The role of government funding in the national carrier’s financial crunch.
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**HISTORY OF CIVIL AVIATION**

The history of Indian civil aviation began with its first domestic air route between Karachi and Delhi in December 1912. It was opened by the Indian Air Services in collaboration with the UK based Imperial Airways as an extension of London-Karachi flight of the Imperial Airways. Without any backing from the Indian Government, Tata Sons Ltd., the first Indian airline, started a regular airmail service between Karachi and Madras three years later. During the time of independence, nine air transport companies were carrying both air cargo and passengers in the Indian Territory.

To further strengthen the aviation sector of India, the Indian Government and Air India (earlier Tata Airline) set up a joint sector company, Air India International in early 1948. And the nationalization of Indian Airlines (IA) in 1953 brought the domestic civil aviation sector under the purview of Indian Government. Later the Government-owned airlines dominated Indian aviation industry till the mid-1990s.

**CIVIL AVIATION: BEFORE AND AFTER LIBERALIZATION**

- **Before Liberalization**

The two state-owned domestic and international carriers, Indian Airlines (IA) and Air India (AI) dominated the market until recently. From their position of strength, they pressurized the state machinery to obstruct foreign airlines from expanding flights to India and also to restrain the growth of private sector players. As a retaliatory measure, foreign players hindered the growth of Indian airlines by not accommodating any deals with them. In the early 1990s, steps were thus taken to liberalize the aviation sector.

- **After Liberalization**

From the consumers’ perspective, the choice of airlines has increased, fares have reduced significantly, and increased routes now operate. From the airlines’ perspective, commercial freedom is the biggest advantage along with increased foreign investment. All these factors have directly and indirectly contributed to the economy in form of increased tax revenues, increased employment opportunities and increased inflow of direct investment, increased tourism etc.
Air India operates a fleet of Airbus and Boeing aircraft serving Asia, Australia, Europe and North America. Its corporate office is located at the Air India Building at Nariman Point in South Mumbai. It is the 16th largest airline in Asia. Air India has two major domestic hubs at Indira Gandhi International Airport and Chhatrapati Shivaji International Airport. An international hub at Dubai International Airport is currently being planned.

In August 1953, the Indian air transport industry was nationalized to provide safe, smooth and economic air travel to the people. It involved eight warring airlines with different work cultures, horrendous safety records, disastrous financial conditions because of cut-throat competition and inefficient managements. Thus come into existence Indian Airlines Corp and Air India Ltd, in order to operate domestic and international long haul services. The nationalization was also expected to spur growth, promote economic activity, rush assistance in times of natural calamities like flood, famine and earthquake, foster national integration and, above all, serve as the second line of defense in the event of war with another country.

The nationalized airlines fulfilled most of the expectations of the nation, particularly at times of natural calamities and during the wars with China and Pakistan. They also helped bring remote places of the country into the mainstream by connecting them with air services.
**FINANCIAL CRUNCH**

For the national carrier, the journey downward began in 2006-07. Air India made a loss of Rs 541 crore and Indian Airline's loss was Rs 230 crore. Between 2007 and 2009, during which the airlines merged, the losses rocketed to an inconceivable Rs 7,200 crore. What separates Air India from other loss-incurring carriers, both private and state-owned, are the reasons that led to the losses. Undoubtedly, it was hit by expanding fuel bills and falling demand. But the crisis at Air India is self-made to a large extent.

The 800% increase in its losses in two years had much to do with the merger of Air India and Indian Airlines; aircrafts were leased or purchased; capacity was gifted away to foreign airlines under bilateral agreements; flights were withdrawn from profitable routes and pilots weren't sent for proper training.

