A New Flight Plan for India's Beleaguered Airline Industry

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Preamble

The airline industry in India, which has experienced upheavals in the recent past much like its counterparts in other parts of the world, is greeting the latest domestic air travel data with much excitement. Nearly 20 percent growth over the previous year is definitely a reason to cheer about but it's not yet time for celebration. To turn growth into profitability, airlines have to find ways to reduce operating costs, control cost of capital, raise employee productivity, and ensure better yield per route and better fleet utilization.

A lot has changed in the Indian aviation sector – the standard of airports, the entry of low cost airlines, increased affordability among Indians and government policies around privatization of the industry. However, with two major Indian airlines grounded and the national carrier continuing its loss-making streak, it's clear that the sector is far from reaching its potential as a major hub for air traffic in Asia.

Indian Airline Industry Recent Milestones:

Early 1990s – Airline industry liberalized, attracting a host of new entrants. This includes Jet Airways, which is the only airline among those to survive till date.

2003-04 – The 2nd wave of liberalization sees new high profile entrants like Air Deccan, Indigo and Kingfisher. These airlines place large orders for new aircrafts for short-haul flights.

Air India and Jet Airways place large orders for long range, wide body Boeing 777 aircrafts for international flights.

2003-2007 – These years see big growth in domestic air market at a Compounded Annual Growth Rate (CAGR) of 26 percent. Airlines experience brief period of profitability in 2003-2005.

2008-2009 – Economic slowdown hits India's low cost pioneer Air Deccan, which gets bought over by Kingfisher and Air Sahara gets bought over by Jet Airways.

2012-2013 – Global slowdown hits the market again; Kingfisher Airlines is grounded.

2013 – Etihad buys stakes in Jet Airways; Air India survives on government subsidy.

2013 – Indigo becomes the only domestic airline to survive from the lot that entered the market in 2005. Indigo has remained profitable since inception.

2014-15 - Indian domestic market clocks growth above 20 percent, attracting more airlines like low cost carrier Air Asia and full service carrier, Vistara.

Developments in the past decade hold valuable lessons for Indian carriers. The global recessions of 2008-09 and 2011-12 showed that the Indian aviation sector is not insulated from a slowdown in global markets. In the heyday of fast growth in domestic air traffic, airlines such as Air Sahara, Air Deccan and Kingfisher chased market share without paying due attention to profitability of core airline operations. An airline is a highly capital intensive business with high labor costs and dollar indexed salaries for operating crew and maintenance engineers. Moreover, history has shown that an airline with weak financials will not survive a lean business cycle. Thus it is imperative that airlines achieve operational profitability, a fact borne out by the only profitable domestic airline today, Indigo Airlines.

Indian Aviation Today – Back from the Brink

From a modest four percent increase during the six months of January to June 2014, domestic passenger growth rebounded to 21 percent between September 2014 and March 2015. With declining fuel prices, airlines are in a position to offer lower prices for profitable growth. With the Indian economy on a revival path, domestic airlines are showing signs of recovery. However, in spite of growth, the International Air Transport Association (IATA) had projected losses of USD 1 Billion in 2014-15 for the Indian airline industry. The latest revenue figures have not been announced yet. Coming out of the red will be difficult for most airlines that have stretched balance sheets with a high component of debt.

> **During the past five years, the airline industry in India incurred operating losses of over Rs. 39,000 Crore, exposing their financers, bankers, creditors, employees and suppliers in the aviation value chain to great financial risk.**

The aviation value chain comprises aircraft original equipment manufacturers, aircraft leasing companies, in-flight catering, ground handling, Maintenance, Repair and Overhaul (MRO) providers, air cargo, airline IT providers, airlines and travel management companies.

Air India's debt mountain

Since liberalization, national carrier Air India's operational losses, coupled with what it owes Boeing for a large order, stands at Rs. 62,971 Crore (as on March 2013) or USD 10 Billion. Its operating parameters are abysmal. It has the highest operating Costs per Available Seat Kilometer (CASK), lowest daily aircraft utilization, lowest employee productivity, highest salaries for operating crew, lowest load factor, negative earnings before interest, taxes, depreciation and amortization (EBIDTA), and highest cost of capital due to a high component of working capital debt. Air India recorded the worst operating margin of negative 35 percent in the entire airline industry in 2012 among the world's top 150 airlines. Its equity would have been completely wiped out had it not been for the support from the government, to the tune of Rs. 11,000 Crore to date.

Today the national airline is ill equipped to compete on domestic routes with cost-efficient Low Cost Carriers (LCCs). On international routes, Air India faces the formidable challenge of competing with foreign airlines from the Middle East (ME) with deep pockets, a strategic hub in the ME and vast resources. The national carrier will have to reinvent its role in today's liberalized economic times. It may not be too long before the government considers privatization of the national carrier, much like governments in most developed countries have done.

Success of the LCC model

The LCC model has been one of the few success stories of Indian aviation. However, ironically, Air

Deccan, which pioneered the LCC model in India, went into liquidation in 2008. Today, LCCs in India account for the lion's share (63 percent) of the domestic air market. Indigo, India's most successful LCC, has proved that it is possible to combine profitability with high growth in India by keeping control over costs. The world over, discerning consumers do not see much difference in value between a full service carrier and an LCC for short haul, domestic routes. LCCs in India are challenging the pricing power of full service airlines. New airlines like Air Asia, the Tata Sons-Singapore Airline joint venture Vistara, Ligare Aviation, Quickjet, LEPL, Air Pegasus and Air Costa are entering the skies to cater to the rising domestic demand.

New private airports

Private airports in Cochin, Bangalore and Hyderabad, and new, swanky terminals in Mumbai and Delhi have shown the transformation that private capital can bring in a short time. However, the guarantee to private airports that prevents the operation of another airport within a 150 km radius has resulted in rendering the old HAL airport in Bangalore and the Begumpeth airport in Hyderabad redundant. Both these airports can be used for ATR LCC flights from nearby destinations such as Mangalore, Chennai and Vizag.

Growth, not profitability

In spite of impressive double digit CAGR of domestic (15 percent) and international air market (13.5 percent) during the past 10 years, India's airline industry collectively has not been profitable.

> **The supply of seats often has run ahead of demand. The yields cannot be pushed above unit costs due to weak pricing power. If air ticket prices are raised, the value conscious Indian leisure traveller explores other options such as rail or road.**

Most of the operating costs like airport fees, fuel costs, lease rentals and allowances for the operating crew cannot be squeezed due to their inelasticity. The gap between the unit cost and the unit yield narrowed to negative (minus) 6 percent in 2012. However, except for two years (2005-2007), unit costs were higher than the unit yields during the past decade. Thus, the industry has to address some key cost issues.

Challenges in international sectors

In recent years, the Indian government has granted liberal increases in bilateral entitlements for foreign airlines. In theory, such increases in bilateral entitlements open the doors for India's designated airlines to operate an equal number of flights on international routes. However, India's airlines have to comply with the 5/20 rule* before they can qualify. In addition, they can ill afford to increase capacity on international operations that cannot offer onward connections. The lack of onward connections, the inability to get desired slots at key airports, and the lack of close integration with global alliances are constraints for India's airlines.

Air India, which earlier had exclusive rights to operate international flights, has lost its bargaining position with foreign airlines due to liberalization of bilaterals.

On long haul international routes, India's airlines are up against international competitors with deep pockets and strategic bases in the Middle East (ME) and Europe. Cash strapped Air India is pitted against foreign airlines that are located in countries with stable currency economies and airlines in the ME that are hugely subsidized by their rich government sponsors. Governments in the ME see a synergistic, pivotal role that a consortium of the national airline, airport, hotels and ground handling agency can play to spur their country's economy. A base in ME also helps foreign airlines to enjoy zero income tax for employees, source cheap fuel, borrow funds at low interest costs and use its strategic geographic location to offer excellent 'hub-and-spoke' connections to multiple points in North America and Europe from South Asia. As compared with this, point-to-point operations of India's airlines are not as cost-effective.

On international routes, India's airlines need to chart out a new flight plan that uses India's strategic geographic position to connect traffic from SAARC, ASEAN and the ME regions.

