



INDIAN AVIATION INDUSTRY - AN OVERVIEW

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ABSTRACT

Aviation contributes transportation network across the world. It is a crucial tool for global business development and enrichment of tourism. Air transportation is necessary for the fastest movement from one place to another, and helps tourist to explore more and more destinations as it offers a broad choice of holiday destinations around the world with its affordable means. The use of commercial aviation has increased significantly since last few decades, and this rapid growth is dependent on some factors. First, rising disposable income and quality of life in many parts of the world have encouraged more people in these areas to travel overseas destinations. Second, deregulation of aviation laws, and bilateral and open-sky agreements between governments have broadened new markets for airline companies, which actually made travel easier and cheaper. Third, demand is increased because of growing confidence in aviation as a safe mode of transport. Fourth, increased efficiency and increasing competition have reduced the airfare worldwide and cost of travel to the visitors. Finally, globalization made world smaller and people started traveling to various countries for trade and commerce. Indian civil aviation industry was introduced in the year 1912 when the first air flight between Karachi and Delhi was started by the Indian State Air Services in association with the UK based Imperial Airways. JRD Tata founded the first Indian airline -Tata Airline in 1932. After independence, the industry has grown rapidly and today we are at the pick of the motion. Due to the increasing operating cost aviation industry is seeing the major difficulty. India's aviation sector lies with the crisis and races against its fastest growing global competitors. Increment in affordability and connectivity add to the expected improvement in the passenger traffic. Huge investment by public and private sector which are supported by government initiatives and policies in air travel infrastructure are expected to pour in. This paper will discuss about Present Scenario of the Indian Aviation Industry and its various phases.

KEYWORDS

Aviation industry, present trends of Indian aviation, operating system of airlines.

Introduction

Aviation industry is a vital segment of the fast growing Indian economy because of its catalytic role in stimulating growth across all other sectors of the economy. In tandem with fast growth of Indian economy and its continuing liberalization, the industry has witnessed rapid growth and expansion in the past decade. According to ICRA report (2011) the Indian Aviation Industry has been going through a turbulent phase over the past several years facing multiple headwinds – high oil prices and limited pricing power contributed by industry wide over capacity and periods of subdued demand growth. Over the near term the challenges facing the airline operators are related to high debt burden and liquidity constraints – most operators need significant equity infusion to effect a meaningful improvement in balance sheet. Improved financial profile would also allow these players to focus on steps to improve long term viability and brand building through differentiated customer service. Over the long term the operators need to focus on improving cost structure, through rationalization at all levels including mix of fleet and routes, aimed at cost efficiency. At the industry level, long term viability also requires return of pricing power through better alignment of capacity to the underlying demand growth.

While in the beginning of 2008-09, the sector was impacted by sharp rise in crude oil prices, it was the decline in passenger traffic growth which led to severe underperformance during H2, 2008-09 to H1 2009-10. The operating environment improved for a brief period in 2010-11 on back of recovery in passenger traffic, industry-wide capacity discipline and relatively stable fuel prices. However, elevated fuel prices over the last three quarters coupled with intense competition and unfavorable foreign exchange environment has again deteriorated the financial performance of airlines. During this period, while the passenger traffic growth has been steady (averaging 14% in 9m 2011-12), intense competition has impacted yields and forced airlines back into losses in an

inflated cost base scenario. To address the concerns surrounding the operating viability of Indian carriers, the Government on its part has recently initiated a series of measures including

- (a) Proposal to allow foreign carriers to make strategic investments (up to 49% stake) in Indian Carriers.
- (b) Proposal to allow airlines to directly import ATF
- (c) Lifting the freeze on international expansions of private airlines
- (d) Financial assistance to the national carrier. However, these steps alone may not be adequate to address the fundamental problems affecting the industry.

While the domestic airlines have not been able to attract foreign investors (up to 49% FDI is allowed, though foreign airlines are currently not allowed any stake), foreign airlines may be interested in taking strategic stakes due to their deeper business understanding, longer investment horizons and overall longer term commitment towards the global aviation industry. Healthy passenger traffic growth on account of favorable demographics, rising disposable incomes and low air travel penetration attracted long-term strategic investments in the sector. However, there are two key challenges: i) aviation economics is currently not favorable in India resulting in weak financial performance of airlines and ii) Internationally, too airlines are going through period of stress which could possibly dissuade their investment plans in newer markets. Besides, foreign carriers already enjoy significant market share of profitable international routes and have wide access to Indian market through code-sharing arrangements with domestic players.