- In 2009, reeling under mounting loans, and dwindling revenues from a falling market share, Air India was asked to prepare a restructuring plan in order to qualify for Government financial intervention.
- In 2011, the Rajya Sabha was informed that the national carrier had incurred a cumulative loss of over Rs 13,300 crore since its merger with Indian Airlines in 2007. Then-Civil Aviation Minister Vayalar Ravi said before the merger in 2006-07, the losses reported by erstwhile Air India and Indian Airlines were Rs 447.93 crore and Rs 240.29 crore, respectively. But the merged entity incurred a loss of Rs 2,226.16 crore during 2007-08. The cumulative losses at the close of financial year 2009-10 were Rs 13,326.86 crore.
- In 2012, the Parliament’s Public Accounts Committee, along with representatives of various unions and associations of Air India diverged on the huge losses incurred by the national carrier and invited suggestions from them to deal with the issue. Chaired by PAC chief Murli Manohar Joshi, Air India unions at the meeting said the merger of the erstwhile Air India and Indian Airlines was a major reason for the financial mess. They suggested that a holding company be formed under which Air India and Indian Airlines can be made separate entities.
**LEASING POLICIES**

The losses began from 2006 onwards when a decision to aggressively dry and wet lease aircraft was taken to increase market share. There was no proper route study, marketing or pricing strategy. The airline took heavy losses till the market built up.

In 2006, Air India dry-leased four Boeing 777s for a period of five years, followed by a delivery of its own aircraft from July 2007 onwards. As a result, between 2007 and 2009, it kept five Boeing 777s and five Boeing 737s on ground at a loss of Rs 840 crores. Thankfully for Air India, Boeing could not meet the delivery schedules for its new B 787 Dreamliners. Had these aircrafts had arrived on time, all of them would have been on the ground.

— Three dry-leased B-747s on the Los Angeles route and one B-767 on the Bangkok and Kuala Lumpur route flew from 2006 till 2008 with less than 40% load, leading to a combined loss of about Rs 200 crore in 2006-07 and again in 2007-08. It takes time to develop a route. Just when the LA route had developed and had started getting full loads, it was shut down (in 2008) because the lease for the B-747s expired. To stop flying a route, especially after developing it with the given infrastructure Air India did, was quite a peculiar loss-incurring move on the airline’s part.

According to information provided by then-civil minister Praful Patel, Air India sold four aircrafts during March 2009, and 13 aircrafts in 2008. The aircrafts sold during 2007 and 2008 were on ‘sale and lease back’ basis. A total of 21 aircrafts were sold between 2007 and 2009 for $451.88 million.

Air India executive director planning and international relations Tridib Kumar Palit was reported to have stated that Air India, since May 2010 had opted against completing any of the lease deals because "we were not getting offers which were actually offsetting the financing cost of the aircraft".

He said the original decision to lease out the aircraft was also controversial because the Government-owned carrier would need to axe some of its long-haul routes once the six
jumbos exited the carrier’s fleet. He claimed the Indian Government was not willing to shrink Air India’s network, especially under a scenario in which the carrier would have to incur a loss in order to lease out aircrafts.

In November 2011, Rediff.com reported that Air India would lease out two Boeing 747-400s and five of its Boeing 777s as ways to tide over the grave financial crisis. The airline's board decided to go in for sale and leaseback of Boeing 787 Dreamliners, due for delivery December 2011. A month later in January 2012, Air India offered to lease five of its eight Boeing 777-200 planes for 8-10 years, and had floated a global tender to dry-lease these B 777-200 (Long Range) aircrafts.

- **IMMETHODICAL MERGER**

The immediate cause of the trouble according to aviation analysts has been ‘the senseless merger’ of the two wings of the airline — the erstwhile Indian Airlines and Air India. According to the Justice Dharmadhikari committee formed four months ago to help resolve staff integration issues in Air India, “one of the biggest challenges is that Air India and Indian Airlines are working as separate entities since their merger in 2007. The merger, in fact, is only on paper.”

— The hurried amalgamation of the two wings of the national airline defied the recommendations of several committees. Earlier, since the managements opposed outright merger, these committees suggested the creation of a holding company to oversee the functioning of the two airlines. The Indian Airlines Corp had its initial niggles, but the merger plan was so meticulously worked out that all issues of integration got sorted out in a couple of years and the new-born airline took to wings smoothly. This success was attributed to the Government’s firm hand and clear stand.