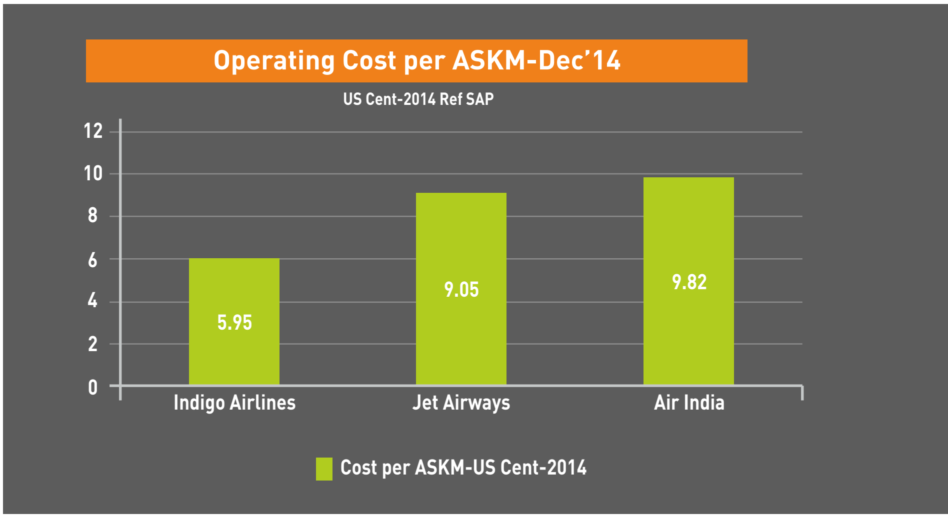
> **India's airlines can embark on a path of profitable growth in the coming decade by focusing on key performance indicators, forging close knit alliances with profitable global airlines of the world and jettison burdensome debt by raising private equity.**

The Jet-Etihad deal is a watershed deal for the entire industry. Such foreign direct investment in airlines provides modicum of stability to India's airline industry. India's airlines can create a level playing field by tapping into cheaper sources of global capital to compete successfully with world's airlines. This will be possible only if there is a regulatory, bureaucratic and political framework in place.

Cost Competitiveness - The Key to Survival:

The airline industry's capital intensive nature demands huge capital investments in foreign exchange. India's airlines are vulnerable to gyrations of a weak domestic currency as foreign currency debt / lease rentals, fuel expenses and so on are calculated in dollar terms. It is also a labor intensive industry. However, unlike other India based global industries like IT, the airline industry does not enjoy low wage arbitrage. Expatriate pilots and aircraft maintenance engineers are highly paid in dollar indexed salaries. Added to this is low aircraft utilization of below 10 hours due to a short domestic block time of less than two hours, the high cost of Air Turbine Fuel (ATF) due to additional state imposed sales tax and the high cost of borrowing capital in the Indian market. All these factors lead to high unit costs for India's airlines.

Unlike other industries, there has been no serious effort for indigenization of aircraft, spare parts, ground handling equipment, MRO, simulator design, pilot trainings, and core IT applications. Hence, these are often extremely expensive. Also industry players do not collaborate with one another to save common costs like infrastructure, ground handling and MRO. As a result, a full service airline in India has 20 percent higher operating costs per ASKM than Air Asia, which has the best ASKM in the industry. (Please refer to the chart below)



The global airline industry has entered a profitable cycle in the past five years (2009-2014) (Chart 18). Airlines in APAC (namely China) have been the most profitable. However, airlines in the Indian subcontinent present a contrast. They will need to raise private equity, go for Initial Public Offerings (IPOs) and neutralize debt to turn profitable in the near future.

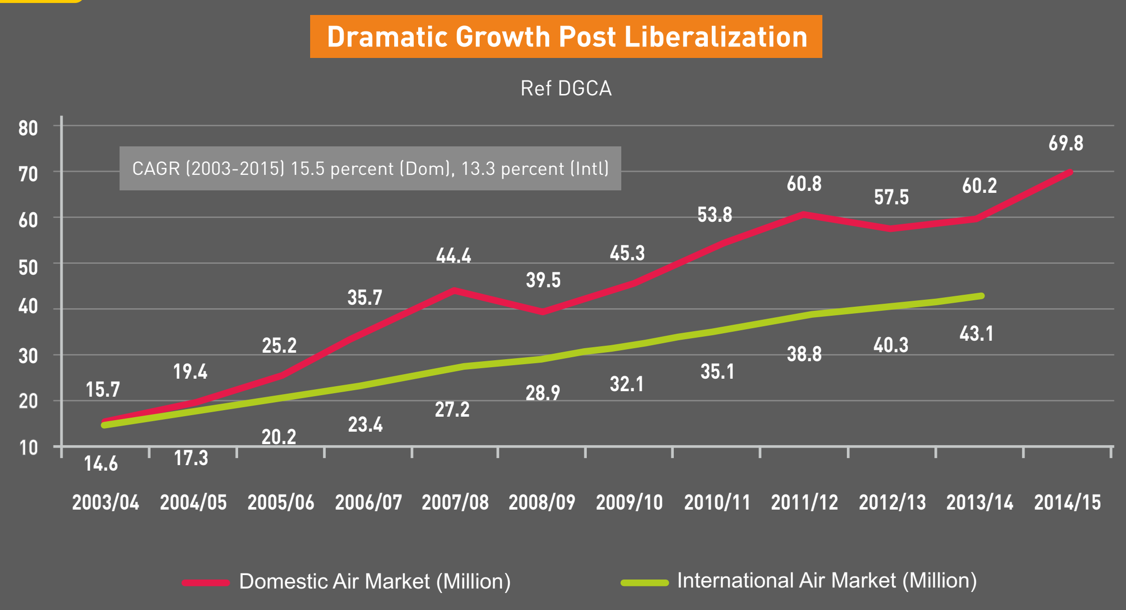
A new flight plan for India's airlines must contain initiatives to enhance fleet utilization per day, raise employee productivity, improve the overall weight load factors to well above the industry benchmark of 80 percent, reduce the cost of capital and transform its business model. Improvement in the Indian economic scene has enhanced passenger load factor.

India's airlines have to leverage the country's unique geographic position to garner traffic from SAARC and ASEAN regions to ME and Europe.

They must consider offering value added IT / MRO / BPO services to the entire aviation value chain through its India based subsidiaries, drawing upon the vast talent pool in India. This strategy adopted by a few legacies and global airlines has shown success. North American and European airlines have achieved capacity discipline, improved load factors and brought renewed focus on profitability. Indian airlines must emulate some of these valuable lessons to move towards profitable growth.

Unveiling a New Flight Plan for Indian Airlines

Chart 1



Note: International carriage figures includes carriage by foreign airlines to / from India

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Air Market in India - Growth unleashed by liberalization

Since the liberalization of India's civil aviation, the rise in domestic passenger carriage has been particularly impressive, as seen in the Chart1. Pre liberalization, both domestic and international carriage were practically at the same point, about 14-15 million passengers. Since 2004, domestic carriage has grown four times, 60.2 Million passengers. Domestic air traffic has grown at a faster rate, a CAGR of 15 percent as compared to a CAGR of 15 percent of international carriage (Chart 2B). In 2013, the domestic market was 50 percent higher than the international market.

Chart 2A

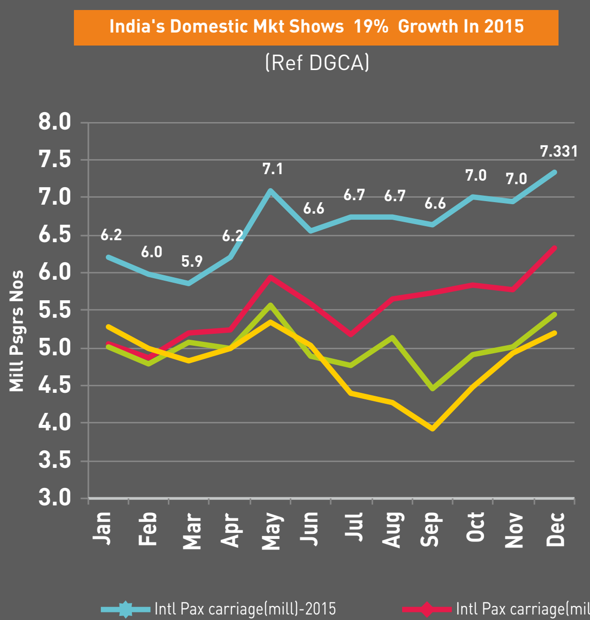
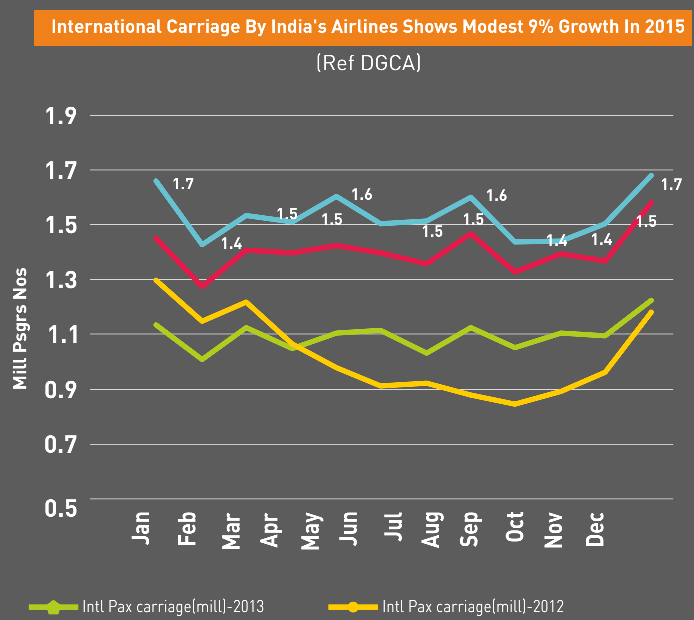


Chart 2B



Note: International carriage figures does not include carriage by foreign airlines

The domestic air market growth has been in sync with capacity enhancement at a CAGR of 15.5 percent during the nine years following liberalization. It is a trend put forth by French economist J. B. Say's law (or law of market) that supply or capacity creation gives rise to demand. In the highly perishable commodity of airline seats, flight operations have to continue even as the price of the product drops below costs (Chart 9).

