

# AIRLINE EMERGENCY IN INDIA



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## PERSPECTIVE

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### Key points:

- Tipping point in India reached this month with 18.5% increase in jet fuel prices;
  - Aviation Secretary estimates airline losses to double in 2008/09 to USD1.9 billion;
  - Prime Minister and Finance Minister now urged to develop emergency package to support airline industry;
  - Government massively exposed through 100% ownership of loss-making Air India, whose domestic market share is collapsing;
  - Fuel surcharges raised, but not all carriers;
  - Domestic growth rate slows to single digits – lowest in four years;
  - India's domestic growth story "now at crossroads" – Civil Aviation Minister.
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The US airline industry has garnered most of the attention in the global airline fuel crisis. But the pain is also being felt keenly in India. Unlike some US carriers, which are slashing capacity by 10% and more, Indian airlines are continuing to rapidly add capacity and expand their networks.

Jet Airways Chairman, Naresh Goyal, stated this week that surging fuel prices have not affected the airline's aggressive route or fleet expansion plans, while Kingfisher Airlines is preparing for a massive international expansion programme from Aug-08.

However a tipping point in India could have been reached this month with an 18.5% increase in jet fuel prices by government-owned Indian Oil Corp. Aviation Secretary, Ashok Chawla, estimates losses at Indian airlines may double in 2008/09 to around USD1.9 billion, due to surging jet fuel costs. This is around 80% of the worldwide airline losses IATA is predicting.

Paramount Airways Managing Director, M Thiagarajan, stated, "there are things that we are doing to reduce fuel consumption, but nothing can really offset the whopping 18.5% hike in ATF prices this week".

### **Emergency package sought**

Civil Aviation Minister, Praful Patel, has requested Prime Minister, Manmohan Singh, step in to help shield the aviation sector from “sickness” caused by soaring fuel prices. The crisis threatens to inflict significant damage to the entire aviation value chain and to undo much of the good work done by the Ministry of Civil Aviation over the last five years.

At a meeting of civil aviation authorities, airlines and airport operators on 06-Jun-08, unnamed airline officials stated capacity could be slashed by up to 20% by cutting less profitable routes, to help offset the fuel crisis. Information gathered will be presented to Mr Singh and the Finance Minister, as part of Ministry efforts to seek a range of emergency measures to support the sector.

### **Short-term measures**

In the meantime, other government initiatives to ease the pain for the sector are already flowing through, such as a halving of the import duty on ATF to 5%. But Jet Airways Executive Director, Saroj Dutta, stated the impact would be “minimal”, as the real problem lies with high State oil taxes.

The government has also permitted airlines to continue with their ground-handling operations until Dec-08, while it will start a new Performance Navigation System at Mumbai and Delhi Airport, from 01-Aug-08, to ease congestion and bring down air traffic delays. It has also set 01-Aug-08 as the deadline for appointment of an Ombudsman to address passenger complaints and has also established a ten-member group of airlines and airports operators to discuss ways to reduce airport charges. Recent requests for 10% increases in charges at Delhi and Mumbai airports were also denied.

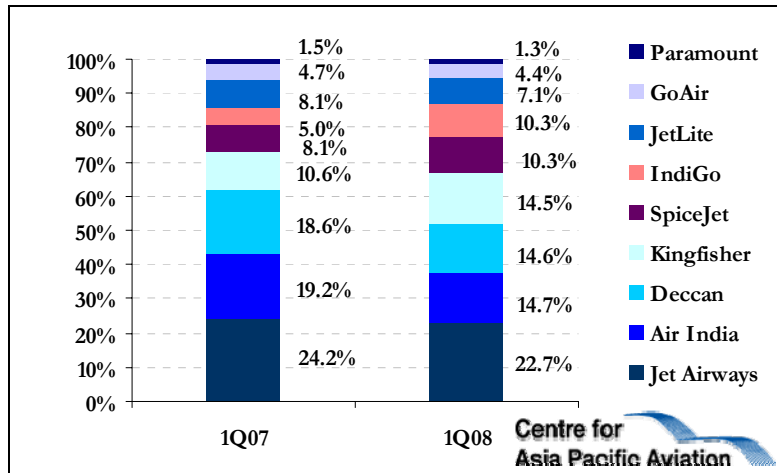
### **Air India’s problems mount**

The government has its own massive exposure to the sector through its 100% ownership of Air India, whose integration with Indian Airlines has been problematic. Losses at the carrier could account for around half of the industry’s total this year.