However, by 2009, Air India had sunk into a huge financial crisis. The company formed by the merger of Air India and Indian, NACIL (National Aviation Company of India Limited), had posted losses of 22 billion in 2008 and 55 billion in 2009, along with a debt burden of 160 billion. Staff salaries for June 2009 had been delayed, and the airline’s chairman and managing director (CMD), Arvind Jadhav, requested in August 2009 that senior officials forgo their salaries while the airline sought Government aid.
Gradually, however, in airports like Chennai, Kochi, Thiruvananthapuram passengers booked incredibly cheap fares to destinations like Sharjah, Muscat and Singapore as Air India Express and Indian Airlines flights competed with each other, even after they merged.

— The outright merger of 2007 was engaged in without working out any solution for the possible problems to be encountered, which is seen to have worsened the financial dents in the national carrier. The employee-agitation faced by the Air India is also suggested to have stemmed from this mismanagement of future costs and role-sharing.

Pre and Post-Merger Profit and Loss of the Airlines

In July 2009, Patel had been cornered in the Rajya Sabha by a battery of non-Congress parliamentarians, who used the time allotted to launch a series of allegations against the ministry: that the merger had been misguided, mismanaged and not approved by Parliament; that the 2005 aircraft purchase order had been conducted hastily and without due diligence; that the airlines—which had both posted profits in 2003, 2004 and 2005—had begun making enormous losses even
before the onset of the global recession; and, most damning, that “middlemen” and corruption had influenced the making of aviation policy.

The deal atypically fast-paced by the norms of Government inertia—a fact that attracted criticism from several bodies investigating the deal in the wake of Air India’s financial collapse. After moving to revisit the initial purchase proposal in August 2004, it took only four months for the Air India board and the ministry to agree to the revised fleet plan stipulating a purchase of 50 rather than 10 aircrafts for Air India.

Within a day—30 December 2005, when the deal was signed—all of the following steps were completed: the prime minister saw the note on the final acquisition proposal from the Empowered Group of Ministers, headed by Finance Minister P Chidambaram, and granted his approval; the PMO forwarded the note, with his approval, to the aviation ministry; the ministry conveyed the Government’s approval to Air India; and Air India signed the purchase agreements with Boeing.
RESTORATION EFFORTS

The attempt to resurrect Air India began in 2009, when the merger of 2007 was concluded as not helping recover the airline’s losses. Alternatives to better the situation, such as privatization, lease-outs, fleet-downsizing and Government bailouts were offered. Other suggestions, such as corporate revamps of the organizational policies and employee-cuts were also made. Of these offered solutions, Government bailouts have been critiqued under the media’s scanner for most of the last three years, and not without good reason.

Air India in 2009 was asked by the Government to undertake a restructuring exercise before getting any financial assistance. The cash-strapped national carrier was asked to restructure its board and get leaner and trimmer. A panel of secretaries headed by Cabinet secretary K M Chandrasekhar was to review the cost-cutting exercise and the performance of the airline every month. SBI Caps was appointed to prepare short, medium and long term growth plans for the carrier, and predicted after researching the company’s financials that it would take at least two years to breakeven, given certain economic and industry performance-related factors. Air India, which was then losing an estimated Rs 250 crore a month chalked out a turnaround plan aimed at generating Rs 3,000 crore through internal accruals by the end of 2009. The short-term target was to achieve a breakeven in the next six months.

— The route rationalization, leasing out of aircrafts, entry management, fuel saving contracts, renegotiating catering contracts helped the airline to reduce costs upto Rs 400 crore by the end of 2009. The biggest cost reduction they planned for 2010 was Rs 300 crore in human resources. Thus, the restructuring plan applied in 2009 worked in Air India’s favour.

The Union cabinet in 2010 approved the first bailout for the ailing national carrier in the form of an Rs 800-crore equity infusion the same fiscal year. However, the Government with this bailout had clearly spelt that any further financial help would depend upon Air India meeting various targets essentially those pertaining to cost-cutting.

