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Indian Aviation Industry - A Growing Industry with High Losses

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Abstract-The Indian aviation industry has often been seen as one which has the potential to be one of the largest in the world in the coming years. However, it has been an irony that in spite of growing at a rapid rate in the last decade it remains a loss-making industry. In this paper we try to find the reasons for this anomaly and mounting losses in a growing industry.

Keywords: Aviation Policy, Concerns, Indian Aviation, Regulatory Framework, Risks

1. Introduction

The Indian aviation industry has seen rapid changes since the turn of the millennium when the process of liberalising this sector began in full earnest. Today, it is the 7th largest in the world and according to International Air Transport Association, it is poised to become the 3rd largest by the year 2024. The entry of low-cost airlines has been a game changer and has made airfares much more affordable. Anever-widening middle income group and increasing income of individuals is bound to give a push to this industry as more people will be able to afford flying. Moreover, there has been a recent push to promote tourism in the country as well as connecting the farthest corners of the country through air connectivity. All this is bound to push this sector into a phase of accelerated growth.

It is a known fact that aviation industry across the globe is a far from stable industry with high risk and low return for operators. However, the situation is even worse in India where the condition of the air carriers is far from good. In spite of the ever-growing size of the industry and huge growth opportunities, there remains a significant problem that continues to hound this industry. The balance sheets of the air carriers have consistently been in the red which is a key concern. This issue is so grave that the industry has seen multiple shutdowns and near shutdowns in the last decade. A deeper study of the industry reveals a few core issues which have been consistently ignored by the policy makers as well as the carriers and these factors are a key area of concern. Recent policy changes with the introduction of the National Civil Aviation Policy (NCAP 2016) has been a long awaited one and it has been able to address the policy issues to a large extent. Yet, there still remain lacunae in the manner in which the participants operate in this sector.

In this paper we will try to cover a few fundamental problems from which the Indian aviation industry is suffering

- Leasing and Maintenance Cost of Airlines
- High Jet fuel Prices
- Low fares
- High Capital Expansion
- Lack of proper Hedging
- Lack of Policy Support

2. Leasing and Maintenance Cost of Airlines

The leasing and maintenance cost of airlines is a major expense of the air carriers and is also one of the core concerns of this sector. According to the CAPA fleet database, 81% of the total aircrafts in India is on lease.[1]This number is even more important to consider since this is much higher than the global average. According to the same report only 52% aircrafts in Asia and 53% aircrafts worldwide are on lease. This further brings the importance of leasing to the fore in the context of Indian aviation industry.

The absence of Indian leasing companies is a key concern for this sector. Most of the lease is denominated in USD and the lessors have very less presence in India. This brings in the huge problem of currency risk in payment of lease charges. The air carriers have the option of either going for hedging or facing the risk themselves. This brings additional volatility in the income statements of these operators. Moreover, due to the lack of a competitive MRO industry in India, majority of the carriers have to send their aircrafts abroad for maintenance. This again brings in additional costs and higher downtime of aircrafts.

The absence of both lessors in the country and uncompetitive Maintenance, Repair and Overhaul industry in India is only resulting in higher costs and risk to the operators.

3. High Jet Fuel Prices

The prices of Aviation Turbine Fuel (ATF) are a key cost component for airlines across the globe. However, this has become a constant thorn in the balance sheet of Indian air carriers due to the high prices of aviation fuel in the country. The prices of jet fuel have been constantly higher in India compared to its global counterparts. Even by IATA sources, fuel constitutes about 25% of total costs of operation worldwide whereas it constitutes about 35-40 % in India [2].

The taxes on ATF in India are higher than that in most other parts of the world.Excise duty on the import of ATF in India stood at11% at the end of October 2018[3]. Although this does not significantly affect the carriers as the net imports of ATF is quite low, it does force the hands of the carriers as they will find it costly to use imported ATF. Added to it is the lack of competition in the domestic sector and dominance of state-ownedOil Marketing Companies (OMC'S), the prices of fuel continue to remain higher.

Moreover, the fuel prices further compound the miseries of the air carriers due to price volatility in the prices of international crude. The increase in global crude oil prices further runs havoc on these operators who already have to bear the costs of leasing and maintenance which are often denominated in US Dollars.