International carriage by India's airlines has picked up momentum - 24 percent growth between April 2014 and March 2015 against the previous year, due to the granting of international rights to LCCs like Indigo and Spicejet.

As per WNS, there is a strong (62 percent) correlation between the rate of growth of the Indian GDP and the domestic air market. Every time the Indian economy growth rate slips below six percent, the air market shows a decline.

Chart 3A

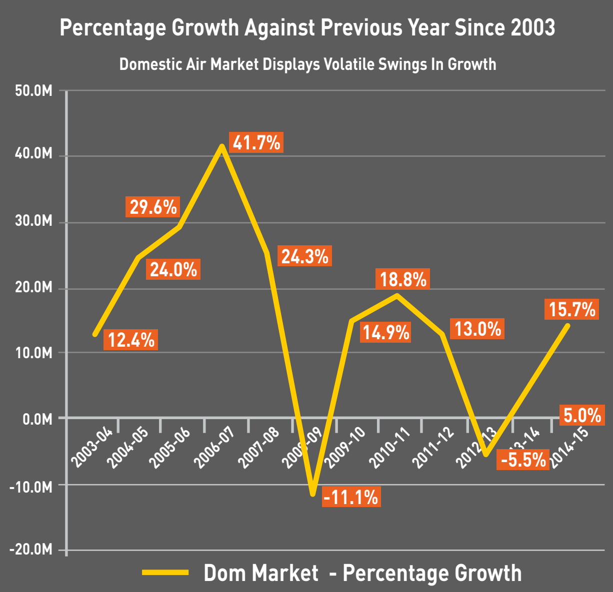
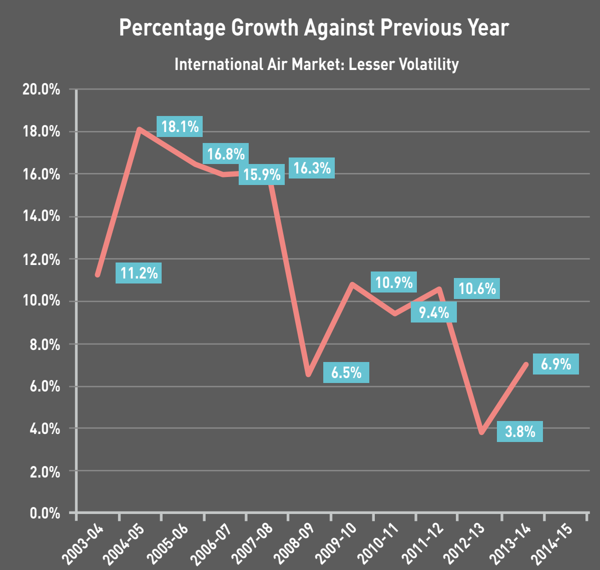


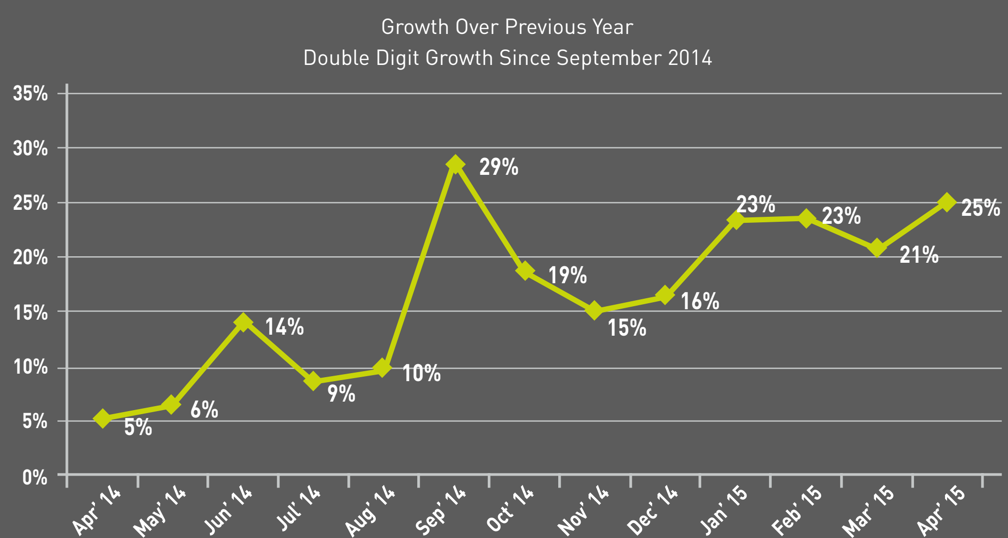
Chart 3B



Note: International carriage figures includes carriage by foreign airlines

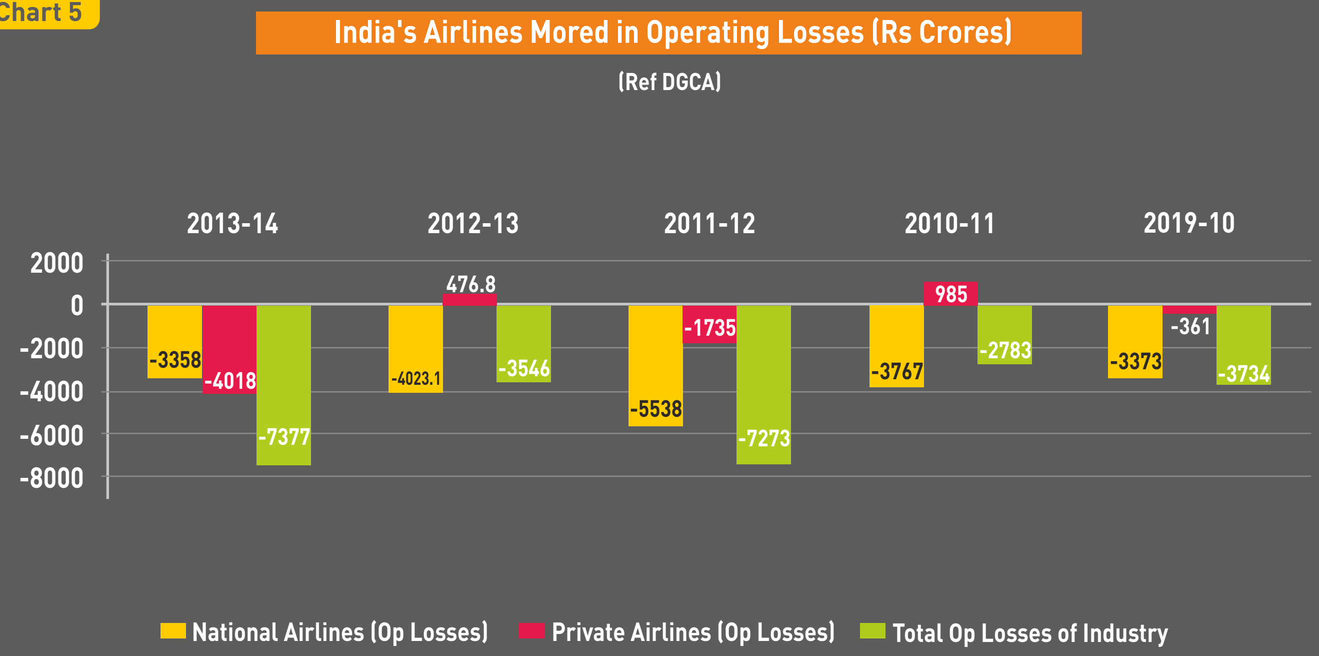
Chart 4A

Uptrend in Domestic Carriage



By contrast, the international carriage by India airlines is not increasing.

Chart 5



Operating losses contrasting growth

The Directorate General of Civil Aviation (DGCA) did not report Kingfisher Airlines' results in 2011-12.

- **Fleet expansion and operating losses have created a mountain of debt:** India's airline industry during its breath taking growth phase has accumulated staggering losses of Rs. 43,878 Crore (USD 6.75 Billion) and a debt of Rs. 93,000 Crore (USD 15.5 Billion) during last 10 years (that is from 2004 to 2014)

- **Benchmarking airline industry KPIs with global players:** Indian carriers must be benchmarked against global airline industry Key Performance Index (KPIs) such as load factor (passengers), overall load factor (including cargo), operating unit cost v/s operating revenue, efficiency of schedule and daily aircraft utilization.

