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Rescue Operation in the Air: A Case of Air India

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ABSTRACT

Air India (AI), the public sector company, which had its beginning sixty five years ago, is involved in divestment process. It was beset with operational inefficiency and has been making losses for the last many years, with an accumulated loss of Rs. 46,256 crores between April 2010 to December 2017. To keep the airline in running condition, the government invested Rs. 26, 545 crores into the airline since April 2011. Finally, the government has decided to divest 76% stake in the company. A 100% stake is offered in its subsidiary Air India Express and a 50% stake on the branch which is handling ground operations. Its other subsidiaries- Alliance Air, Hotel Corporation of India, Air India Air Transport Services and Air India Engineering Services, are not offered for sale and would be transferred to a special purpose entity (SPV). Apart from financial re-structuring, focus has also shifted to organizational and managerial re-structuring too. For prospective buyers, the strengths of AI which could have attracted them to buy were its bilateral flying rights, lucrative international destinations, large fleet of wide bodied and narrow-bodied aircraft and a large customer base. However, these were offset by the huge debt burden and the large employee base. The government could not attract a single potential bidder for the company. The government was in a dilemma. It had to put on hold the divestment process. The future is bleak, whether the government will be able to revive the ailing airline remains to be seen. The objective of the case is to identify the reasons for divestment and the structure of divesting an enterprise. Also, to identify the financial, HR, operational and marketing implications of the process of divestment.

Keywords: Divestment, Financial Restructuring, Debt Burden, Air India, Public Sector Undertaking

INTRODUCTION

Air India (AI), the public sector company, which had its beginning in the year 1932 (as Tata Airlines) and grew into an international airline owned by the Indian Government (nationalized in 1953), is today involved in divestment process. The decision has been taken. AI has made multiple efforts to revive the ailing airline. It had been making losses for many years. The accumulated loss is estimated to be Rs. 46,256 crores between April 2010 to December 2017. The company also has a working capital loan (taken from banks) at Rs. 31,088 crores as on March 31, 2017. To keep the airline in running condition the government invested Rs. 26,545

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crores into the airline since April 2011. There are many who are of the opinion that Air India should remain with the government, that is, it be government owned. However, the government has finally decided to divest 76% stake in the company. A 100% stake is offered in its subsidiary Air India Express and a 50% stake is on offer in the branch that is handling the ground operations. Its other subsidiaries like Alliance Air, Hotel Corporation of India, Air India Air Transport Services and Air India Engineering Services are not offered for sale yet; but is expected that they would be transferred to a special purpose entity (Special Purpose Vehicle (SPV)) along with a third of AI's Rs. 48,781 crores of outstanding debt.

The Government had initially planned to give away 76% equity capital of the national airline and also transfer the management control to private players. The buyer was also required to take the Rs. 24,000 crores of debt and also the Rs. 8,000 crores of liabilities. However, it failed to attract any bidder when the bidding process completed on 31st May 2018.

Of late in August 2018, the government had received consent of Parliament for the infusion of Rs 980 crore of equity funds in Air India for a purpose of initiating a turnaround of the airline. The Parliament also approved a further Rs. 2,345 crore equity infusion into the airline. These were all steps taken to revive the airline.

Of late, a ministerial panel has already cleared the sale of Air India's ground handling subsidiary, Air India Air Transport Services. Now it also plans to sell another subsidiary, that is, Air India Engineering Services. And the proceeds from the sale of subsidiaries and land and building assets is expected to go to the SPV and is planned to be utilised towards lowering the debt burden of the airline.

However, as of now, the government has postponed the sale of Air India.
The question arises as to why the government is indecisive with respect to sale of Air India when it already has huge debts (historical debts) of around Rs. 50,000 crore (approximately); which continues to increase every year lowering further its standing in the industry.

WHY DIVEST AIR INDIA?

Air India has huge debts and it is increasing day by day. Therefore, it was a wise decision to divest it. In the words of Director Finance, Air India, Vinod Hejamadi, "The government has put on hold, not given up on Air India divestment". He further added that it had done so as market conditions were not conducive at that point in time. Therefore, the government has not given up plans for privatization of Air India but it has been kept on hold.

"There are mixed feelings among employees. Of course, everyone will like it to be government-owned but people also realise that the airline cannot be with the government forever," Hejamadi said.

There are many who would prefer the airline to remain with the government. There is opposition particularly from its employees. Eleven unions[1] of Air India which represent over ten thousand employees started a "Save Air India" campaign on social media.

However, Director-Finance, Air India, defends the government's decision for sale. According to him, the Indian Government's plan to sell 76% stake of Air India has terms and conditions laid down wherein it protects the interests of the employees. The terms and conditions guarantee that the permanent employees of the airline would be retained for a minimum period of one year. After one year the employees could be offered voluntary retirement scheme (VRS).

FINANCIAL TURNAROUND

The Director Finance, Air India further added that the government's decision to give off the airline to a special purpose vehicle would help Air India save around Rs 3,000 crore which would enable it to turn around financially. He also explained in detail the steps taken by the airline to improve its operations and financial performance. He said that almost $100 million had been invested in the engineering department which has helped it to add fourteen (14) aircrafts into the fleet. He added that the airline was also hopeful of ensuring that its aircraft would able to be flown for more hours than they are flying at currently.

