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A Study of Business Models in Airlines Industry in India

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KEYWORDS

Introduction
India's civil aviation industry is on a high-growth trajectory. India aims to become the third-largest aviation market by 2020 and the largest by 2030.

The Civil Aviation industry has ushered in a new era of expansion, driven by factors such as low-cost carriers (LCCs), modern airports, Foreign Direct Investment (FDI) in domestic airlines, advanced information technology (IT) interventions and growing emphasis on regional connectivity. India is the ninth-largest civil aviation market in the world, with a market size of around US$ 16 billion. India is expected to become the third largest aviation market by 2020.

"The world is focused on Indian aviation – from manufacturers, tourism boards, airlines and global businesses to individual travelers, shippers and businessmen. If we can find common purpose among all stakeholders in Indian aviation, a bright future is at hand" said Mr. Tony Tyler, Director General and CEO, International Air Transport Association (IATA).

Market Size
In May 2016, domestic air passenger traffic rose 21.63 per cent to 8.67 million from 7.13 million during the same month of last year. Passenger traffic during FY 2015-16 increased at a rate of 21.3 per cent to 85.57 million from 70.54 million in the FY 2014-15. In March 2016, total aircraft movements at all Indian airports stood at 160,830, which was 14.9 per cent higher than March 2015. International and domestic aircraft movements increased 10.5 per cent and 16.0 per cent, respectively, in March 2016.

Indian domestic air traffic is expected to cross 100 million passengers by FY2017, compared to 81 million passengers in 2015, as per Centre for Asia Pacific Aviation (CAPA).

India is among the five fastest-growing aviation markets globally with 275 million new passengers. The airlines operating in India are projected to record a collective operating profit of Rs 8,100 crore (US$ 1.29 billion) in fiscal year 2016, according to Crisil Ltd. The structure of India's airline market, Nearly two thirds of the seats flying on domestic routes are on LCCs (Low Cost Carriers), one of the highest proportions in the world.

In this highly competitive system the six scheduled airlines have largely converged in terms of pricing and product. But given their significantly different cost structures, this situation is unsustainable for some, while presenting opportunities for others. Over time the competing airlines will inevitably attempt to carve out more clearly differentiated market propositions, ranging from ultra-low cost to hybrid and premium full service. While India's low cost carriers (LCCs) have a domestic market share of 63%, passengers flying on full service airlines (Air India and Jet Airways) pay close to LCC fares in economy class. As a result India is virtually a 100% low fares market. As, in reality, the operating environment makes it very difficult to be genuinely low cost this poses a significant challenge to industry viability.

Difference between LCCs and FSCs

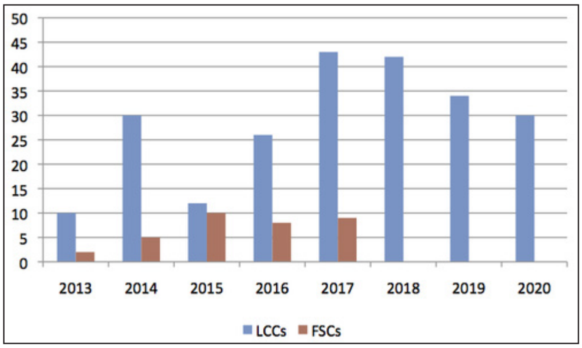
Feature	LCCs	FSCs
Brand	One brand : low pricing	Extended brand : price and service
Price	Simple pricing structure	Complex pricing structure
Distribution	Internet, direct booking	Internet, direct and travel organization
Airport	Mostly secondary	Primary
Network	Point-to-point	Hub-and-spoke
Classes	One class	Multiple class
During Flight	Unbundling-pay for 'extras'	Bundling-free 'extras'
Aircraft usage	Very intensive	Average-intensive
Aircraft type	One type	Multiple types
Turnaround times	25 min	Slow :congestion/work
Product	One product	Multiple integrated product
Secondary revenue	Advertisement, onboard selling	Focused on primary product
Seating	Tight, no reservations	Flexible, reservations
Operational activities	Outsourcing (focused on flying)	Extending (maintenance, cargo)
Target group	Mostly tourists	Tourists and business

In the Indian market LCCs and FSCs both operate from the same airports with new aircraft, offering high frequencies on key markets. LCC reliability, on-time performance, consistency, ground product and cabin crew service standards, particularly on IndiGo, are comparable with or even better than FSCs. Baggage allowance on discount fares is the same on all carriers. As a result, from the Indian passenger's perspective there is little to distinguish between an LCC and an FSC in economy class, other than the fact that the latter offers a complimentary onboard meal, but this too is being rationalized. And as a larger proportion of seats are being sold in lower fare buckets even the accumulation of frequent flyer points has diminished on FSCs. Air India and Jet Airways continue to offer a premium cabin but the business case for such an offering is limited to certain key routes, such as the Delhi-Mumbai-Bangalore corridors and that too primarily during peak hours. In light of the weak economic conditions, which are likely to continue for the next 12-18 month, a negative impact on business class traffic is inevitable in the short term. Currently business class load factors average around 50%.As the economy strengthens in due course there will be absolute growth in demand for full service operations but this is likely to represent a declining share of the total market, especially as LCCs offer a high quality product.

The Shift from LCCs to FSCs
Today FSCs are capturing some of their traffic because they are pricing below cost, but this is not sustainable. As and

when FSCs increase their fares to reflect their cost base and charge a premium above LCCs, which at some point will become necessary, we can expect to see passengers increasingly shifting to low cost. LCCs will also continue to grow their share in part because most of the fleet expansion is occurring in this segment. In the second half of FY14 LCCs are expected to induct an additional 20 aircraft on domestic routes, whereas little or no additional fleet deployment is likely by Air India on domestic sectors.