Unique characteristics of Indian airline sector:

Passenger load factor shows great improvement in 2015:
The average domestic load factor in 2015 was at 83.6 percent, which is a vast improvement over the previous years (Chart 6A). It is clear that there is demand at the current price point and soon the industry will restore its lost pricing power. International load factors are also improving to 80.4 percent.

Emphasis on cargo uplifts for improving overall load factor:
Even though the passenger load factor has improved, the overall load factor in 2015 on domestic (75.3 percent) and international operations (68 percent) presents ample room for improvement, indicating the potential role of air cargo to impact an airline's bottom line. (Chart 6B)

Chart 6A

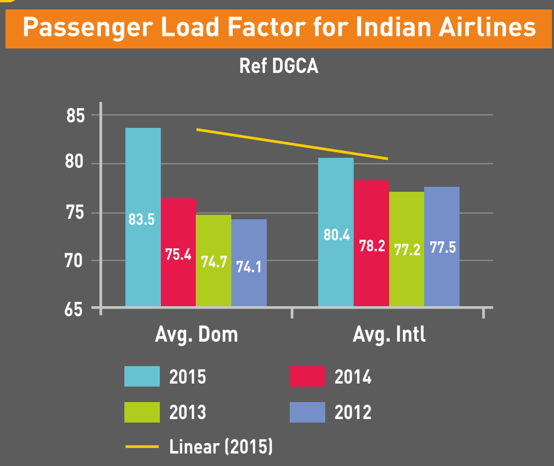
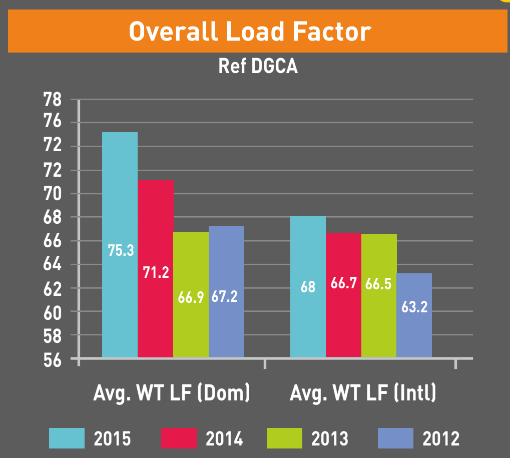


Chart 6B

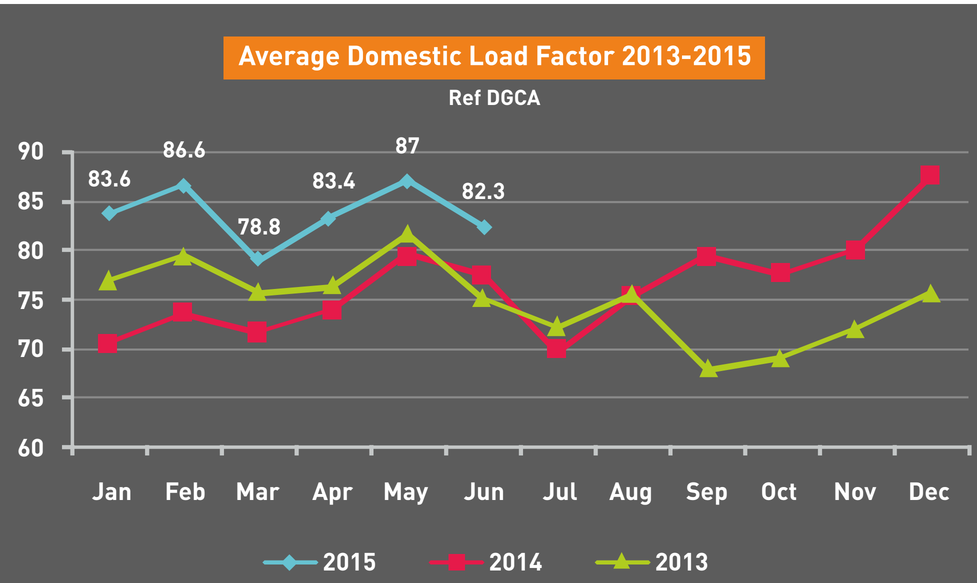


As per WNS, although the contribution of air cargo to revenues is merely 5-8 percent of total revenues, it can make a positive impact on airlines' bottom line.

Cargo revenues come at little incremental costs and can often be the difference between loss and profit for many airlines. Profitable airlines recognize the role of cargo and invest resources to enhance cargo's contribution.

Seasonality of carriage:
Domestic carriage is seasonal, peaking with school vacations in May and December and lean periods in February, March, September and October. The international peak season coincides with school vacations in August and December. In 2015, the load factors were above 75 percent even in the lean months, which is a healthy sign for the industry.

Chart 7



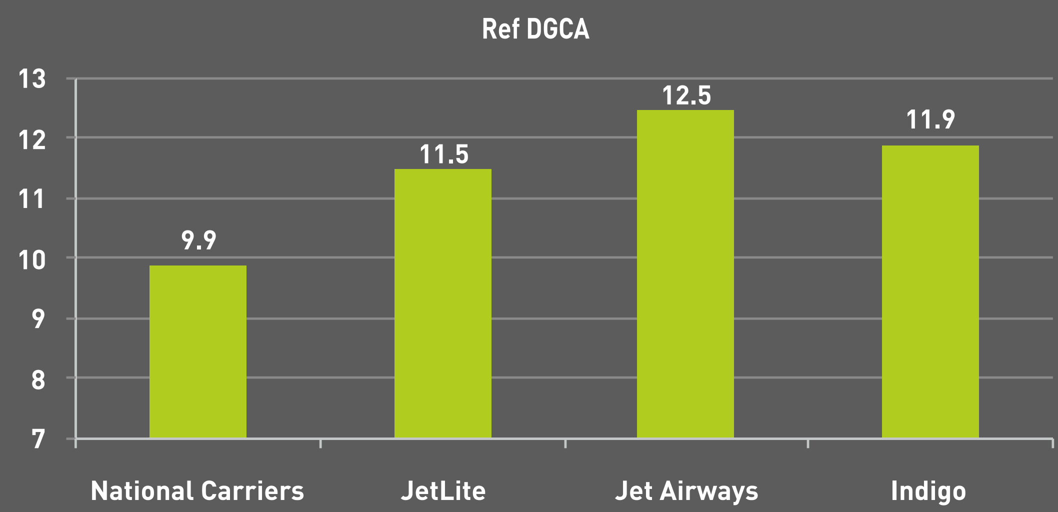
Aircraft utilization:

The average daily utilization of fleet of national airlines in India (Chart 8) is low due to many endemic issues such as old, fuel inefficient planes that cannot be profitably deployed. Common industry issues that adversely affect utilization are short domestic sectors, congestion in metro airports leading to flight delays, lack of peak hour slots, and the absence of night parking facilities in key metro airports. Even small increments in daily utilization can result in a big swing in airline topline.

An analysis of the load factor and daily utilization shows that India's airlines have to improve on these two parameters to stay profitable.

Chart 8

Index of Airline Efficiency-Avg Daily Utilization- 2013-14 (hours)



Negative gap between yield and costs:

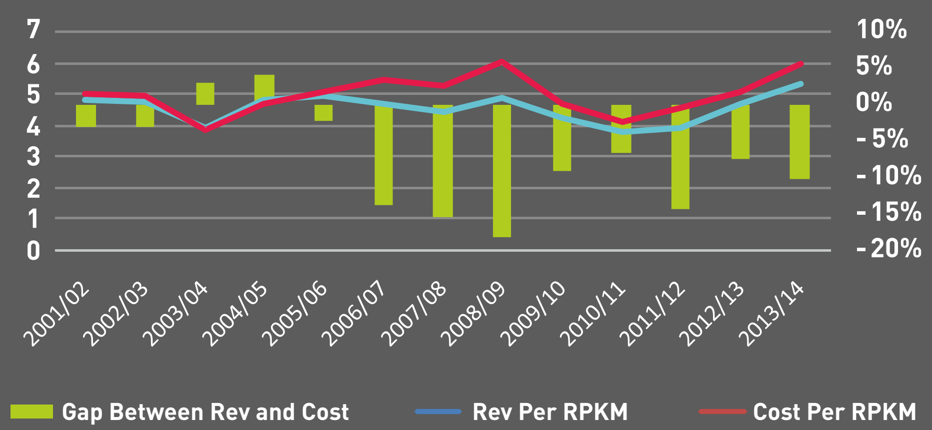
Post liberalization, airlines in India have rarely demonstrated 'pricing power'. There has been an average negative (minus) 7 percent gap between 'yield per RPKM' and 'cost per RPKM' (Revenue Passenger Kilometre). This negative gap between unit revenues and unit costs narrows during boom times, and widens during periods of slowdown or times of new capacity addition. Only briefly during 2003-05, the yields were higher than costs (Chart 9). In 2012, the negative gap widened to 14 percent. This gap between unit cost and unit yield was expected to grow in 2013-14 due to cost inflation (DGCA is yet to update the results).