WOULD AI GET A SUITOR?

The question arises-Would Air India get a suitor? That would depend on a number of factors.
High Debt: With so much debt burden, would there be any prospective buyer? The debt burden is estimated to be of Rs. 53,000 crores. It plans to transfer about Rs. 33,000 crores from the total debt of the airline into a special purpose vehicle (SPV). And the remaining debt which was against aircraft purchases would remain in the company's books. Despite Air India having many positive aspects, its large debt is a burden and a great hindrance for its sale to take place. Further there have been losses too. And many reasons were quoted for its losses.

In 2016-17, a high interest costs led to the company bearing a loss of Rs. 5,765 crores. Operational inefficiencies and poor management also contributed to its losses. These include a very high turnaround time, repeated cancellations of flights, delays by the cabin crew and also poor fleet planning. It was estimated that out of its 370 daily flights, only nine were assessed to be profitable, and of these, six were on domestic routes, and the remaining three were overseas. Of the 20 A320s in Air India's total fleet of 103 aircrafts, six were in service in the last 26 years and seven were in service since 21 years. To have an ideal situation, these aircrafts should have been written off. Therefore, the company experienced high maintenance cost due to high average age of fleet.

Culture: Poor culture of the organization was also a negative feature of the company. It was quoted that there was indiscipline and complacency was rampant among employees. Also, there existed high turnaround time which led to delaying of aircraft flying to subsequent connections. All this led to poor customer experience, decrease of customer satisfaction and goodwill.

Also, there were many other airlines operating in the domestic market with Air India having only a small share of the pie. (See Exhibit-1 for market share). And, it was expected that, prospective investors would also look for many other finer details to ascertain the real worth of the national carrier.

Employee Base: There were other issues too. Its large employee base was one grave concern. The employee base was said to be as high as 18,834. (Air India EoI Document, DGCA) (See Exhibit 2)

WHAT CAN ATTRACT INVESTORS AND WHO CAN BUY?

From a customer's perspective, buying AI could be a wise decision as the domestic air traffic was growing fast. The passenger carried by the domestic airlines during January 2018 was 114.64 lakhs while in January 2017 it was 95.79 lakhs which indicated a 19.69 percent growth. The major attractions for any investor for buying AI were the lucrative international routes, AI's bilateral flying rights, the large customer base which was said to be as high as 23 million, highly trained staff, and also its large fleet of aircrafts which were both wide bodied and also narrow planes.

The prospective investors on the anvil were the domestic carrier Indigo. It had a market share of 42.5% and with the buying of AI (with AI having 12.2% market share) its market share was expected to increase to 54.7%. (See Exhibit-1) Indigo would then emerge a formidable force to reckon with. The Tata Sons and Singapore Airline joint venture Vistara had also shown inclination in buying AI.

There were also some international airlines who had shown interest in taking Air India. Qatar Airways was a bidder. Further, Turkey's Celebi Holding, Bird Group, Menzies Aviation Plc and Livewel Aviation Services Pvt. Ltd were quoted to have shown interest in buying AI subsidiaries.

WOULD PRIVITISATION BENEFIT THE AIRLINE?

The major benefit expected was that the airline would become financially viable. It would no longer consume the tax payers' valuable funds. Huge amount of money had been infused to keep it operating and in running condition but with no improvement in its performance; however, the private player could bring some change. The company which was otherwise overmanned (overstaffed) would also cut down on its employees and thus create a more rational workforce. It was expected that a private player would be more careful about the way it would utilize its funds (rationalize the funding) and also the workforce. It was expected that the Government would start the process of sale of AI in the last quarter of 2019 and would also work towards selling its subsidiaries and monetize its assets.

WHAT IS EXPECTED?

A very comprehensive financial package was planned, which would include the transfer of non-core debts and assets to a SPV. Implementation of reforms in the governance system and organization system; and maybe introduction of differentiated business strategies were on the cards. A deep focus on managerial issues was also to be introduced.

The government could not attract a single potential bidder for the company. The government was in a dilemma. It had to put on hold the divestment process. The future seemed bleak, whether the government would be able to revive the ailing airline remained to be seen. However, the scenario has changed.

CHANGING SCENARIO

There were many changes in the airline industry. The major changes were:

Jet Airways Operations Wound-up: So far Air India which was in search of an investor had no success. But with Jet Airways having closed operations, which was a major competitor in full service carriers (FSCs), in both domestic and international arena, the future of Air India seems to be bright. AI faced stiff competition from Jet Airways in the international space. But with its closure, AI would get the international slots of Jet Airways and thereby become more attractive to investors. AI would dominate the international space. Currently it flies to forty one (41) international destinations and fifty-four (54) domestic destinations.

AI has also been given many of the flying slots in the domestic space which were freed by Jet Airways and also for its low-cost carriers like Air India Express and Alliance Air.