The Indian Aviation Industry has been going through a turbulent phase over the past several years facing multiple headwinds – high oil prices and limited pricing power contributed by industry wide over capacity and periods of subdued demand growth. Over the near term the challenges facing the airline operators are related to

high debt burden and liquidity constraints - most operators need significant equity infusion to effect a meaningful improvement in balance sheet. Improved financial profile would also allow these players to focus on steps to improve long term viability and brand building through differentiated customer service. Over the long term the operators need to focus on improving cost structure, through rationalization at all levels including mix of fleet and routes, aimed at cost efficiency. At the industry level, long term viability also requires return of pricing power through better alignment of capacity to the underlying demand growth. India aviation industry promises huge growth potential due to large and growing middle class population, favorable demographics, rapid economic growth, higher disposable incomes, rising aspirations of the middle class, and overall low penetration levels (less than 3%). The industry has grown at a 16% CAGR in passenger traffic terms over the past decade. With advent of LCCs and resultant decline in yields, passenger traffic growth which averaged 13% in the first half has increased substantially to 19% CAGR during 2006-2011. Despite strong growth, air travel penetration in India remains among the lowest in the world. In fact, air travel penetration in India is less than half of that in China where people take 0.2 trips per person per year; indicating strong long term growth potential. A comparative statistic in United States, the world's largest domestic aviation market stands at 2 trips per person per year. Despite reforms, the domestic aviation sector continues to operate under high cost environment due to high taxes on Aviation Turbine Fuel (ATF), high airport charges, significant congestion at major airports, dearth of experienced commercial pilots, inflexible labor laws and overall higher cost of capital. While most of these factors are not under direct control of airline operators, the problems have compounded due to industry-wide capacity additions, much in excess of actual demand. Intense competitive pressure from Low cost carriers (focusing on maximizing load factors) and national carrier (looking to regain lost market share) have constrained yields from rising in-sync with the elevated cost base. Besides, aggressive fleet expansions (LCCs have added aircrafts mainly on long-term operating leases; FSC's have purchased aircrafts – debt financed, most often backed by guarantees from the US EXIM Bank or Europe's ECA) to leverage upon the anticipated robust growth and to support international operations have significantly impacted the capital structure and weakened the credit profile of most domestic airlines. (Source: ICRA Limited, 2012)

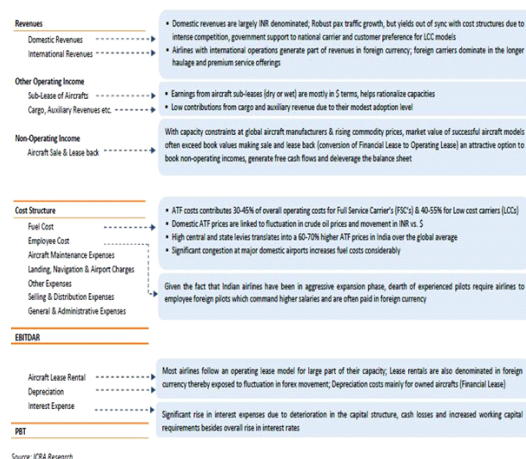
Present Scenario of the Indian Aviation Industry