As a rule of thumb, it is said that the airline industry in emerging economies grows at one and half or two times the country's GDP growth. If the Indian GDP goes back to double digit figures, this gap is likely to vanish. However, the airline industry in emerging economies is also sensitive to deceleration in GDP growth. The airline industry must learn "capacity discipline" to survive in the price conscious leisure travel market in India. Two class cabin (instead of three cabins) offering on international routes can reduce unit costs per seat kilometre. Many airlines have done away with the first class cabin. It's important to raise both the load factor and yield to bridge the gap between unit costs and unit revenues.

Chart 9

Unit Costs Running Above Unit Yield Since 2006

Ref DGCA

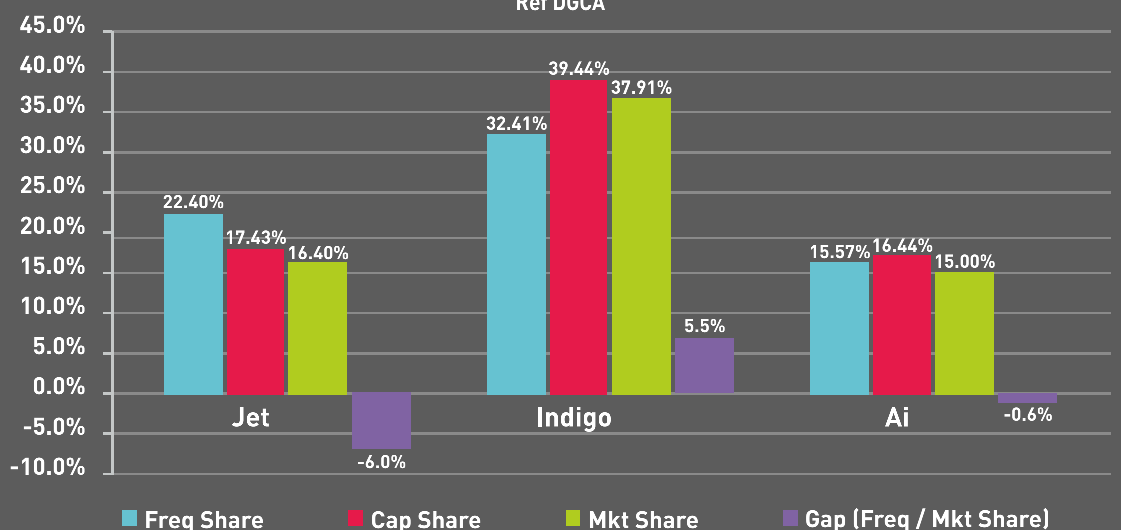


Share gap analysis:
The effectiveness of an airline's schedule and competitive pricing result in proportionate market share. An airline can have positive or negative gap between its market share and capacity / frequency share. As you can observe from Chart 10, Indigo has a 5 percent positive gap while Jet Airways has a 3.3 percent negative gap.

Chart 10

Freq Share / Cap Share / Mkt Share Jan-Dec 2015

Ref DGCA



Benchmarking with global peers on cost competitiveness:
The Cost per Available Seat Kilometre (CASKM) for airlines in India shows that Air India has 65 percent higher costs than Indigo. The national airline's high costs are due to low aircraft utilization, high overhead costs or non-fuel operating costs. Other industries in India have moved to low cost production through import substitution, innovation or reduction of wastage in the production process. India's airlines need to show similar innovation to reduce unit costs (Chart 11B).

Chart 11A

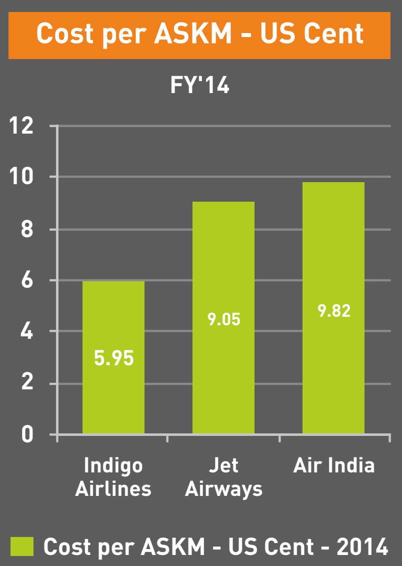
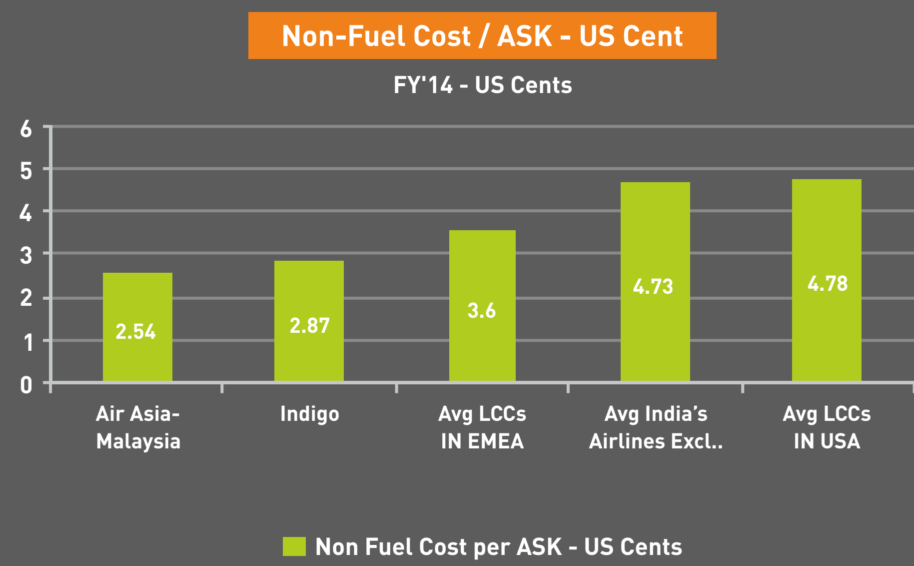
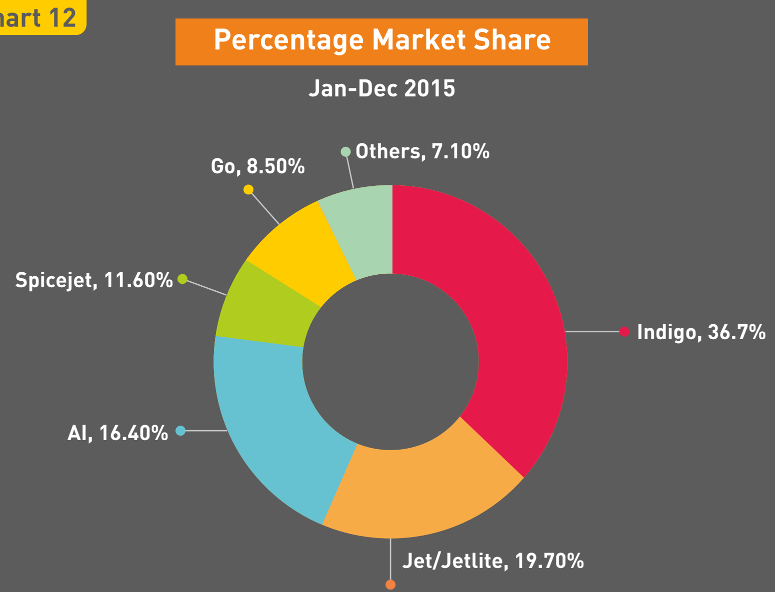


