ISSUES&TRENDS

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Pacific Asia Travel Association

The Skies Open Up Over India

The liberalisation of aviation in India is exciting for tourism, but there are challenges facing the Government

The new Indian carriers believe the Indian market is big enough for everyone

The low-cost carrier (LCC) euphoria in Southeast Asia, which began with the launch of Air Asia in December 2001, is already going through a period of consolidation. Not so in India, where the LCC boom (some would call it 'bubble') is in full swing.

Like all businesses, the new Indian carriers believe the Indian market is big enough for everyone, that their business models will work, and that when the shakeout comes, their airlines will be among the survivors.

At the moment, there is a considerable thrill in seeing the shackles of fettered and over-regulated markets make way for those that are free and open. Airline seats are being treated just like any other commodity, saleable at prices governed by market forces, not government intervention.

MARKET SIZE

If a product launch is based on the number of prospective buyers it can attract, there is no shortage of buyers in India.

The world's largest democracy, India has a population of 1.1 billion, with a middle class (income over IDR90,000 per annum) estimated at 300 million in 2005 and projected to hit 400 million in 2010. That would be equal to the enlarged European Union and larger than the USA.

Over 30 million students in India complete school every year, most of them proficient in English. From an aviation perspective, India also has an ideal geographic location midway between Europe and the rest of Asia Pacific.

THEN AND NOW

Air travel in India was once seen as a mode of transport only for the elite. With a low compounded annual growth rate of 3.9% over 1998-2003, it operated in a highly regulated environment, which meant little or no inflow of investment or expertise.

Today, favourable regulatory changes have converted air travel into a mode of transport for the general public. Domestic passenger traffic growth of roughly 20% is projected in 2004-2005 and is expected to continue for the next few years.

THE COMPARISON GAME

One popular means used by advocates pushing for open markets is to provide comparisons to other countries and industry sectors.

Country comparison: Comparing India to China (PRC) always works, because they are both so huge and at similar stages of economic development. Although the two share large populations of more than one billion, China (PRC) is estimated to have 140 million domestic air passengers flying on 750 aircraft compared to India's 15 million passengers and 164 aircraft as of early 2005.

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Factor	China (PRC)	India
Population	1.4 billion	1.1 billion
Air passengers	140 million	15 million
Aircraft	More than 750	164
Number of LCCs	5	1
Middle class population	400 million	300 million
Longest (densest) route	2.5 hours	2.5 hours
Growth (air) forecast	17% per annum	25% per annum

Source: Centre for Asia Pacific Aviation

Trip comparison: At 0.015 trips per capita, India is said to rank with Ethiopia and Nigeria – countries with a much lower per capita GDP. Per capita trips in countries with similar per capita GDPs are far higher, such as China (PRC), Egypt, Pakistan, Philippines and Vietnam. Malaysia, with a population of 28 million, has the same number of air passengers per year – 15 million. Ireland, the home of LCC Ryan Air, has a population of 3.7 million.

Commercial aircraft comparison: India's 164 domestic aircraft may be compared with US-based LCC Southwest Airlines' 417 aircraft.

Transport sector comparison: 16 million passengers travel every day on India's trains. This means that more Indians travel by train in one day than travel by air in a year. Of 16 million daily passengers, 5% (800,000) are upper class travellers. If just 5% of this segment switches to air travel, 40,000 seats a day would be added. Furthermore, it is easier to create air capacity than rail or road capacity.

Other industry sector comparisons: From 3 million users of cellular telephony in 2001, India now has 55 million in 2005 – largely as a direct result of price stimulation and reliable and easily available capacity. Meanwhile, fixed line growth is stagnant.

RIPE FOR A LOW-COST REVOLUTION

India is seen as being ripe for a low-cost revolution. Airline executives note that:

- Dominant carriers are high cost, full service models
- Domestic fares are very high
- Indian consumers are price sensitive
- Road and rail offer no competition – except price.

The forecast is that as the middle-class grows and becomes more affluent, travellers will switch from trains to planes – if the price is right. However, price stimulation can be done profitably only if the cost model is deliberately designed to be 'low cost', which means simplicity, standardisation and lowering cost without sacrificing brand quality and service reliability.