Air India has already requested a USD240 million government capital infusion to help it through the current turmoil. This could by no means be the last request for funds, as Air India embarks on a significant fleet upgrade and expansion programme, to help raise its competitiveness and restore its flagging international and domestic market shares.

In the domestic arena alone, Air India has lost almost 5 ppts of market share in the past 12 months.

**Indian domestic market shares (%): 1Q07 vs 1Q08**



Source: Centre for Asia Pacific Aviation & DGCA

**Fuel surcharges rise again, but a split occurs**

Despite its dwindling market share, Air India led a fuel surcharge increase this month that was quickly matched by Jet Airways and Kingfisher and their subsidiaries, JetLite and Deccan. Fuel surcharges now stand at around USD53 for sectors below 750 kms, or USD69 for longer sectors.

The latest surcharge increases, of USD7-13 per sector, are well short of the levels needed to offset soaring fuel costs. Jet Airways estimates that ticket prices in India would have to increase on average by around USD40 per sector for airlines to break even in the current environment.

The cost of travel in India has soared in the past 12 months as airlines have raised their surcharges and levied congestion surcharges. It is not surprising that traffic growth rates have fallen to their lowest levels in four years in Apr-08, to 8.7% (see the Traffic Watch section below for more information). The increase in fares is most apparent on routes connecting metro cities to non-metros. According to CAPA research, the average Delhi-Jammu fare has increased from around INR1,700 in Sep-06 to INR4,000 today. This compares with a second class train fare of INR1,200. The significantly increased price differential has slowed the switch from surface to air.

The loss of price sensitive customers is of major concern to India's LCC sector, which is facing a revitalised rail alternative, in terms of pricing.

And for the first time this month, SpiceJet and Indigo have failed to match the other airlines' surcharge increases, with SpiceJet choosing to raise base fares and rapidly growing Indigo standing on the sidelines.

### **Indian aviation "at a cross-roads"**

Minister Patel stated India's domestic growth story "is now at crossroads". The recent growth of the airline sector, and economic benefits that have flowed as a result, have been a key achievement of the current government.

But the implications of the crisis are much broader than a reduction in air travel demand. The fuel crisis in India carries significant political ramifications across the entire Indian economy.

In the aviation sector, fuel is a particularly poisoned chalice for the government. It faces a dilemma as both industry regulator and operator, a situation that will extend indefinitely with the partial privatisation of the struggling Air India on hold.

Mr Chawla stated, "airlines have assured us that they'll do everything possible to cut costs and ensure that the cost to passenger is kept to minimum", and reiterated that airlines were free to take such "commercial decisions" on routes, except on government-mandated services to Northeast and Island states.

### **Consolidate? Ownership maybe, but capacity?**

Whether airlines do act to cut capacity by the 20% indicated is doubtful, particularly as all the evidence to date suggests that carriers are concerned primarily with building and defending their market shares for the long-term, at the expense of short-term profitability - even as ownership of airlines consolidates. The recent split on fuel surcharges policy indicates that there is no unity among the airlines in tackling the problems of the sector.

It could be argued that it is the lack of a concerted and united effort by the airlines to push for fiscal and structural reform that has resulted in the current situation.

At the IATA AGM in early Jun-08, the airline body urged Indian carriers to restructure or consolidate to restore profitability to the sector. Chief Economist, Brian Pearce,

stated, “there are a large number of new entrants and there exists a huge amount of capacity in India”. He added, rising fuel costs will accelerate the restructuring of this capacity, while the new entrants and even large leading carriers will find it difficult to maintain their bottom lines because high costs and high capacity have to be matched - so, it is either consolidate or exit the market”.

That is the logical conclusion. But India is different.

Jet Airways Chairman Naresh Goyal stated, “we all have been doing crazy and irrational pricing, selling tickets below costs”. Jet CEO, Wolfgang Prock-Schaeur, added, “airlines are speaking to each other to end the policy of low-priced tickets as that is making everyone bleed. However, raising fares means a problem in filling up planes”.

GoAir and SpiceJet separately confirmed they are in talks with potential investors to raise up to USD100 million each to safeguard their operations and fund further expansion. But price negotiations with the promoters of new Indian carriers are delicate and the processes have been drawn out. No promoters are wishing to exit cheaply.

#### **Conclusion: Intractable situation – watch the red ink flow**

Minister Patel stated at the start of Jun-08 that it is a “matter of time before this dynamic sector becomes unhealthy”. India’s aviation industry has arguably crossed that threshold long ago. It will be interesting to see what the Prime Minister and his Finance Minister come up with for India’s irrational airlines.

Tax relief is a possibility, but capacity cuts by airlines are realistically the best way forward to dry the red ink. But who will move first?