4. Low fares

The air carriers in India have been consistently been ranked among the cheapest airlines to fly across the globe in both domestic as well as international category.[4] The seats of airlines have become more of a perishable commodity with unsold seats being given away at throw away prices. While this might seem like the right thing to do as more passengers mean more revenues, this is not helping the air carriers. In a fight for more market share, flight tickets are highly under-priced. Though this has helped to maximize capacity utilisation the revenue per average seat mile (RASK) has not been rising at the same rate.

The lower fares are even more worrying because the cost of Indian operators is higher than their foreign counterparts due to higher fuel costs. Yet, they continue to offer seats at lower fares than what their competitors in other countries. There has been a concern for a long time that increasing the fares beyond a limit might make it unaffordable for the middle class. Hence, low fares have become the norm, however it has led to a business model that is unsustainable in the long run and resulting in increasing losses for the air carriers.

5. High Capital Expenditure

The Indian aviation industry is operating at a near capacity with addition aircrafts needed to match the growing demand for air travel. However, expansion of fleet is not as easy for Indian air carriers. Faced with bleeding balance sheets, going for further expansion comes with its own risks and costs. However, the need to connect to new and inaccessible airports brings the need for additional capacity. Further, the UDAN scheme has brought with it the need for smaller aircrafts which most carriers don't have in sufficient numbers at present.

Orders for more than 1000 aircrafts have already been placed and these require huge financing in the years to come.[5] The Indian air carriers will be facing capital needs up to the tune of $50 billion in the next 10 years to support order deliveries that have already been placed. Moreover, there is already a high proportion of leased aircrafts in India and the additional risk that it brings with it.

Low fares and High Capital Expenditure needs have become twin problems for this sector which are related to each other. The Indian carriers have for a significant time been focusing on expansion and higher market share. Even with the airline operators suffering losses, the strategy has remained the same. The operators have not really focused on increasing their revenue per miles but rather just on volume of passengers. This has led to an unsustainable model where losses are mounting and yet the operators are going for further expansion. This has already led to multiple operators going out of business including the recent case of Jet Airways where they have defaulted in various payment including lease charges.

6. Hedging Problems

A critical problem facing the air carriers is that they have not been able to build a successful strategy to reduce the uncertainty that they face due to the general macroeconomic factors. They have been facing the biggest threat from the variable fuel prices which has been a key component of their mounting losses. However, there has not been much effort to mitigate these threats. A number of airline operators across the globe have been able to successfully minimize the risk of variations in fuel prices through hedging strategies. The hedging programme of Southwest Airlines has been a very successful one which has been able to reduce their fuel costs significantly and is seen as a global standard.[6] More recently, a number of operators even in Asia including Malaysian Airlines and Singapore Airlines have gone for hedging programme in a big way.

This becomes even more crucial considering that the Indian air carriers are highly exposed to currency risks due to their leasing costs which are dollar denominated. As such, hedging is the way forward for these carriers as it could provide a medium to minimize risk that looms large on them.

7. Lack of Policy Support

Most of the lease agreements in India are on dry lease. This ensures that the maintenance charges also have to be borne by the carriers. This has brought additional problems for the carriers as well as the Maintenance, Repair and Overhaul industry. A high rate of GST on this sector ensures that most of the operators are forced to send their aircrafts abroad due to lower cost. Prior to the GST regime, exemption from customs duty on import of spares and abolition of value-added tax by Maharashtra, which houses 80% of the Maintenance, Repair and Overhaul units in India, had given a shot in the arm to this sector. But with change in taxation policy these benefits are no longer available. There has been a consistent request from this sector to reduce the GST rates to make them more competitive. The carriers have been forced to go abroad for the maintenance of the aircrafts but receive no credit in taxes for those paid outside the country.

Moreover, ATF prices have not been included in GST as yet. This further creates differences in the prices of fuel across different cities. There is also an expectation that inclusion of ATF in the GST list will result in rationalisation of taxes that will result in lower cost for the carriers. There has to be a sustained effort on the part of the government to reduce costs and tax burden on the operators which will help them to turn profitable in the long run.