Scheduled Deliveries of Narrow body Aircraft (domestic and international) to Indian LCCs and FSCs to 2020



(Source: CAPA Fleets**)**

The aviation sector is often believed to be in very close correlation with a region's economic growth and prosperity. In parallel with rapid globalization and India's recent growth story, the Commercial Aviation sector in India has witnessed a paradigm shift over the past two decades. It has changed from an over regulated, monopolized and ill-managed sector to a liberal and investor friendly playground. In 1953, nine existing companies were transferred to two government run entities: Indian Airlines (serving domestic routes) and Air India (serving international routes. From such a nationalized beginning the sector gradually opened up and 1992 was marked with the government deregulating India's aviation sector. This marked the beginning of a new era in Commercial Indian Aviation where private airlines flourished and air travel came of age. Through a broad view point, the Indian LCCs have emulated their international counterparts who achieved success much earlier but there have been considerable efforts to include the Indian pulse.

Low Cost Carriers in India

The LCC model is not just about low fares but also about more efficient operations and a constant drive to reduce operational costs. Very plainly, LCCs represent a leaner and fitter organization. The entire structure rests on the important principle of volume gain, no-frill plain travel services and an aim to commoditize air travel for the common man. Their operations are characterized by low margins and load factors are crucial for profitability.

Growth Drivers

Passenger Growth: Airline passenger growth is generally related to the GDP of a country. It is seen that air transport grows at twice the rate of GDP growth. The international passengers have grown by around 16% and the domestic passengers have grown by over 22% over the years. Air travel has increased a lot over the years because of multiple reasons. Some the important ones being:

- Increase in inbound and outbound tourists and medical tourism
- Over 300 million strong middle class which can be tapped as a potential passenger and can be drawn away from railways.
- Disposable incomes are expected to grow at an average rate of 8.5% per annum till 2015, which shows willingness on the part of passengers to shift to air travel.

Economic factors

The economy of India in the recent past has played an important role in giving a boost to many sectors in the country out of which aviation is a prominent one. The economy of India is growing steadily at about 9% per annum which has led to overall prosperity, growth and investments. More and more players want to be part of the aviation sector and offer better deals and better deals and service to the passenger.

Strategies adopted by different LCCs in India

Differentiation

The LCCs in India are mainly characterized by low fares but are positioned very differently in the market. They offer different value propositions to the customer and this is a major factor in the success of one airline over another.

Conquering the rail market

The demand potential for LCC air travel is huge. As of today, Indian railways carry about 17 million passengers every day which is more than what Indian Airlines carry in a year. Even a small percentage of it if attracted to LCCs will generate enormous revenues for the carriers. It is also observed that 20% of the railways' revenue is generated by upper class travellers and that is exactly where LCCs wish to target their marketing campaigns.

Consolidation

Being an extremely competitive industry, the aviation sector has seen a fair amount of consolidation. In the near past we have seen lot of activity happening in this sector when it comes to consolidation. The Jet-Sahara deal and the Kingfisher-Air Deccan deal for example define the dynamics of the industry. These consolidation activities have been a direct result of the introduction of the concept of LCCs.

Impact of Low Cost Carriers on Indian Aviation

From an era of natural monopoly dominated by the state-run Air India and Indian airlines to a hypercompetitive industry that is integral to India's vision for growth; the aviation industry has evolved and so have the business practices and industry dynamics. In addition to the liberalization by the Indian government in 1990 which allowed private players to enter the aviation sector, the introduction and establishment of Low Cost Carriers - as discussed in previous sections - has been a significant game changer.

Impact on fleet sizes and seat capacity

The increase in passenger statistics due to evolution of LCCs has had a direct impact on capacity expansion in the aviation sector. Fleet sizes, routes and available seat capacity have grown tremendously. The increase in traffic on air routes has opened up opportunities that allow scalability in operations and thus airlines have been increasing fleet sizes. At present India accounts for more than 11% of global aircraft demand which is huge considering the low penetration of air transportation in India.

Impact on Air Fares

As a fundamental of the LCC business model the average air fares in India have dropped considerably. Low fares are aimed at higher penetration levels and at commoditizing air travel. LCCs consistently offer 10-40% lower fares than FSCs. Low fares have been the most important factor in the success of LCCs in India. However, the LCCs face constant pressure on fares due to variability issues in demand and ATF prices.

Impact on Full Service Carriers (FSCs)

Rise of LCCs has had strong impact on FSCs in Indian airspace. The popularity of the initial LCCs such as Air Deccan forced the FSCs to rethink their business moves and induced stiff competition between the airlines. Fares have been the main point of competition. Although the FSCs viz. Jet Airways and Kingfisher airlines are still preferred over LCCs for the quality of service, the economical flying segment demonstrates much greater growth rates for the years to come. The LCC phenomenon led to Jet Airways launching its own all economy class airline JetKonnect which is aimed at competing with the LCCs.

The LCCs have also proven to be robust and easier to sustain than FSCs during business downturns that have been more frequent than ever before. Even during the financial crisis, among volatile ATF costs and a bleeding aviation sector, LCCs fared decently well and performed much better than heavy debt laden FSCs who continue to make losses.

The emergence and growth of LCCs poses significant competitive challenges to the network airlines. Significant progress has already been made in improving cost efficiency, with progress given more urgency by the rise in fuel costs, though large cost gaps still exist with the major LCCs. Further progress in reducing unit costs is essential but a complete move to an LCC model is not. There are still many competitive advantages in an efficiently delivered.

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