Chart 11B



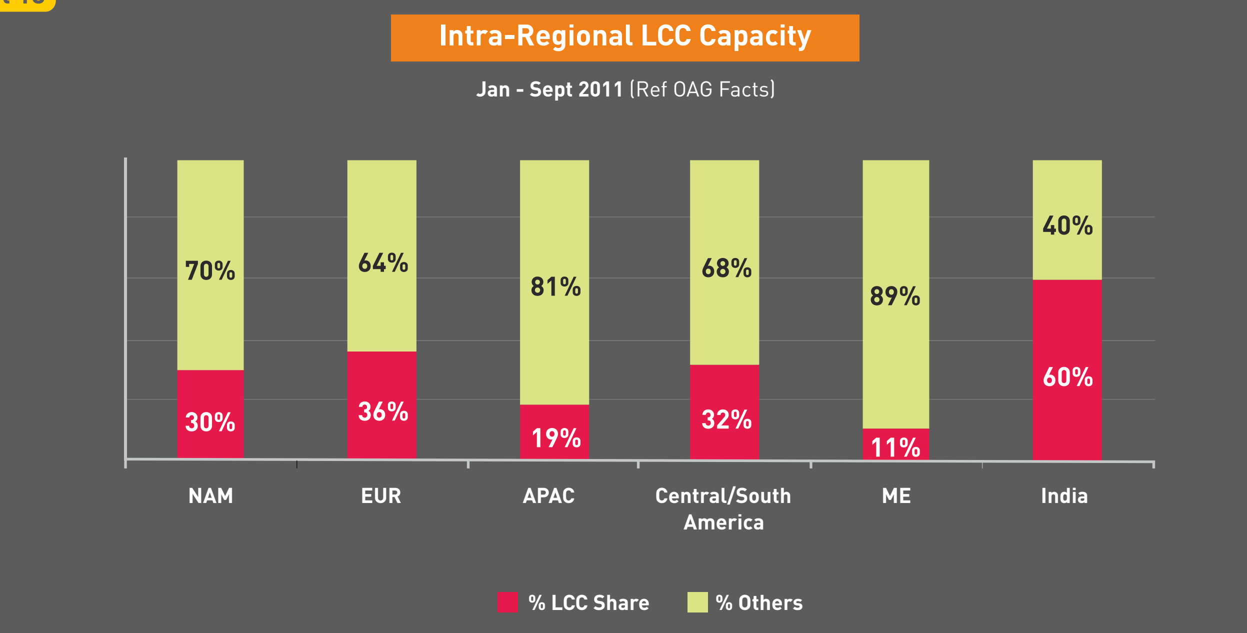
Challenges from LCCs:
LCCs now account for the majority market share of the Indian domestic air market as seen in Chart 12 with 63 percent share. No other region in the world has such dominance of LCCs.

Chart 12



The success of Indigo Airlines, the largest airline in India by market share (37.5 percent Jan-Jun 2015), has demonstrated that it is possible for LCCs to combine profitability with growth. Full service airlines are unable to get any price premium in economy cabin in the Indian domestic market. Full service airlines such as Jetlite, are now adopting the LCC business model like single class economy cabin.

Chart 13



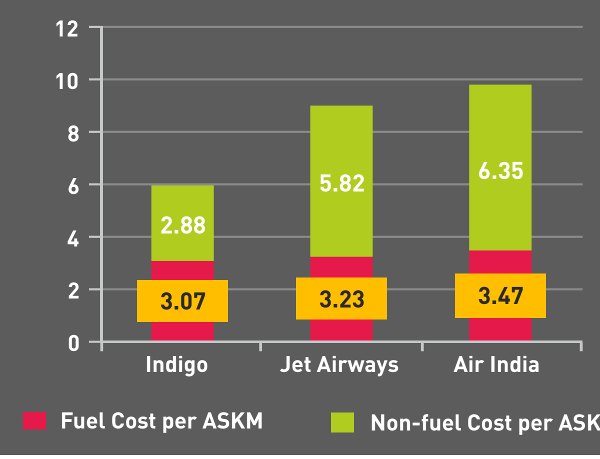
A lean business model:
The operating costs per unit of capacity have two components - fuel costs and non-fuel costs. Fuel costs are usually considered as the most inelastic part of airline costs and are in the range of 30-50 percent of total costs, depending on the business model of the airline.

Airlines that have successfully squeezed their non-fuel operating costs tend to have a higher percentage of fuel costs and a lower percentage of non-fuel operating costs. This trend is visible in airlines that have tied up with an IT or Business Process Management (BPM) partner at an offshore location.

As shown in Chart 14 A and 14 B Indigo's unit costs are lower than industry standards by 35-40 percent. In addition, its non-fuel operating costs are 52 percent of operating costs. On the other hand, the non-fuel operating costs of Air India and Jet Airways are pegged at 65 percent of their operating costs. LCCs with lean business models have lower overhead costs. They have achieved this by making strategic decisions of simplifying their business model. Over the

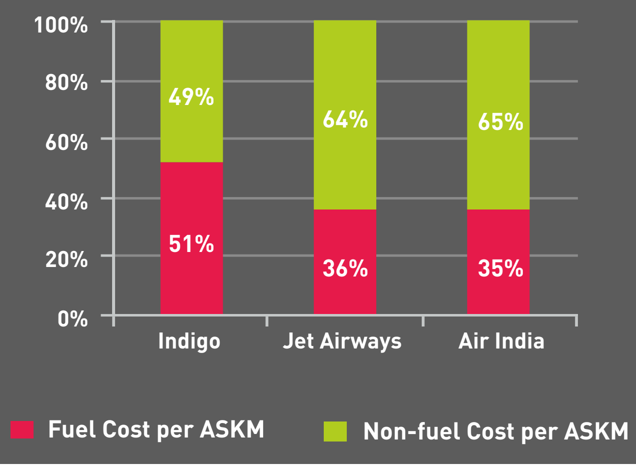
Chart 14A

Cost Breakup - FY 2014



Percentage Cost Breakup

Chart 14B



years, these steps can transform a traditional airline into a lean business with much lower non-fuel operating costs.

Stiff international competition: Post liberalization, Indian carriers had an opportunity to exploit bilateral entitlements of foreign airlines to expand operations internationally. However, airlines from richer economies with a stable currency and government support are much better placed to take advantage of increased bilaterals. They have resources to sustain operations in lean cycles, funnelling traffic from South Asia through their domestic hub. Huge subsidies from their government, surplus balance sheets built over the years, massive fleet strengths and membership of global airline alliances have worked in their favor. All this has enabled them to develop a wider base of international frequent travellers. International travellers now have better connectivity due to increased frequency of airlines like Lufthansa, Singapore Airlines and Emirates out of India. As a result, India's international airline market doubled from 20 million in 2004-2005 to 43.1 million in 2013-14. Airlines in India could add only

Chart 15A

International Market Share Analysis - CAGR 10 Percent

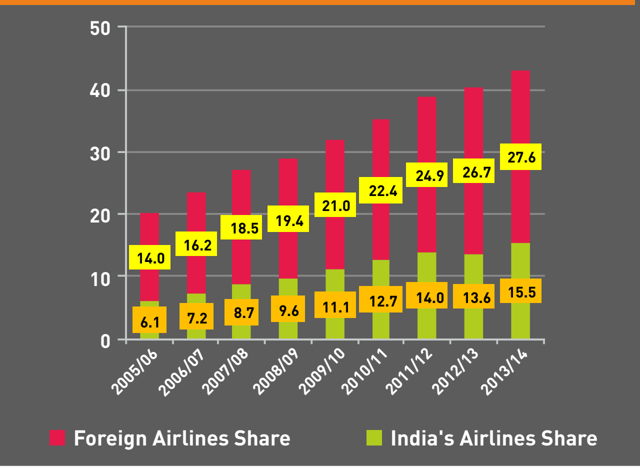
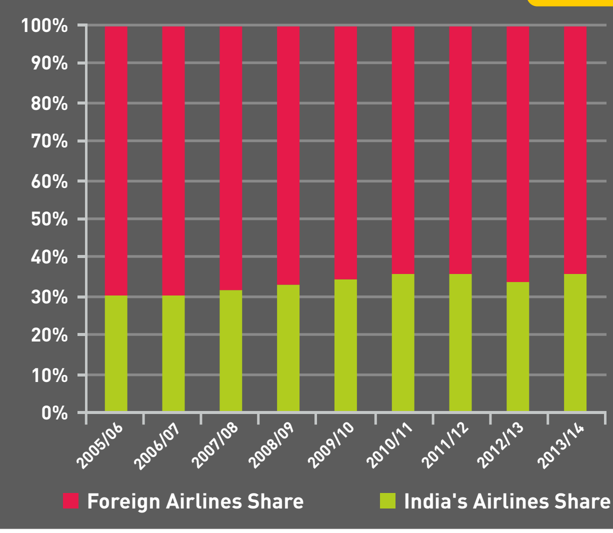