8. Policy Changes and Current Scenario

The government has also come up with the National Civil Aviation Policy in 2017 which takes into consideration some of the problems of this sector and lays out the framework of future growth. One of the core areas of focus of this policy has been the UDAN scheme which attempts to connect the various regional and interior areas and bring them on the aviation map of the country. This is a good step considering that at present the large bulk of passenger capacity is assigned to a few major airports. This policy has also done away with the 5/20 rule and come up with the 0/20 rule which makes it easier for domestic carriers to expand to international routes.[7]

In spite of the efforts to provide regional connectivity the scheme is yet to take off as desired. However, there has been increased interest from a number of major players as well as a few regional carriers to fly on these routes. As per the Ministry of Civil Aviation, functional routes stood at 186 out of the 706 sanctioned routes.[8] This is a good start and attempts have to be made to make other routes operational as well as profitable.

The carriers in the industry have largely been focused on expansion of their capacity rather than focusing on revenue growth. This is important to consider since the total capacity of carriers has consistently exceeded the demand. The basic goal of these operators should be to reduce their Cost Per Available Seat-Kilometre (CASK) and maximize their Revenue per Available Seat-Kilometre (RASK) which will lead to more profitability.

Table 1: Difference between Revenue and Cost (per available seat kilometer) [9]

Carrier	2018	2017	Change %
Indigo	0.49	0.4	22.5
SpiceJet	0.29	0.26	11.53846154
Jet Airways	-0.18	-0.07	-157.1428571

Looking at the table shows the difference between RASK AND CASK of the 3 major players in the Indian market. The red signs for Jet Airways were clear even a year before the actual crash. The national carrier Air India is in similar losses and faces an uncertain future. However, there are a few small players like Vistara, Air Asia who are looking at selected routes and focusing on sustainable growth. The introduction of UDAN has also brought a number of regional carriers into operation. However, it too faces an uncertain future with a number of them like Air Costa and Air Pegasus ceasing operations just 2 years since the launch of the scheme.[10] The Indian carriers also hold a very small share of international passengers carried with the figure standing close to 40% in the year 2017-18.[11] This is a poor showing on the part of the Indian players with a large bulk of international passengers being captured by foreign operators.

9. Conclusion

The Indian aviation industry remains one with huge growth opportunities. However, the industry is plagued by various problems that are acting as roadblocks and preventing the industry from realising its true potential. With the increased focus on tourism as well as new schemes like UDAN which aims to connect every part of the country, this sector could be at the cusp of a turnaround. The government policies could play a key role in this by creating a better environment for the sector so that they are able to not just cater to the domestic demand but also expand their wings to international markets.

The important points to consider for the development of these industries could be:

- Airlines focusing on better revenue streams and sustained profitability rather than just capacity expansion.
- Government creating conducive business environment with taxes and regulations in line with major centres across the globe.
- Focus on expansion on international routes with greater passenger share of foreign travellers.
- Growth of Maintenance, Repair and Overhaul industry should be priority as it presents immense opportunities for growth and also aids the air carriers.
- The air carriers should look at hedging in a big way especially considering their high exposure to currency risks
- The aim of UDAN should not be just to connect new areas but also to makes these routes profitable.

It is also important to consider that in this sector there are large number of players burning cash and not being able to realise sufficient revenues. This industry calls for lesser number of players with consolidated markets who can run a sustainable business in the longer run. Carriers like Vistara are very good examples of running business in a sustainable manner with planned growth. On the other hand, Indigo presents the perfect study of managing books in a loss-making industry with huge cash reserves which could significantly help in further expansion. The overall effort on the part of the government as well as the individual players has to be to move towards a more profitable business model rather than just focusing on expansion with bleeding books. It is important to understand that the aviation industry like any other sector of the industry has allied industries like Maintenance, Repair and Overhaul (MRO) which are closely related to it. So, the overall effort should be to make the growth of these industries in line with the aviation sector.

The Indian aviation sector continues to be one with immense possibilities and as such is bound to be a success story in the long run. The aim at this moment should be to streamline activities through better regulatory framework and efficient management goals on the part of the government and the carriers respectively.

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