PLAYERS IN INDIAN AVIATION

India's aviation landscape has changed markedly in recent years. Here is a brief who's who of the current players:

Air India – www.airindia.com. Fully government-owned, Air India (AI) is India's national flag carrier. It was also one of Asia's first privately owned airlines, founded as Tata Airlines by Indian entrepreneur JRD Tata in 1932.

In 1933, the first full year of its operations, Tata Airlines flew 160,000 miles, carried 155 passengers and 10.71 tonnes of mail. It was partly nationalised and the name changed to Air India in August 1946. In 1947, it was given the right to operate international services. The airline was fully nationalised on August 1, 1953. The network today covers 44 destinations, including both self-operated and code-shared flights.

In April 2005, Air India launched its own low-cost airline, Air India Express (IX), to respond to the competition. Operating Boeing 737-800 aircraft in a 180-seat single-class economy configuration, it is targeting destinations within four hours flying time. It began with Dubai, Abu Dhabi, Muscat and Salalah, with services from five Indian cities – Calicut, Kochi, Thiruvananthapuram, Mumbai and Delhi.

Future plans include Bahrain, Bangkok, Doha, Kuwait, Kuala Lumpur, Sharjah and Singapore. In India, plans are afoot to introduce flights from more Indian cities such as Chennai.

Indian Airlines – www.indian-airlines.nic.in. Indian Airlines (IC) is also fully government-owned. Set up as a domestic airline, IC, together with its fully owned subsidiary Alliance Air (Y2), is one of Asia's largest regional airline systems, with a fleet of four A300s, four A320s, 11 B-737s, two Dornier D-228s and four ATR-42s.

For several years, it has been expanding to short-haul regional routes and the network currently covers over 75 destinations – 57 within India and 20 abroad – including points in the Gulf, South Asia and Southeast Asia. It has a dominant position in India's four main metropolitan hubs – Delhi, Mumbai, Calcutta and Chennai.

Together with Alliance Air, Indian Airlines carries more than 7.5 million passengers annually and has a staff of around 18,560. It has not launched a low-cost subsidiary but plans to capitalise on its

- Established structures and expertise
- Scalable and efficient systems
- Cost effectiveness
- Properly planned expansion strategies
- A combination of domestic and international strengths
- A solid financial base
- People.

They will also need to focus on:

- Stabilising capacity
- Increasing asset utilisation
- Increasing load factors
- Introducing yield management systems and innovative fare schemes
- Improving personnel productivity
- Restructuring aircraft leases
- Automation
- Stabilising industrial relations
- Lowering unit cost per available seat kilometre
- Identifying key markets.

TOTAL TOURISM IMPACT

As shown in the following tables, as India's aviation sector continues to liberalise and open up, it will not only stimulate domestic trips, but also contribute to inbound and outbound travel.

Inbound Forecasts 2005-2007

Origin Region	2005	2006	2007
The Americas	762,037	840,687	918,938
Europe	1,311,051	1,443,357	1,555,135
Asia	1,524,434	1,649,093	1,756,262
The Pacific	118,506	132,796	146,497
Others	158,925	171,817	179,538
Total	3,874,953	4,237,750	4,556,370

Source: Turner & Witt, Asia Pacific Tourism Forecasts 2005-2007, PATA, 2005

Outbound Forecasts 2005-2007

India to:	2003	2005	2006	2007	AAGR (%)
Singapore	309,446	553,456	590,106	636,954	7.28
Thailand	230,316	384,178	423,500	447,010	7.87
Hong Kong SAR	178,130	281,652	322,557	369,610	14.56
China (PRC)	219,097	351,993	357,658	367,260	2.15
USA	272,161	321,900	349,190	364,170	6.36
Malaysia	145,442	215,390	234,040	260,103	9.89
Sri Lanka	90,603	107,260	114,361	120,494	5.99
Nepal	86,363	99,417	106,900	112,420	6.34
Bangladesh	84,704	93,509	98,761	104,540	5.73
Australia	45,700	73,230	82,112	93,047	12.72

Source: Turner & Witt, Asia Pacific Tourism Forecasts 2005-2007, PATA, 2005

CONSTRAINTS AND CONCERNS

Airline executives say that Indian domestic aviation can grow from 15 million passengers to 50 million in the next five years, and the number of commercial aircraft from 164 to 500. But this growth will not be free of constraints.