— The whopping bailout - Rs 7,000 crore as a soft loan and Rs 5,000 crore as equity infusion- was demanded to cover Air India's fleet expansion at a time when most
commercial airlines were leasing out aircrafts that have been grounded due to shrinking load factors. Air India had used its’ working capital to purchase aircrafts so far. The Government’s bailout meant an extension of the carrier’s working capital by Rs 1,000 crore taking it to Rs 16,000 crore till the next bailout came through. Given the airline’s intentions to buy over 100 aircrafts – at an estimated cost of Rs 50,000 crore over the next several years, despite all its’ working capital already exhausted- would lead to yet another fund infusion over and above the one then-recently given. Thus, the decision to extend this mammoth sovereign guarantee at a time when Air India was facing proactive competition from domestic airlines, and was simultaneously burdened by its’ enormous employee-maintenance costs, came across as a high-risk/low-return move on the Government’s part.

After Air India lost about Rs 5,200 crore in the 2009-10 mainly due to weak demand, low yield and under-utilization of resources, the struggling flag carrier claimed release of the second installment of the earlier approved Rs 5,000-crore bailout package from the Government mid-2010 – this time, an Rs 1,200-crore infusion.

In 2011, a consortium of banks was, according to minister for heavy industries and public enterprises Praful Patel, willing to participate in financial restructuring plan of the national carrier Air India after ICICI Bank’s move to refinance long term debt.

- Lenders of cash-strapped Air India in February, 2012 approved its’ corporate debt restructuring plan worth Rs 18,000 crore and decided to provide a fresh cash credit of Rs 2,200 crore. Of the Rs 18,000 crore plan, Rs 7,400 crore worth of non-convertible debentures, guaranteed by the Government, are reportedly to be issued. The 13-bank consortium, led by State Bank of India, has also agreed to give Rs 2,200 crore worth of fresh working capital loan to the ailing national carrier. A call on infusing an additional equity worth Rs. 6, 600 crore is also likely to be taken soon.

Later in 2011, a panel of secretaries in the Government voted in favour of providing support of Rs 30,000 crore to Air India. The plan forbade the carrier to induct any new aircraft, except
Boeing 787 and if required, the aircraft could be acquired on lease. Also, the fresh induction would be possible only when the profitability of the route was established.

— Then-Civil Aviation Minister Vayalar Ravi’s categorical statement that Air India would not be privatized is to be considered in respect of this infusion. The sale of the Air India’s stake in 2001 was seen as a litmus test of the Government’s ability and willingness to privatize. Political opposition to privatization, bureaucracy and the global slowdown - which made companies less willing to part with their cash - were all thought to have conspired against the privatization process. Thus, the capital pumping into the ailing airline by the Government in 2011 was once again questioned, as the denial of privatization clashed with its’ constant support to the sick-PSU, which made the Government seem as though it were helping out the airline with the masked intentions of selling its’ stake later to private parties.
SUGGESTED CORRECTIVE MEASURES

Finance infusions aside, Air India requires a rapid increase in qualitative methods to bring out the airline of its crisis. First required is a change in the management by inducting a team of professionals, such as marketing and HR personnel, two of the company’s largest weak points. Induction of individuals at various levels where professionals are needed must be allowed. Presently, the company depends on home-grown talent since induction from outside affects the seniority of some and is therefore resisted. Importantly, the product and service standards of Air India need identification and ought to be benchmarked against the best in the industry. This leads to the creation of a brand loyalty that Air India desperately seeks to retain market share.

Significantly, emergent and effective measures for ensuring the success of the merger between Air India and Indian Airlines need to be taken, so that the combined gains can be achieved. It would also motivate employees to give their best. With many experienced employees, Air India has great potential to threaten and ward off competitors.

The Government must provide an environment where Air India and other Indian carriers can grow. Any imbalances in operation between two countries must result in payouts by the foreign carriers to Air India, which can be adjusted as financial aid. Unproductive use of assets must end. The prolonged ground time of B777s at US airports must be brought down to no more than a couple of hours. Keeping the aircraft on ground for prolonged hours is a criminal waste of costly resource. Operational aspects such as fleet size, route network, and induction of B787s should be given a fresh look by experts keeping Air India’s interests and capacity to bear in mind. Utilization of capital-intensive equipment must be enhanced to optimal levels for an effective financial turnaround.