Chart 15B



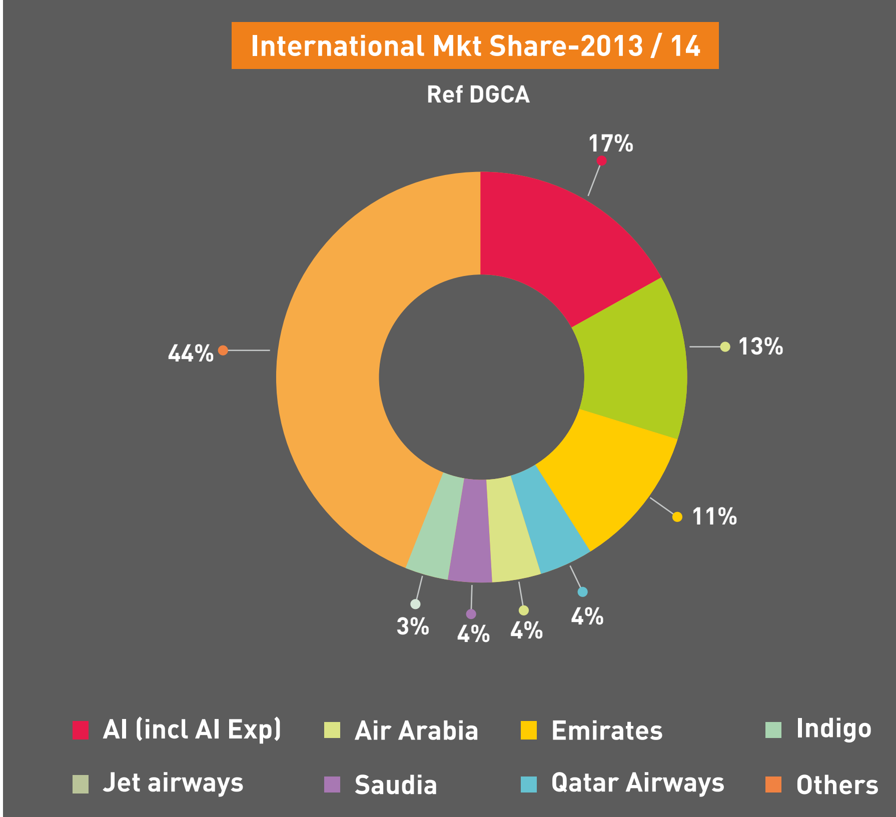
9.1 million incremental international passengers during this time.

The combined international market share of Indian airlines has stagnated at 30-35 percent over the past five years, even though the market has grown at 13.3 percent per annum.
(Refer Chart 15A and 15B)

The international air market has had a CAGR of 10 percent since 2005-2006. This increase is in step with increases in bilateral entitlements that have been granted by the Indian government. More airlines from ME and Europe are knocking at the Indian civil aviation ministry's doors asking for further increase in bilateral entitlements. These airlines want to use their home base to offer 'sixth freedom connections' to USA and Europe. Sixth freedom is an aviation term for routing passengers to a foreign airline's home base and then offer transfer connections. Beneficiaries of this development are Indian expats who now have a wide choice of direct flights to India from different parts of the world. With the Jet-Etihad deal, the airline will become India's largest international carrier surpassing Emirates and Air India in the near future.

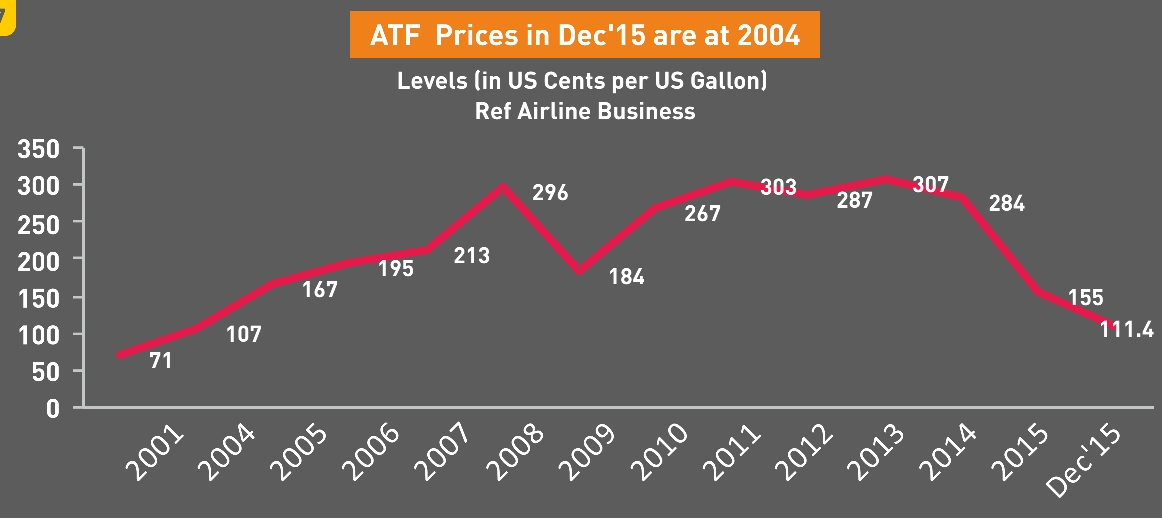
India's airlines need to explore global alliances through code shares / joint operations to take on the international market.

Chart 16



Declining fuel prices:
International ATF prices have fluctuated along with the ups and downs of the global economy. In 2014-2015, ATF prices went below the 2009 levels when an economic slowdown had plummeted rates. ATF prices in India are indexed to global oil prices in US dollar, plus there are state sales taxes of 10-15 percent and exchange rate between US dollar and Indian rupee to be considered. Depreciation of the Indian rupee against the US dollar raises the cost of ATF in India, in addition to other costs (Chart 17).

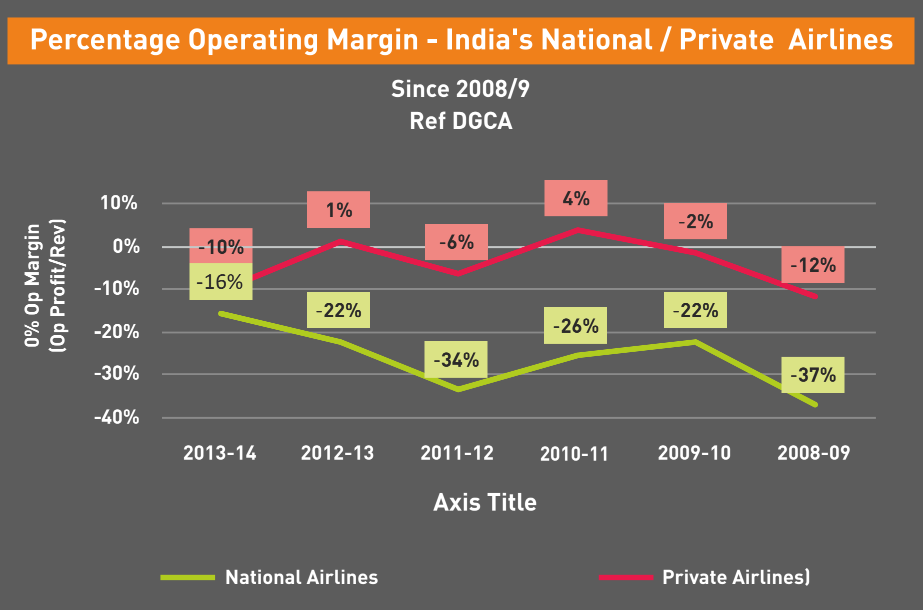
Chart 17



Stability of the Indian currency: As 60 percent of an airline's operating costs (forex loans, lease rentals, allowances, ATF and handling charges) are indexed to the US dollar, depreciation of the Indian rupee results in cost escalation. Due to a slowing economy in 2012-2013, airlines were not able to pass on the additional burden to the consumer. State taxes on ATF for domestic flights are a contentious issue. IATA rules do not allow local sales tax to be levied on international flights; however, state governments charge sales tax on ATF for domestic flights.

Airlines in Asia Pacific (APAC) are the most profitable with the highest operating profits in absolute numbers. APAC airlines had combined operating profits of USD 8.1 Billion in 2012, with the highest (4 percent) operating margin among the world's airlines. The exception is airlines from the Indian subcontinent, which are operating at a record negative operating margin of 15 percent since the past five years.

Chart 18



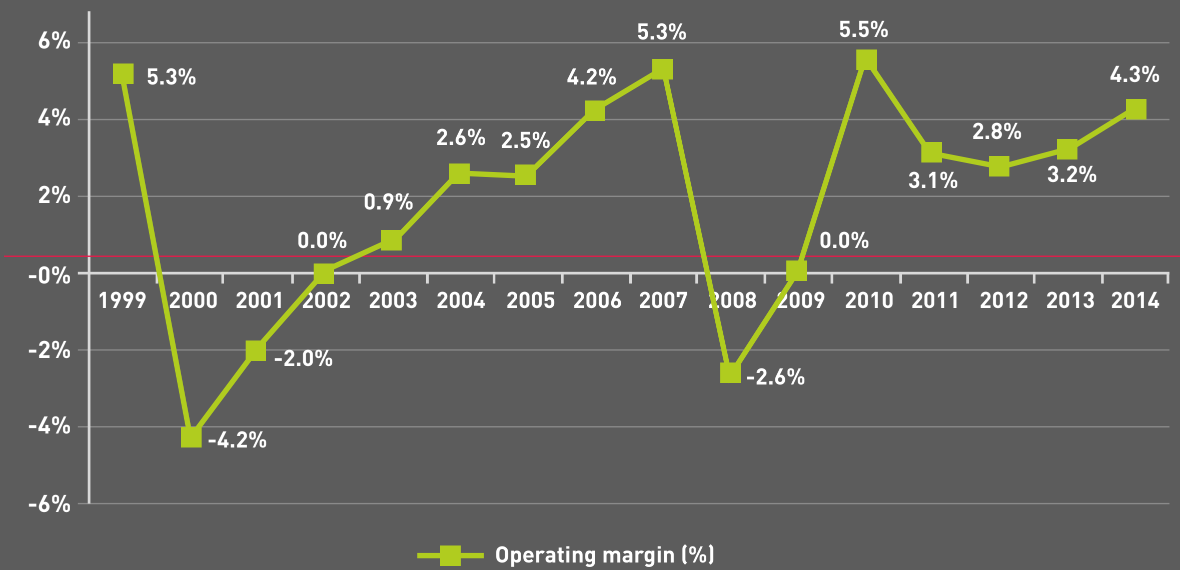
Global cycles, local challenges: The airline industry follows a cyclical growth pattern (as seen in Chart 19) and is a barometer of the performance of the world economy.