Pilots. All planes need pilots, who currently number about 1,500 in India. Training schools, which are losing instructors, produce few commercial pilots. If the expected number of commercial aircraft grows by 200 by the year 2010, an estimated 2,400 additional pilots will be required.

Pilots need 1,500 hours of flying experience for a First Officer to be eligible for an Airline Transport Pilot's License, followed by 4,000 hours and five years of experience as a First Officer to be a Commander. Until current training facilities are expanded and revamped, the airlines expect substantial use of expatriate pilots.

Airport congestion and bottlenecks. The following tables show the concentration of international and domestic traffic at key metropolitan airports, which put them under severe infrastructure pressure in terms of both passenger and aircraft handling:

Domestic Traffic

Airports	Avg. flights/day	Avg. pax/day
Mumbai	273	21,776
Delhi	203	16,627
Visakhapatnam	300	10,451
Bangalore	115	7,407
Chennai	101	6,854
Kolkata	88	6,849
Hyderabad	61	4,442
Ahmedabad	30	1,984
Goa	24	1,944
Guwahati	37	1,471

International Traffic

Airports	Avg. flights/day	Avg. pax/day
Mumbai	103	14,619
Delhi	86	11,851
Chennai	40	5,628
Cochin	24	2,359
Thiruvananthapuram	20	2,261
Hyderabad	16	1,672
Kolkata	18	1,619
Calicut	11	1,397
Bangalore	14	1,309
Goa	6	762

Source: Directorate-General of Civil Aviation, India

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cial aircraft from 164 to 500

THE THORNY ISSUE OF FOREIGN OWNERSHIP

Aviation is a huge cash-guzzler. Over the next few years, India will need billions of dollars for runways, terminal and air traffic control facilities, safety and security, simulators, maintenance hangars, training and much more.

This will mean a new focus on how the industry raises money, be it from the government, private investors or public equity sources. As most investors also seek some element of control, the issue of foreign equity ownership in Indian aviation has come to the fore.

This is a particularly thorny issue, especially for the current Congress-led government, whose survival depends on a coalition of political parties, including some categorised by the media as 'the left'. These parties have some concerns about the growing privatisation of Indian infrastructure, including transportation, telecommunications, energy and other sectors.

Although considered a nuisance by some businessmen, bankers and consultants, in a democratic society, the 'left' provides a vital check and balance system against the excesses of the private sector.

The Government of India on November 10, 2004 increased the Foreign Direct Investment Limits in "Air Transport Services (Domestic Airlines)." The revised limits are: 49% by foreigners "through automatic route" and 100% by Non-Resident Indians (NRIs) "through automatic route". An additional caveat was that no direct or indirect equity participation by foreign airlines would be allowed.

It has, therefore, become necessary that guidelines for the interpretation of indirect investment by foreign airlines, which are in conformity with the provisions of the Aircraft Rules, 1937 and the existing Domestic Air Transport Policy are promulgated. Accordingly, on July 11, 2005, the Director General of Civil Aviation issued the following guidelines to clarify foreign equity participation in the domestic air transport sector (the full text follows):

Permission to operate scheduled services will be granted either

(i) to a citizen of India; or

(ii) to a company or a body corporate provided that

   (a) it is registered and has its principal place of business within India;

   (b) its Chairman and at least two-thirds of its Directors are citizens of India; and

   (c) its substantial ownership and effective control is vested in Indian nationals.

Foreign financial institutions and other entities who seek to hold equity in the domestic air transport sector shall not have foreign airlines as their shareholders.

An applicant shall be required to furnish full and detailed information with regard to the shareholding of any airline in the foreign investing institution/entity, if any, and composition of the Board of Directors and senior management of the said foreign investing institution/entity.

An applicant who seeks permission to operate air transport services in the domestic sector shall be required to give a declaration that no foreign airline is in a financial or commercial tie-up with him/her or has the management/ ownership interest in him/her.

While the foreign investing institution/entity which seeks to hold equity in the domestic air transport sector may have representation on the Board of Directors of the Company, such representation shall not exceed one-third of the total.

Any foreign financial institution/entity which seeks to make an investment in the domestic air transport sector shall not be a subsidiary of a foreign airline.

However, the air transport operators may be permitted to import aircraft on dry lease from foreign airlines. Wet leasing of an aircraft may also be allowed from any source subject to the fulfilment of the guidelines issued by the Government/DGCA.