Lastly, responsibility and accountability need to be pegged higher than they currently are in the Air India organizational setup. Given the state of affairs of Air India as it is today, ridden with bankruptcy and nepotism, a corporate way of business as mentioned above, coupled with more accountable managers could augment Air India’s state of affairs.
THE CASE FOR DOMESTIC AIRLINES IN THE COUNTRY

The sector is bleeding losses on such a scale is because the Government levies the world’s highest aviation fuel taxes on a fledgling, low-cost air travel revolution that promised to bring the safest and quickest form of passenger travel to millions of first-time fliers. Aviation turbine fuel (ATF) taxes of between 35% and 60% charged by the central and various state governments have resulted in crippling operating costs, the private industry complains, where the fuel bill comprises 30% to 40% of overall expenditure. Neither Finance Minister Pranab Mukherjee, Civil Aviation Minister Ajit Singh, Petroleum Minister Jaipal Reddy nor Prime Minister Manmohan Singh have attempted to answer this query. The lack of an aviation policy in the country compounds this taxation concern.

*Market share of various Indian airlines in the aviation market, 2010.*
CONCLUSION

The Government has finally acknowledged that all is not well with Air India. This knowledge assumes significance because in spite of pejorative evidence of Air India’s decline on all key performance parameters in the recent past, nothing noteworthy – besides infusion of finance - has been done to arrest the decline. The facts listed above lead to this conclusion.

The once iconic national carrier is today on its’ way to shutdown. Serious corrective measures need to be undertaken along with doling out measured financial aid in installments. What Air India needs today is multiplicity of Government actions on all fronts, after firming up its determination that Air India has to survive as an airline. With privatization ruled out and the realization that Air India isn’t doing well means that drastic changes are called for to let Air India survive.
Glossary

- **ACMI** is the acronym for **Aircraft, Crew, Maintenance & Insurance**, where the lessor provides the aircraft, one or more complete crews (including engineers) including their salaries and usually allowances, all maintenance for the aircraft and insurance, which usually includes hull and third party liability. The lessor will charge for the block hour (choc off to choc on) and depending on the aircraft type, sets a minimum guaranteed block hours' limit per month. If the airplane flies or not, the lessee must pay the amount for the minimum guaranteed block hours. The lessee has to provide all fuel, landing/handling/parking/storage fees, crew hotel accommodation, including meals and transportation as well as visa fees, import duties where applicable as well as local taxes. Furthermore the lessee has to provide passenger/luggage and cargo insurance and in some cases need to cover the costs for war risk.

- **Accruals** are accounts on a balance sheet that represent liabilities and non-cash-based assets used in accrual-based accounting. These accounts include, among many others, accounts payable, accounts receivable, goodwill, future tax liability and future interest expense. By using accruals, a company can measure what it owes looking forward and what cash revenue it expects to receive. It also allows a company to show assets that do not have a cash value, such as goodwill.

- **AOC** refers to an **Air Operator’s Certificate**. It is the approval granted from a national aviation authority (NAA) to an aircraft operator to allow it to use aircraft for commercial purposes. This requires the operator to have personnel, assets and system in place to ensure the safety of its employees and the general public. The certificate will list the aircraft types and registrations to be used, for what purpose and in what area - specific airports or geographic region.

- **Dry Lease** is the lease of the basic aircraft without insurances, crew, maintenance etc. Usually dry lease is utilized by leasing companies and banks. A dry lease requires the lessee to put the aircraft on his own AOC and provide aircraft registration. A typical dry lease starts from two years onwards and bears certain conditions as far as depreciation,
maintenance, insurances etc. are concerned. This depends on the geographical location, political circumstances etc.

- **Lessee** is a person to whom a lease is granted
- **Lessor** is the group or person who grants a lease of property
- **Fleet** is a large group of ships, airplanes, trucks, etc., operated by a single company or under the same ownership
- **Route** or an **aviation airway** is a designated route in the air. Airways are laid out between navigational aids. It is a controlled air space which forms a corridor secured for use of air transportation.
- **SBI Caps** or **SBI Capital Markets Limited** is wholly owned subsidiary of the State Bank of India. SBI Caps is an investment bank and project advisor, assisting domestic companies’ fund-mobilization efforts in India.
- **Wet Lease** is basically an extension of the ACMI. The period of a wet lease can go from one month to usually one to two years. Everything less than one month can be considered as ad-hoc charter.
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