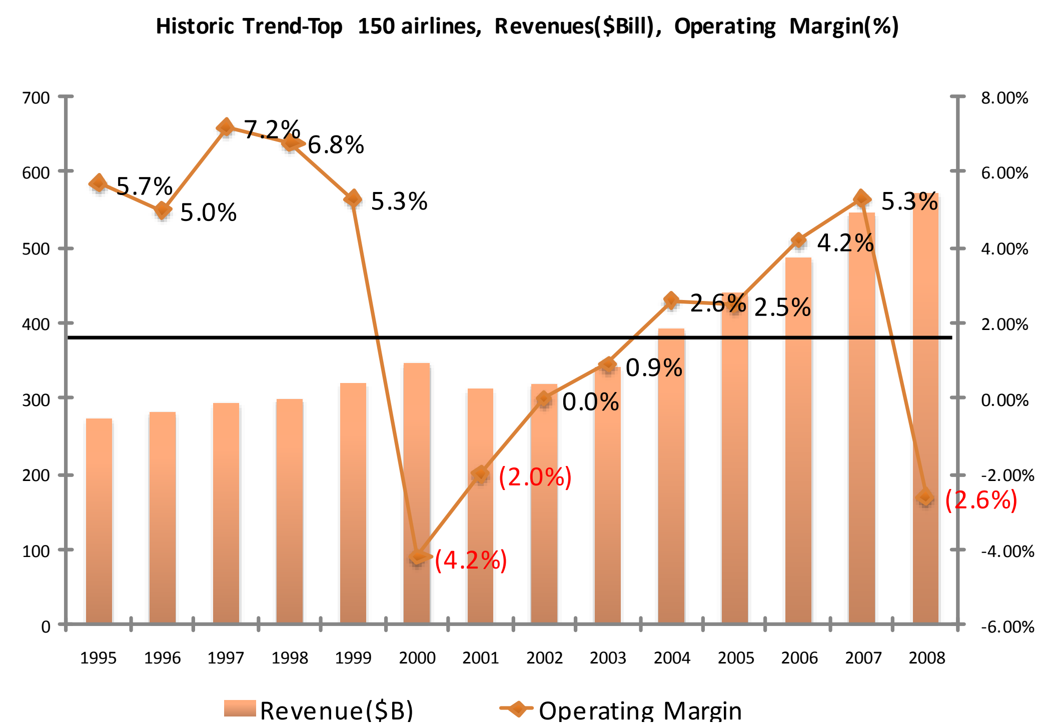
Key foreign airlines have now unleashed huge capacities in India, using geographic position in their home base to offer sixth freedom connections to USA and Europe. The huge passenger base of Indian origin and Indian Diaspora, spread across continents, now has a varied choice of direct flights into India's hinterland. (Sixth freedom is an aviation term for routing passengers to foreign airline's home base and then offer transfer connections). The combined international market share of India's airlines remains stagnated at 30-32%, even though the market has been growing @ 18% since 2003-04.

What ails India's airlines?

Sales tax on ATF (Aviation Turbine fuel), Airport landing charges, and UDF at new airports are not the real issues that are hurting our airlines.



International ATF prices have come down in 2009, after hitting a high in the last two years. (ATF prices in India are indexed to global oil prices, though local sales taxes are added for domestic flights). As per IATA resolution, there can be no local sales tax imposed on fuel for international flights. However sales tax on ATF (Aviation Turbine Fuel) for domestic flights has always been a contentious issue with India's State Governments. On the other hand, the landing fees, charged per MTOW (Maximum Take Off weight) at Indian airports, are regulated by the Government. Airport landing charges and ground handling charges in India are quite reasonable in comparison to other countries.

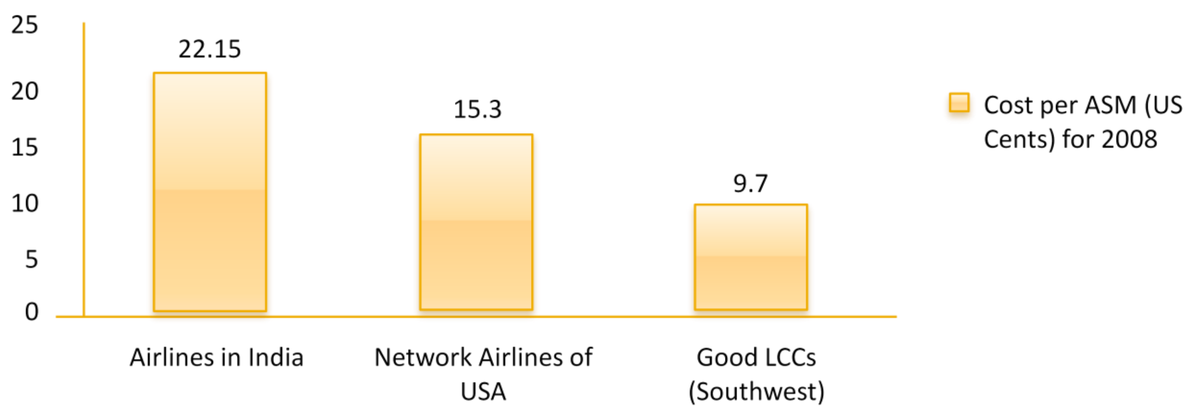


Source: Airline Business Aug 2009

Overcapacity in global economic slowdown and unviable costs

These are the real issues facing the Indian airline industry. Airline industry is cyclical like most other industries. In 2008, the global airline industry registered net losses of over $ 33 billion. After liberalization of the airline industry in India, airlines here are no longer immune to global cycles. Airlines in India can address overcapacity issues by grounding aircrafts, or by offering their aircrafts on dry /wet lease to foreign airlines for short terms. As per DGCA statistics, the average salary paid by the airlines in India to their pilots, ranges from Rs. 50 to Rs.60 lacs per annum. In today's challenging times, can airlines sustain such high salary costs? The cost per ASM (Cost per Available Seat Mile) for airlines in India works out to US Cents 22.15, while CASM for mega airlines of USA is 15.3, Southwest 9.7. The higher cost of ATF for domestic flights cannot be the only reason for such unviable costs. High salaries, low aircraft use, low utilization of aircraft (both low load factors less than 70%), as well as aircraft utilization per day less than 10 hours) are other significant factors.

Unviable costs plague India's Airlines: Source (DGCA, DOT/BTS)



Source: DGCA, BTS-USA

ASM: Available Seat Miles; BTS: Bureau of Transportation

What can the Government do?

Foreign airlines are prohibited from investing in India's scheduled airline sector. Relaxation in this investment norm can help the airline industry in India raise fresh capital from foreign airlines. During the last 5 years, India's airlines have built an enviable fleet, with an army of youthful, enthusiastic and trained human resources. Huge capital outlays as well as very large human capital both from public as well as private sector is locked in India's aviation sector. The airline industry has a strategic role too in an emerging economy like India. The industry now needs a helping hand from the Government. However, as per IATA, the global airline industry is expected to stage slow recovery from the economic slowdown and the recovery process is expected to start only by later half of 2010. The airlines that will survive the current economic downturn will be the ones that are paranoid about cutting operating costs and conserving cash in order to run profitable operations.

The views expressed in this article are the personal views of the author.

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