A domestic sector air transport operator shall not have agreements such as shareholders agreements etc. with a foreign airline containing provisions/arrangements empowering such foreign airlines or others on their behalf to have effective control in the management of the domestic airline.

A domestic air transport operator shall not enter into an agreement with a foreign airline which may give such foreign airline the right to interfere in the management of the domestic operator.

A domestic air transport operator may enter into financial arrangements with a bank and/or other financial institutions for the purpose of lease-finance, hire-purchase or other loan arrangements, but such a tie-up shall not be permitted with a foreign airline.

Management contract with a foreign airline shall also not be permitted to a domestic air transport sector operator.

Marketing arrangements such as ground handling, general sales agency, code sharing, interlining will, however, be permitted.

A domestic air transport sector operator will also be permitted to get maintenance, overhaul, repair works done and training of pilots/engineers conducted either at the facilities available with other airlines or those certified by the Director General of Civil Aviation on such terms as may be prescribed.

A domestic air transport sector operator may be permitted to employ foreign pilots/engineers until he/she is able to train his/her own manpower. This shall, however, be permitted with the express approval of the competent authority and for such period and terms as may be prescribed by the said authority.

An applicant who seeks permission for domestic air transport operations will be required to give a declaration that he/she fulfils all the requirements mentioned in the above guidelines and in case of any change, he/se shall notify the competent authority within one month of such change. In addition, the applicant will be required to furnish such a declaration every year.

A domestic air transport operator who furnishes wrong information in respect of any of the above prescribed guidelines at any stage shall be liable for suspension/ cancellation of his/her Operating Permit.

**Note: In these guidelines, Domestic Air Transport Operator includes both Scheduled and Non-Scheduled Operators.*

US$25 million, the company is publicly traded on the Bombay Stock Exchange, and in June 2005 received approval from shareholders for a US$90 million cash-raising plan.

IndiGo Airlines – no Web site at time of writing. IndiGo Airlines is a subsidiary of Inter-Global Enterprises, a leading travel conglomerate based in Bangalore. IndiGo placed an order for 100 A320s at the 2005 Paris Air Show, worth US$6 billion, one of the highest by any domestic carrier. It plans to start operations by November 2005.

An indication of the expansion plans of these airlines in the next few years lies in the orders placed at the 2005 Paris Air Show:

Customer	Aircraft	Number
IndiGo	Airbus A320	100
Jet Airways	Airbus A330	10
	Boeing 737-800	10
	Boeing 777-200LR	6
	Boeing 777-300ER	4
Kingfisher Airlines	Airbus A330	5
	Airbus A350	5
	Airbus A380	5

Sources: www.airsider.net/files/2005/0605/006/airbusshow.htm
www.airsider.net/files/2005/0605/007/boeingshow.htm

Others in the pipeline. Two more airlines, Yamuna Air and Indus Air are expected to have submitted applications for a licence. The Tata Group, the original owner of Air India, is also reported to be interested in exploring opportunities. It once made an abortive attempt to link up with Singapore Airlines to bid for Air India.

AIRPORTS

A programme of airport privatisation and expansion is also underway. In December 2004, India launched a six-year US$9 billion programme to upgrade facilities at 30 airports. Management at airports in Delhi, Mumbai, Hyderabad and Bangalore are to be transferred to private consortia. Ownership of airports in Delhi and Mumbai will be transferred from 100% government ownership to 26% government, 25% private (Indian citizenship), and 49% foreign.

DRIVING FORCE

The United States is one of the driving forces behind this liberalisation process because Indra represents a huge market for suppliers of US products and services. In a presentation at the Aviation & Tourism Investor Summit organised by the Centre for Asia Pacific Aviation (CAPA), the US Department of Transportation Senior Negotiator for South and South East Asia, Asia/Pacific, Mr David Modesitt was upfront about the financial payoff for US companies.

"There will be certain 'public goods' necessary to the efficient function of an aviation system that governments must continue to supply either directly, through teaming with the private sector, or by private sector management," Modesitt said. The Federal Aviation Administration is offering private sector assistance to provide technical support, job training, and personnel exchanges between the US and India, he said.