While in the beginning of 2008-09, the sector was impacted by sharp rise in crude oil prices, it was the decline in passenger traffic growth which led to severe underperformance during H2, 2008-09 to H1 2009-10. The operating environment improved for a brief period in 2010-11 on back of recovery in passenger traffic, industry-wide capacity discipline and relatively stable fuel prices. However, elevated fuel prices over the last three quarters coupled with intense competition and unfavorable foreign exchange environment has again deteriorated the financial performance of airlines. During this period, while the passenger traffic growth has been steady (averaging 14% in 9m 2011-12), intense competition has impacted yields and forced airlines back into losses in an inflated cost base scenario. To address the concerns surrounding the operating viability of Indian carriers, the Government on its part has recently initiated a series of measures including (a) proposal to allow foreign carriers to make strategic investments (up to 49% stake) in Indian Carriers (b) proposal to allow airlines to directly import ATF (c) lifting the freeze on international expansions of private airlines and (d) financial assistance to the national carrier. However, these steps alone may not be adequate to address the fundamental problems affecting the industry. While the domestic airlines have not been able to attract foreign investors (up to 49% FDI is allowed, though foreign airlines are currently not allowed any stake), foreign airlines may be interested in taking strategic stakes due to their deeper business understanding, longer investment horizons and overall longer term commitment towards the global aviation industry. Healthy passenger traffic growth on account of favorable demographics, rising disposable incomes and low air travel penetration could attract long-term strategic investments in the sector. However, there are two key challenges: i)

aviation economics is currently not favorable in India resulting in weak financial performance of airlines and ii) Internationally, too airlines are going through period of stress which could possibly dissuade their investment plans in newer markets. Besides, foreign carriers already enjoy significant market share of profitable international routes and have wide access to Indian market through code-sharing arrangements with domestic players. Given these considerations, we believe, foreign airlines are likely to be more cautious in their investment decisions and strategies are likely to be long drawn rather than focused on short-term valuations. On the proposal to allow import of ATF, we feel that the duty differential between sales tax (averaging around 22-26% for domestic fuel uplifts) being currently paid by airlines on domestic routes and import duty (8.5%-10.0%) is an attractive proposition for airlines. However the challenges in importing, storing and transporting jet fuel will be a considerable roadblock for airlines due to OMCs monopoly on infrastructure at most Indian airports. From the working capital standpoint too, airlines will need to deploy significant amount of resources in sourcing fuel which may not be easy given the stretched balance sheets and tight liquidity profile of most airlines. (Source: ICRA Limited, 2012)

Operating system of the domestic airlines

Historically, the Indian aviation sector has been a laggard relative to its growth potential due to excessive regulations and taxations, government ownership of airlines and resulting high cost of air travel. However, this has changed rapidly over the last decade with the sector showing explosive growth supported by structural reforms, airport modernizations, entry of private airlines, adoption of low fare - no frills models and improvement in service standards. Like elsewhere in the world, air travel is being transformed into a mode of mass transportation and is gradually shedding its elitist image. The domestic airlines industry is facing significant operating (slowing growth, rising fuel costs) and non-operating (interest costs, rupee depreciation) challenges as evident in the quarterly performance trends of listed airline companies. Overall, the industry has been marred by cost inefficiencies and is bearing the brunt of aggressive price cuts, rising costs, expensive jet fuel, a weaker rupee, high interest payments and hence mounting losses. The government support required to bailout the loss making Air India has increased substantially; while the leading private players like Kingfisher Airlines, Jet Airways and SpiceJet are making significant losses. With Banks unwilling to enhance their exposure to the industry, recast their loans or pick up equity stakes without viable business plans, industry needs to come out with strong equity infusion plans. Hence, the government is mulling allowing foreign carriers to pick strategic stakes in domestic airlines to help them stay afloat in these difficult times, besides bringing global expertise and best industry practices over the medium term. (Source: ICRA Limited, 2012). In the present perspective, to understand the operating performance of the domestic airlines the following operating matrix of the domestic airlines is now given below:



Operating matrix of the domestic airlines

3.4 Challenges faced by the industry

The industry was facing major challenges such as

- a. Rising Operational costs
- b. Higher air fares

These are the major challenges arises because of the following factors:

- i. Challenges with policies
- ii. Procedures
- iii. Taxation

Many factors are responsible for the high operational costs in India.

- a. Higher cost of fuel in India
- b. High taxation
 - i. Excise duty
 - ii. Customs duty
 - iii. Sales tax
- c. High airport fare

These factors are leading to high operational costs. It is observed that in India 35 to 45 percent operational cost is of fuel. Whereas 20 percent is the global average. Major oil providing companies in India are Indian oil Corporation Ltd and Bharat Petroleum Ltd. These companies charge around 16 to 30 percent sales tax on fuel. This results into high price. Along with this there are different taxes imposed by the government.

