Goodbye, Blue Skies

The flailing aviation industry needs to get its act together and that doesn't only imply a blind dependence on FDI from foreign airlines

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Civil aviation has been hugely responsible for India's globalisation. Ironically, India's own civil aviation sector is far from globalised. On the one hand, the number of passengers who can afford flights in India has swelled dramatically over the last decade; newer airports have opened up across the length and breadth of the country. On the other hand, a pall of gloom hangs over almost all of India's airlines, barring just one low-cost, no-frills, private carrier. India's aviation minister recently estimated that the airline industry is likely to post mammoth losses to the tune of Rs. 100 billion in the financial year 2012.

Just when the collective conspiracy of the economic slowdown, increased interest rates and rising jet fuel prices looked all set to make 2012 the *annus horriblis* for the civil aviation industry, the Government has given it a breather by allowing airline companies to raise external commercial borrowings (**ECBs**) to meet their working capital needs. In this article, we will take a look at the troubles plaguing the civil aviation industry in India, the implications of liberalising the ECB regulations for airlines and relaxation of foreign direct investment (**FDI**) norms in the aviation sector.

Flight to Nowhere

During the WWII, an Air Commander of the Allied Forces likened air power to a game of poker in that a second-best hand wins nothing and costs a lot of dough (moolah). In India, this analogy behoves the civil aviation sector.

Let us consider the case of Air India, the government-owned domestic carrier, for which bailouts have become something of an opiate. Since April 2009, Air India has received cash injections worth Rs. 32 billion from the government. With its accumulated losses amounting to a staggering Rs. 203 billion, the Government's recent approval of another restructuring package of Rs. 300 billion for the airline has raised eyebrows. No sooner than the announcement of the restructuring package, the Government also permitted Air India to induct twenty seven Boeing 787 Dreamliners and three Boeing 777s through the sale-and-lease-back model—a decision the Comptroller and Auditor General (**CAG**) has described as "a recipe for disaster".

Kingfisher Airlines with accumulated losses of Rs 64 billion is not too far behind the woebegone government carrier. Its worsening financial situation and the resulting flight cancellations, employee strikes and unpaid tax dues have become a permanent fixture in

the national dailies. In what can be described as a horrendous turn of fate, Kingfisher Airlines has gone from being the country's largest stand-alone carrier with a 20 per cent market share in April 2011 to becoming the smallest airline a year later. Its motto, "Fly with Good Times" has become every columnist's pet punching bag.

The other players in the market namely, Jet Airways, SpiceJet and Go Air, too are saddled with debt. The Aviation Ministry has recognised that India's "civil aviation sector is passing through a phase of crisis" due largely to the high costs of aviation turbine fuel (**ATF**) and the distorted rate of taxes on all services and commodities associated with the sector viz., fuel, aircraft leases, airport charges, air tickets, air navigation service charges, maintenance costs, fuel throughput fees and into-plane fuel charges. This being the state of affairs, many an airline CEO in India would vouch for Richard Branson's famous recipe to become a millionaire: "Start as a billionaire and then buy an airline!"

'In FDI We Trust'

FDI is often naively thought of as the panacea for all ills plaguing India's economy. Presently, FDI of up to 49 per cent is allowed in domestic carriers, but foreign airlines cannot participate directly or indirectly in the equity of airline companies, effectively stifling foreign investment into the sector.

Last year, the civil aviation ministry had mooted a proposal to allow foreign airlines to buy up to 24 per cent stake in Indian airline companies. This threshold drew widespread criticism from various quarters since a stake below 25 per cent would not allow the foreign investor to block special resolutions, effectively reducing it to a sleeping partner—a highly uninviting proposition for any strategic investor intent on protecting its interests.

Subsequently, the Government moved a proposal for permitting foreign airlines to pick up a 26 per cent stake in an Indian airline. This too hit an air-pocket as an investment of 25 per cent or more in a listed company—and three out of the six airlines in India are listed—triggers an open offer from the acquirer to buy another 26 per cent in the target company according to the Takeover Code, an anomaly pointed out by the Department of Industrial Policy & Promotion (**DIPP**). When prodded, the Securities and Exchange Board of India (**SEBI**) pooh-poohed any talk of diluting the Takeover Code for any one sector, thus snuffing out the proposal without even a whimper.

The latest in the string of proposals is a cabinet note that suggests a 26 per cent plus 23 per cent equity formula,

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where the foreign airline will begin with an open offer of 26 per cent and then go on to acquire the remaining 23 per cent. However, given the mercurial disposition of the Government's allies, the proposal is unlikely to see the light of day any time soon.

While the debate rages over the pros and cons of FDI from foreign airlines, no one seems to be asking the inconvenient question: are foreign airlines genuinely keen on investing in loss-making Indian carriers?

ECB: It Pays to Borrow

On the back of the Finance Minister's promise to allow the aviation sector to raise up to USD 1 billion through the ECB window, the Reserve Bank of India (**RBI**) has conditionally permitted licensed Indian operators to obtain ECBs for their working capital. As per the apex bank's circular of April 24, 2012, a borrowing limit of USD 300 million would apply to an individual company within the overall sectoral ceiling of USD 1 billion. Further, such borrowings are required to be raised within a period of 12 calendar months from the date of issue of the RBI circular and must have a minimum average maturity period of 3 years.

Since ECBs have been placed under the approval route, for an airline to be able to avail of ECBs, the regulator must be persuaded that its cash flows, foreign exchange earnings and debt servicing capabilities are in shipshape.

Tough Passage to India

The airline industry, placed by an overprotective government under a bell-jar of regulation for decades, is burdened with the challenges of debt servicing, rupee devaluation, labour issues and increased operating costs, primarily stemming from spiralling ATF rates. However, all is not lost for the sector. In fact, soothsayers globally have prophesied that India's airline sector is set to witness exponential growth in the near future. While regulators should play their part to alleviate the crisis currently plaguing the sector, it is up to the players in the sector to adopt astute business models with an emphasis on cost-cutting and efficiency. Captain G R Gopinath, who pioneered the low-cost airline model by founding Air Deccan, once dreamt that every Indian must fly at least once in their lifetime. Lurking beneath this dream is a vast, untapped domestic market comprising India's emerging middle class, something the critics have grown tired of pointing out to the traditional full-service carriers.

In the current scenario, even if the Government were to permit FDI from foreign airlines, the response to it is unlikely to be spectacular. In the past, Air Asia had evinced interest in flying to Europe and America via India to fill planes from here. But lack of business prompted it to discontinue via-India flights. Lufthansa, at one time keen on India, partnered ModiLuft in the early 1990s, but withdrew with burnt fingers. Airlines in the Gulf and neighbouring Asian countries looking to establish a presence in India may be drawn to investing in domestic carriers as India's civil aviation market has a compounded annual growth rate of 18 per cent, which is higher than that of Europe as well as the US.

The other factor which an international airline might consider is the fact that there is considerable traffic between India and West Asia, and India and Europe and North America, some of which could be tapped by entering into a strategic tie-up with a local carrier which enjoys the confidence of the market. However, if airlines that are in the doldrums—instead of setting their house in order—wish away their troubles lobbying for FDI, they may soon end up with a sore ego, besides a bruised balance sheet.

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