After recounting the history of change in the US aviation industry from highly regulated and restricted to more open, he cited the 1995 announcement of the US government's international aviation policy. While the overriding goal is the "provision of safe, affordable, convenient and efficient air service for consumers", the "approach is to expand the overall international aviation market, to further increase airlines' opportunities, and to expand international service to as many communities as possible".

Modesitt added: "This new policy gave us a 'full-speed-ahead' mandate for more open skies bilateral agreements", which have "now been the focus of US international aviation policy for 13 years".

As of June 2005, the US has negotiated open skies bilateral agreements with 68 partners. The agreement with India was signed in April with "liberal, pro-market features, compared to a very restrictive agreement that had been in place for nearly a half-century".

A new agreement has been signed with China (PRC) which is "not an open skies agreement", according to Mr Modesitt."The new rights that are being phased-in by 2010 will eventually provide a nearly five-fold increase in weekly flights, and will provide for new code sharing and charter operations as well," he said.

He added: "Given that air service is an engine providing power to overall economic growth, no nation can continue to set aside its broader economic interests in order to protect its airlines."

THE CONSEQUENCES OF COMPETITION

Competition is a question of survival, which means coming up with creative ways to ensure it. Indian airlines are rapidly adjusting their pricing strategies, hatching innovative frequent flier programmes, re-jigging their distribution systems, enhancing customer service, cutting costs and developing new value-added services.

The new era means that both the public and private sectors will have to contribute to ensure that the benefits of competition are not undermined. While the airlines wait for the government to put in the necessary infrastructure and sort out the regulatory systems, their executives say key success factors will be:

Airline executives say that Indian domestic aviation can grow

and the number of commer

competitive advantage as the operator of the largest domestic network, providing more linkages to its international destinations.

Jet Airways – www.jetairways.com. Privately-owned Jet Airways (9W) began operations on May 5, 1993 following the Indian government's decision to offer limited open-skies opportunities to the private sector.

It operates a fleet of new and next-generation B737 aircraft, as well as Airbus 340-300Es and ATR72-500s. More than 22% of its passenger revenue earnings are derived from overseas sales. During the fiscal year 2004-2005, it is estimated to have secured a 43% share of the Indian domestic air travel market.

Mumbai is its primary hub and maintenance base, with Delhi, Kolkata and Chennai as secondary hubs. It operates to 48 destinations in India and abroad. It started operations to Colombo and Kathmandu in 2004 and has expanded to London, Singapore and Kuala Lumpur in 2005.

The airline was to get three A340-300s in 2005, with firm commitments for 10 A330s and 10 B777s due to join in 2006. For domestic routes, it has 16 B737s firmed up until 2007.

Air Sahara – www.airsahara.net. Air Sahara (S2) began operations on December 3, 1993. It is part of the Sahara India Pariwar conglomerate which has interests in finance, media and entertainment, housing and infrastructure, tourism, consumer products and information technology.

Its fleet includes B737-700s, 737-800s and 737-400s as well as a fleet of seven Canadair regional jets. Offering 123 daily flights across India, the airline is undergoing a complete overhaul and restructuring.

As a full-service airline, it also has a frequent flyer programme and interline agreements with almost 87 international airlines and 21 general sales agents worldwide.

Air Deccan – www.airdeccan.net. A unit of Deccan Aviation, India's largest private heli-charter company set up in 1995, Air Deccan (DN) started operations in May 2003, claiming to be India's first low-cost, no-frills airline. As of July 2005, it was operating five A320-200s, nine ATR 42-320s and three ATR 42-500s, with another two A320s due for delivery in September 2005.

A further 30 A320s are on order with deliveries starting in 2007. The airline has also ordered 30 new ATR 72-500s (half to be leased), along with three used ATR 42-500s and three used ATR 72-500s.

The airline's initial business plan was to connect smaller towns with the metros, starting in South India. These include Belgaum, Hubli, Mangalore, Coimbatore, Madurai, Rajahmundry and Vijaywada, linked to Bangalore, Chennai, Hyderabad and Mumbai. In September 2003, it started a hub at Hyderabad.

Air Deccan takes pride in calling itself 'the Udipi Hotel of the airline industry', after a well-known South Indian restaurant chain.

Kingfisher Airlines – www.flykingfisher.com. Kingfisher Airlines (IT) is a wholly owned subsidiary of United Breweries Holdings, one of India's largest conglomerates with a turnover of US$2 billion and the largest manufacturer of alcoholic beverages in India. Kingfisher is also the name of one of its best-selling beers.