Recently new airports are built in PPP mode. These airports are highly modern. This infrastructure change is also an area of high concern for aviation industries. Investment cost for these airports is very high. To recover this amount airport holding company charges very high this directly results into high costs. For example recently Airports Economic Regulatory Authority of India (AERA) approved to raise tax of Delhi and Mumbai airport to 346 percent and 154 percent respectively in 2012. Chennai and Kolkata also proposed to increase in airport tax to 118 percent and 242 percent respectively. This increased tax will eventually lead to higher price paid by the aviation companies for landing and parking their flights. This increases the cost of operation.

Along with this getting aviation license in India is main hurdle for small companies to enter into the market. The procedure of getting license is bit slow and hectic. This is major hurdle to growth of the industry. This will responsible in coming years also if not addressed properly.

In 2014 government has taken some initiative such as they have allowed direct import of the fuel, which will help to save sales tax to be paid to the oil companies in India. Spice Jet is the first successful company to import oil for its own in September 2013. Also government has promised to reduce the custom duty charges.

3.5. Analysis of main players

3.5.1 Main players in the industry

Indian aviation industry is dominated by the Low Cost Carriers (LCC). These players can be classified into three major categories.

1. Public Players

- i. Air India
- ii. Alliance Air- Air India Regional- LLC

2. Private Players

- i. Jet Airways
- ii. Kingfisher India
- iii. IndiGo
- iv. Spice Jet
- v. Go Air

Also in last few years the industry has saw entry of few new players. These new players are:

- i) JET Etihad deal has been finalized (FDI)
- ii) Tata-Singapore airlines Ltd-VISTARA

iii) Air Costa (Part of LEPL Group)

iv) Tata-Air Asia Ltd

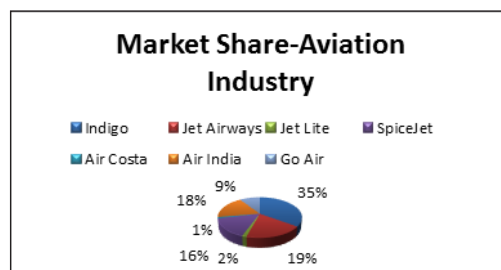
v) Air Pegasus Ltd

These are the five new players in the industry. They have different strategies to tackle the market.

3.5.2 Market share analysis of the players

Players in Indian Aviation Industry are fighting to gain maximum market share. Domestic market is dominated by LLCs. IndiGo is the only domestic company which has shown all time profits in its balance sheet. At the time of crisis Indigo sustained itself while gaining profits. It is India's most preferred LLC.

According to analysis presented by Business Standards Indigo retained at top position followed by Jet Airways. This analysis was at the end of November, 2014.



Source: http://www.business-standard.com/article/companies/indigo-jet-airways-gain-while-spicejet-loses-market-share-114121801142_1.html

3.6 Competitive landscape of the Indian Aviation Industry

As per the report of crisilresearch.com the Indian aviation industry has passed through different phases since 2002 and they are:

2002-03: Moderately competitive landscape: In 2002-03, competition in the domestic airlines industry was low with 2 players dominating the industry: Jet Airways and Indian airlines group (which comprised of Air India, Alliance Air and Indian Airlines) together had 88 per cent market share. Sahara airlines also operated at this time and had a smaller share of the overall domestic market. The players did not undercut each other on ticket prices to grab market share and concentrated on profitability.

2006-07: Competition intensifies: Low-fare carriers (LFCs) forayed into the industry, beginning with the launch of Air Deccan in 2003-04. Subsequently, three more - Spice Jet, Go Air and Indigo - began operations between 2005-06 and 2006-07. Two full-service carriers (FSCs) - Kingfisher and Paramount - also entered the market in 2005-06. Thus, the number of carriers in the domestic airlines industry trebled from 3 in 2002-03 to 9 in 2006-07. LFCs offered tickets at much lower prices as compared to FSCs and hence, managed to capture 42 per cent of the domestic market share in 2006-07.

