CAPA welcomes foreign airline investment in Indian carriers – positive for long term capital and expertise

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CAPA welcomes foreign airline investment in Indian carriers - will bring much needed long term financial and strategic capital and expertise

The long-awaited decision by the Indian Cabinet today to approve foreign airline investment in Indian carriers finally brings to an end a regulatory anomaly that has existed for more than 15 years. India already permits 49% foreign direct investment in the airline sector, but since 1996 the regulations - unique in the world – have specifically excluded the one class of investor that has the greatest strategic interest and can add value to the sector, namely foreign airlines.

In the 1990s when deregulation allowed the entry of private carriers on domestic routes, initially as air taxis and subsequently as scheduled airlines, India permitted up to 40% foreign direct investment, including by foreign airlines. Jet Airways at the time in fact maximised this provision, with both Gulf Air and Kuwait Airways each holding a 20% stake in the fledgling airline. This strategic investment undoubtedly provided Jet Airways with a number of benefits including access to expertise and international feed.

However, in 1996 the Government of India announced that foreign airline shareholdings were not in the interests of India's aviation sector and would no longer be permitted. Ostensibly this was because private carriers were still relatively small and the concern was that foreign airlines would control their development in such a way as to feed their offshore hubs, relegating the Indian carrier to the status of a regional carrier. But in reality it was a move designed to thwart the ambitions of the Tata Group and Singapore Airlines to jointly launch a domestic carrier in India.

Jet Airways had to buy-back the shares from its Gulf investors. The government position was that as and when Indian carriers were of a sufficient size to be able to negotiate as equals with foreign airline investors then the restriction would be removed. But with the changing global environment in the 2000s, the spectre of security concerns, and the potential impact on Air India, were raised whenever the issue came up for discussion. And for many of the incumbents it suited their cause to limit the potential for a professional, well-funded competitor to arise in the market.

So what has changed? Firstly, the crisis in Indian aviation, which has resulted in almost every carrier, except IndiGo, facing some level of financial stress, created an environment in which all measures to support the recovery of the sector had to be considered, even those which had been off the table for so long.

And secondly, the new Minister of Civil Aviation appointed at the start of the year has understood the challenges faced by the industry and is prepared to push for solutions that are beneficial to the sector as a whole. Mr Singh deserves credit for persisting with this issue which was mired in considerable political complexity. He must now turn his attention to addressing the significant structural challenges in the sector. It is encouraging to see that he has taken up the challenge of having aviation turbine fuel categorised as a declared good which would reduce the sales tax from an average of 24% to 4% and have a substantial positive impact on airline financials. There will be strong resistance to this from state governments, but if successful Mr Singh will have taken great strides towards addressing arguably the most significant challenge in the Indian aviation sector.

What can we expect as a result of this reform? CAPA believes that allowing foreign airline investment is an important step in establishing a more professional and corporatised sector. The move will result not only in strategic capital and expertise coming into the market, but as a result of its presence, other institutional funding may also feel more confident about investing alongside.

However, it should also be noted that the results are unlikely to be immediate. Carriers from the Gulf, as well as the likes of IAG, Lufthansa and Singapore Airlines have all been watching the sector with interest, and informal discussions have taken place in several cases. But the balance sheets of most of the incumbent carriers are relatively weak, and the sector faces numerous structural challenges, so foreign airlines will make their own assessments about whether they consider a carrier to be a suitable investment at this time. Just because they are now allowed to invest does not necessarily mean that they will. Pending a change in the regulations the official position of most prospective suitors has been that they are not interested, however we expect this to change now. And of course not all Indian carriers are actually seeking a strategic partner.

GoAir and SpiceJet are perhaps the carriers with the greatest prospects of attracting foreign airline investment but this will take time as due diligence will need to be conducted and the parties will need to reach agreement on issues such as management structure, corporate governance mechanisms, the role of the current promoters and the level of capital that is required for growth.

Kingfisher has an outside chance, but a very difficult one as any deal will be complex, requiring significant capital to be committed by the current promoters, and the concurrence of the banks to take a haircut on outstanding loans to the carrier. In addition it will take time to develop and agree upon a realistic business plan. CAPA estimates that the successful turnaround of Kingfisher will require an immediate capital infusion of USD600 million (of which half would need to come from the current promoters before meaningful discussions with a foreign airline partner could progress), supplemented by a further USD300-400 million over the next 18 months.

The real benefits are likely to be seen in the longer term. If the government is serious about granting new licences to well-funded, professional start-ups, we could in due course see the launch of greenfield joint ventures by carriers such as AirAsia, Jetstar and Tiger Airways. And a serious restructuring and turnaround of Air India will surely require the support of a strategic partner. Today’s developments open the door to that possibility. The floodgates of investment are unlikely to open in the short term but from the perspective of improving sentiment and demonstrating that the government is committed to supporting the development of a viable airline industry this is a positive milestone.

One of the primary features that investors seek is regulatory and policy certainty, in the past the goalposts have changed too often and too arbitrarily. If a predictable framework can be established and combined with improvements to the structural dynamics of the sector then Indian aviation has a very positive long term outlook. We are a long way from that, but today’s announcement is an important step in the right direction which all stakeholders should welcome.