Indian airline companies can mitigate the problem of ATF price fluctuation with fuel hedging.

In addition, airlines in India must address overcapacity issues by simply grounding aircrafts. They can explore offering their aircraft on dry / wet lease charters to foreign airlines for short term holiday / Haj charters.

Chart 19

Top 150 Airlines in Profitable Phase Since 2009



What Does the Future Hold for the Indian Airline Industry?

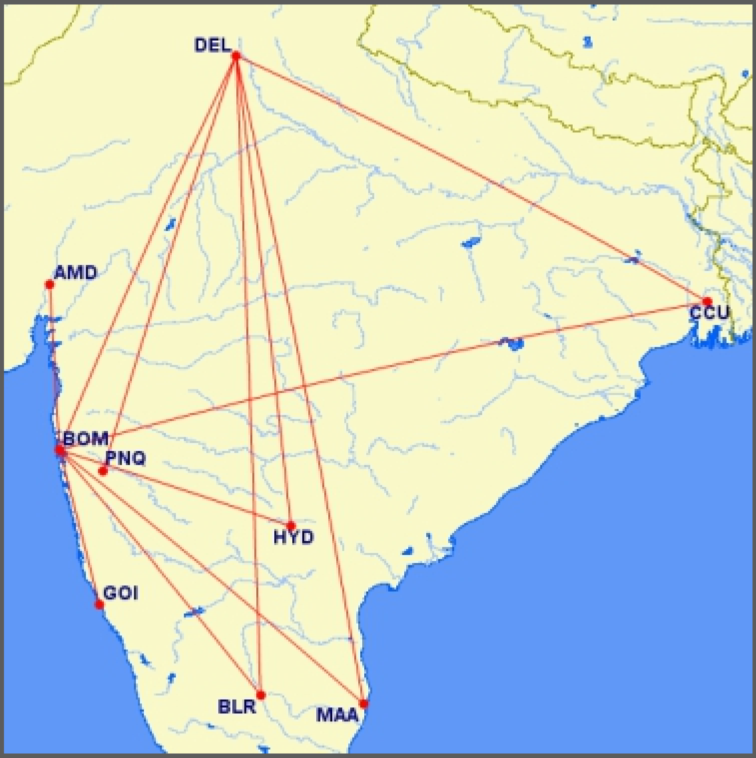
The future of India's national carrier: Air India has been relegated to the fourth position in the domestic market and may soon be demoted to a third position in the international market among Indian carriers. Though Air India's yields and load factors have improved after the grounding of Kingfisher, they are way below the international benchmark of 80 percent. As the government grants liberal increases in bilateral entitlements for foreign airlines, Air India's international carriage is bound to go down. On the domestic front, the entry of new airlines may trigger a price war. By joining Star Alliance in July 2014, Air India now offers frequent flyers of other Star Airlines partners to redeem their miles on Air India. However, it is not likely yet to be a game changer for the airline unless its schedules are fully integrated with at least one dominant alliance partner. Air India has sought Rs. 30,231 Crore from the government as equity infusion to help the company acquire a new fleet of Boeing 787s. Air India is hoping that the fuel efficient 787 will contribute in the turning around of the beleaguered national carrier.

Jet-Etihad partnership - A watershed deal for industry: Until last year, foreign airlines were prohibited from investing in India's scheduled airline sector. Relaxation in this investment norm in September 2012 helped Jet Airways to raise fresh capital of USD 600 Million from Etihad. With the sale of 24 percent equity, Jet can retire part of its USD 2.4 Billion debt. This is a watershed deal for the industry. In India, bank loans have a high interest cost, and foreign exchange loans have a low interest rate but are fraught with exchange risks due to a weak Indian currency.

This deal demonstrates that in global capital markets, it is possible for India's airlines to raise private equity money at a low cost. More airlines like Indigo are likely to follow this trail.

Top 10 domestic O&Ds in India: The domestic market in India is concentrated around the metro cities of Mumbai, Delhi, Bangalore, Chennai, Hyderabad, Ahmedabad, Kolkata and Pune. Any large airline will have to focus on the key top 10 Origins and Destinations (O&Ds), while smaller airlines can work on a niche schedule that brings travellers into the metro cities from tier 2 cities in the vicinity.

Chart 20



Survival of the fittest: Since the de-regulation of civil aviation, India's airlines have built an enviable fleet, set up new airports and built a large talent pool of young and trained human resources. Huge capital outlays as well as large human capital are locked in India's aviation sector. The airline industry has a strategic role in an emerging economy like India. Only those airlines that manage to cut operating costs and conserve cash will survive the current decade and run profitable operations.

The industry must take the example of indigenous innovations in other sectors to turn the tide in its favor. It can also hugely benefit from cost arbitrage through an outsourcing partner in India.

Emerge as a champion in South Asia: India's air traffic market in the next 10 years will double to 120 million domestic and 80 million international travellers, if the Indian economy grows at a modest 5-7 percent. Due to its large geographical spread, India cannot have a single city as its international hub. Each of the metro cities of Mumbai, Delhi, Bangalore, Chennai, Kolkata and Hyderabad has the potential to emerge as O&D hubs for international destinations. They can also funnel traffic from / to SAARC countries to the ME, Europe and USA. India is at the center of the SAARC region. India's airlines have bases strategically located between growing regions of the ME and Africa in the west, and South-East Asia and APAC in the east. SAARC nations with their dense populations and a large diaspora in the ME and Europe also present favorable conditions for India's airlines. As seen in Chart 21, Indian metros are only short flights away from the SAARC countries. India's airlines can exert influence on its neighbors as the undisputed political, economic giant to open up these air routes further, and later extend them to the ASEAN region. The absence of a strong national airline in SAARC countries also works in India's favor. Indian airlines must rise to the occasion and take their rightful place on the world stage.

Chart 21

Conclusion

The industry has to set realistic goals of achieving modest growth with profitability. The need of the hour is a business model that helps in keeping overheads in the form of non-fuel operating costs down. They need to raise private equity to reduce the cost of capital.

> **They need to offer value added IT-BPM services for the entire aviation value chain by using the wide pool of skilled, English speaking resources in India.**

The airline industry, which typically operates on very thin operating margins (2-3 percent), must be run as an efficient business to survive. Airlines need to recover more than just cash expenses to sustain flight operations. Effective alliance strategies help in meeting capacity discipline or to take 'make or buy' decisions such as to withdraw from a route and operate a code share flight with an alliance partner) like any manufacturing or supply chain company. Airline top management must be singularly focused on achieving profitability while maintaining modest growth, and maintaining high standards of safety, punctuality and customer satisfaction levels. They need to create an enlightened work force of pilots and engineers who have a holistic view of the industry. They need to identify and eliminate costs that add little value to a passenger. They must rationalize decisions regarding buying new planes, adding new capacity and increasing frequencies. These strategies should be part of an airline's must-do list if it wants to turn growth into profitability in the near future. This will truly be a new flight plan to transform India's airlines into global, profitable entities.

Notes

1. * Government of India's 5/20 rule mandates that an airline has to operate in Indian domestic skies for minimum five years and should have a fleet of 20 aircraft for the airline to operate flights to foreign countries.

2. References: Directorate General of Civil Aviation (DGCA), Airline Business, Official Airline Guide (OAG), SAP

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WNS (Holdings) Limited (NYSE: WNS) is a leading global Business Process Management (BPM) company. WNS offers business value to 200+ global clients by combining operational excellence with deep domain expertise in key industry verticals, including banking and financial services, consulting and professional services, healthcare, insurance, manufacturing, media and entertainment, retail and consumer packaged goods, telecommunications and diversified businesses, shipping and logistics, travel and leisure, and utilities and energy. WNS delivers an entire spectrum of business process management services such as customer care, finance and accounting, human resource solutions, research and analytics, technology solutions, and industry-specific back-office and front-office processes. WNS has delivery centers world-wide, including China, Costa Rica, India, the Philippines, Poland, Romania, South Africa, Sri Lanka, UK and US.

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