2007-08: Extremely competitive landscape: With competition rising rapidly, the new entrants and incumbent players rapidly expanded their fleet, in a bid to capture market share. The share of LFCs rose to 47 per cent in 2007-08 from 42 per cent in 2006-07. However, this expansion heavily eroded players profitability. Costs incurred by airlines on ATF, manpower, etc, rose sharply, but companies were unable to hike fares due to intense competition. This led to pressure on realizations, and profit margins of most airlines slid into the red. The industry's combined losses amounted to Rs 49 billion in 2007-08. The capital structure of most airlines deteriorated, while some carriers faced a liquidity crunch and had to raise further debt to meet capital expenditure requirements.

The consolidation phase: Steadily increasing losses eroded the network of airline companies, forcing financially weak companies to sell out or merge with stronger companies. This led to

consolidation in the industry, wherein JetLite (erstwhile Air Sahara) was acquired by Jet Airways, while Kingfisher bought Air Deccan. The government decided to merge Indian Airlines with Air India to form a new entity, National Aviation Company of India Limited (NACIL). The move was taken due to the steadily mounting losses of Air India and Indian Airlines. As a result of such consolidation, the market share of the top three players, (NACIL, Jet Airways group and Kingfisher airlines) rose to around 70 per cent at the end of 2008-09.

2009-10: Growing market share of LFCs: LFCs such as Go Air, Indigo and SpiceJet continued to gain market share by expanding their fleet. As a result, the share of the top three players (Jet Airways, Kingfisher and NACIL) dropped to around 60 per cent in 2009-10. To sustain and expand their market share, Jet Airways and Kingfisher introduced low-fare operations under the Jet Konnect and Kingfisher Red brands, respectively. Jet Airways converted two-thirds of its seating capacity to Jet Konnect by the end of the second half of 2009-10. Consequently, more airlines shifted to the LFC model from the FSC model.

2010-11: PLFs touch record highs: Entry of LFCs, higher household income, strong economic growth, surging tourist inflow, increased air cargo movement, sustained business growth and supportive government policies were major drivers for the growth in the domestic aviation industry in 2010-11. During the year, PLFs reached record highs due to limited fleet addition and strong demand from business and leisure travellers. Few efficient airlines with better operating cost structure and financials turned profitable. The market share of the top three players (Jet Airways+ Jetlite , Kingfisher and Indigo) in the industry was about 61 per cent in 2010-11. PLFs increased to 77 per cent in 2010-11 from 72 per cent in 2009-10.

2012-13: Pricing Discipline post kingfisher exit: The period saw a marked decrease in passenger traffic due to ongoing economic slowdown and high air fares. Kingfisher exited domestic operations beginning in the 3rd quarter on account of its financial woes, leading to about 13 per cent of total domestic capacity going out of market. The remaining 6 players namely Indigo, Air India, Jet Airways, Jetlite, Spicejet and Go air registered marginally better PLFs of 77 per cent and higher realizations post kingfisher's exit. Indigo, Jet Group(Jet airways+ Jet Lite) and Spicejet together captured close to 73 per cent of the domestic market.

2013-Till now: Deals and Discounts: The year saw discounting on ticket prices during the peak seasons too. Overall, the both international and domestic realizations declined during the year. Also, Abu Dhabi based Etihad Airways bought 24 per cent minority stake in Jet Airways for Rs 20.6 billion during the year . As a part of the deal, Jet also sold three of its flying slots at London's Heathrow Airport for a sum of USD 70 million to Etihad. The entry of AirAsia India, a three-way venture between the Malaysia-based low-cost airline, the Tata Group and investment firm Telestra Tradeplace, in June 2014 is expected to further increase pricing competition among existing LFCs. Another joint venture between Tata Group and Singapore Airlines awaits operating permit which will further intensify the competition in the industry

Conclusion: India's civil aviation sector has evolved over time. The aviation industry in India is one of those sectors that saw a constant pace of growth among the other industries in the world over the past many years. Enormous growth in domestic passenger traffic, substantial strengthening through government initiatives, decrease in global crude oil prices and airlines showing profits indicate a significantly positive transformation for the Indian civil aviation market. The close partnership between the government and the sector in ongoing and future projects will further improve regional connectivity.

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