The first A320-232 was introduced in May 2005 with plans for 12 by January 2006. This is the same aircraft type as that being operated by the government-owned Indian Airlines. Rather than pare back on frills, the A320-200 aircraft is equipped with an in-flight entertainment system that offers a personal video screen at every seat. The single-class seating configuration of 174 seats also has a wider 30-inch seat pitch and larger overhead bins.

In a strategic move, Kingfisher signed an agreement with Indian Airlines, the first 'public-private' partnership under which Indian Airlines will provide all ground handling services at its exclusive terminals in Mumbai and Delhi.

The deal allows Kingfisher to cut overhead costs on account of cockpit commonality, engineering and schedule coordination. It also gives IC 'incremental returns' on its existing infrastructure.

SpiceJet – www.spicejet.com. SpiceJet (OS) was the third low-cost airline start-up in India. It is owned by Royal Holdings Services, a Nevada-based company, the UK-based Kansagra group and other minority shareholders like Citibank and Goldman Sachs.

The budget airline, a reincarnation of an airline known as ModiLuft in the 1990s, began with three B737-800s and plans to add 20 more by the end of 2006. They have an all-economy configuration of 189 seats.

Initial operations were on trunk routes such as Delhi to Mumbai via Ahmedabad, with rapidly emerging destinations like Bangalore, Goa and Pune being added later. The Delhi-Ahmedabad-Mumbai route was launched on May 23 with seats going for IDR99 (US$2.50) for the first 99 days of operation.

The airline provides a free light snack and a bottle of water on board and advance seat selection. Reported to have invested

Peak-hour congestion is the main concern. In Mumbai Airport, for example, the peak times for scheduled aircraft movements, both domestic and international, are between 0500-1000 and 1700-2200. With all the airlines competing for the best slots, there does not seem to be any way of sorting this out, especially at one-runway airports.

Airport pricing policies. While privatisation and competition are being touted as solutions for the Indian aviation industry, airport privatisation operates under a different set of principles, which is to make maximum use of a monopoly situation to maximise shareholder and investor return. There is no low-cost philosophy.

The International Air Transport Association (IATA) is particularly worried and is trying to convince the Indian Government that the "best systems of economic regulations are judged by investors by their fairness to both users and providers, transparency, predictability and stability. This gives lower risks and high long-term returns to airport investors".

IATA wants the government to choose between active and passive regulation of the costs of items such as landing and user charges. It is also seeking to interest the government in regulating airport charges, such as via rate of return (ROR) indexing, price-caps, yardstick competition, automatic rate adjustment or trigger regulation.

IATA is offering the research and case-study material it has compiled based on its worldwide experience. One key issue it is watching closely is the proposed establishment of the Aviation Economic Regulatory Authority (AERA) to decide on the charges and, eventually, a Competition Commission of India.

Foreign investors' concerns. According to Rothschild India, investors will look at a number of areas before committing money. These include the standard market risk, competition, funding, business model and management issues common to all businesses, plus the availability of enabling infrastructure and the level of regulatory controls critical to aviation.

CONCLUSION

As India follows the US liberalisation model and enjoys the massive immediate benefits that derive from it, it is not preparing for a potential fallout. Such a fallout is inevitable, especially in the wake of soaring oil prices, which have clearly thrown many feasibility-study calculations completely out of kilter.

Mr Modesitt warned: "As we in the United States and others worldwide have learned, however, aviation liberalisation does have a price in terms of its effects on older, inefficient high-cost carriers. They must adapt or perish."

While Modesitt claims that the "the costs are greatly offset by the benefits", that applies only to those who do not have to pay the costs of poor maintenance, poor service and financial collapse.

At least three areas need to be looked at carefully:

- Are consumer protection laws in place to sort out compensation for travellers in case of an airline collapse?
- What is the impact on the national balance of payments and current accounts of aircraft purchases and the import of other aviation-related products and services?
- What is the impact on global warming as India upgrades its entire transportation infrastructure, including aviation, highways and railways? Global warming remains a contentious issue and the transportation industry is likely to remain dependent on fossil fuels for years to come.

While short-term aviation growth is clearly beneficial, perhaps it needs to be tempered by more holistic medium- and long-term perspectives.

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