Reduced Debt Burden: The government's initiative to reduce the debt burden is encouraging for the bidders. The government has plans to reduce the debt burden the airline is trapped in which was acting as a major deterrent for investors. Rs. 29,464 crores of rupees of its working capital debt which was not secured by an asset would be transferred to a new company, Air India Asset Holding. The company would then have a debt burden of only Rs. 25,000 crore which would include mostly long term debt secured by aircraft purchases. This would also reduce its outgoing interest to Rs. 1,700 crores a year.

Efforts to make Air India operationally viable: The Government plans to make AI operationally viable before divesting it. In the words of the Civil Aviation Minister, Hardeep Singh Puri, “Our plan is to revive Air India, make it more operationally viable and then to divest it. So far as Air India is concerned, the government is committed to the privatization of Air India. Let there be no ambiguity on that”. He further added that currently the company was making revenue and was expected to make profits during the current financial year. In his words, “There has been a steady improvement in Air India’s finances. It has been my expectations that in the current financial year, we are hoping to make profit”. He stressed on this fact that its position was improving. He added, “Our expectation is that in the coming months, in the current year, we will make a profit and turn Air India around and then privatise the airline”. “It is customary for situations like this for employees and stakeholders in the process to put pressure on the government. We have increased the Air India profitability by 7 crore revenue per day. We are doing all that we can”.

AI’s Valuable Assets: Though the company has a huge debt of Rs. 53,000 crores, it would retire Rs. 33,000 crores into a SPV. In the words of Puri, “Now when Air India’s alternative mechanism is established, we will take a view on these. After all, Air India is a viable airline and it has some prized assets and when we go for divestment, we will also take care of this. But, the press report was motivated in order to put pressure on the government not to divest Air India”.

Further, it was noted that Air India has some very valuable assets which could fetch a high market price. The head-quarters at Nariman Point in Bombay was an example and during the process of divestment these would not be overlooked.

Its fleet of aircrafts was also a valuable asset. AI owns fifty-five percent of its aircrafts. The investor could have the option to monetize these assets by selling the aircraft to pay off part of the heavy debt. Currently it has a fleet of 163 aircrafts.

Liberalisation of terms and conditions of sale: The government has also liberalised the terms and conditions of sale. It was believed that AI could get a bidder as it was retaining a 24% stake; but, now chances are that it could sell 100% of the airline. After the failed attempt to divest in 2018, the government has decided to liberalise the terms and conditions of sale. If not the entire 100 percent, 95 percent would be for sale retaining 5 percent for the employee stock option. It would also allow a buyer to sell the airline immediately after acquiring it, that is, enable merger or a reverse merger of Air India with any existing business of the bidder.

The Air India Specific Alternative Mechanism (AISAM)[2] was reconstituted with F M Nirmala Sitharaman and Civil Aviation Minister, Hardeep Singh Puri on board who have again initiated the divestment process.

The government invited bids to sell 76% stake in Air India along with transfer of management control. However, it did not attract any bidder. The transaction advisor EY prepared a report citing probable reasons that led to the failure of the sale process; government retaining a 24 percent stake and corresponding rights and its high debt, being the prominent two. As the government by now has taken action on these, would the future be all set for sale of Air India? It remains to be seen.

There have been successful turnarounds in the airline industry in the past. Examples are in plenty. British Airways is a prominent example. Lessons can be learnt and models can be replicated. What is the modus operandi of AI remains to be seen?

QUESTIONS FOR DISCUSSION

1. Identify the problems faced by Air India? How can such problems be resolved?
2. What do you mean by divestment strategy? What are reasons for divestment? What are the approaches to divestment? Discuss in depth.
3. What are the reasons for divestment of Air India? According to some AI should remain government owned? Do you agree? Give reasons in support of your answer.
4. Discuss the measures taken by government for divestment process? In your opinion, are these adequate for dealing with problem faced?
5. Identify the financial, human resources, operational and marketing implications of the process of divestment.
6. What lessons do we learn from the case?

ENDNOTES

[1] There are many unions of AI. They are: Air Corporation Employees Union, Air India Employees Union, Indian Airlines Technicians Association, Indian Commercial Pilots Association, Air India Aircraft Engineers Association, Air India Cabin Crew Association, Air India Engineers Association and Aviation Industry Employees Guild.

[2]Air India Specific Alternative Mechanism (AISAM), basically constituting of a Group of Ministers was formed in 2017 and was given responsibility of giving approval for the divestment process.

EXHIBITS

Exhibit-1: Market Share of Airlines

Airlines	Mkt Sh*	Mkt Sh**
Indigo	42.5%	43.2%
Air India	12.2%	12.4%
Spice Jet	13.3%	12.3%
Jet Airways	11.9%	12.2%
Go Air	08.7%	08.8%
Air Asia	05.3%	05.3%
Vistara	03.8%	03.8

*As of Dec 2017, **As of Dec 2018

Source: www.economictimes.indiatimes.com

Exhibit 2: Employees Base of Air India

Kind of Employee	Number
Executive (AGM ad Above)	
Pilots	194
Engineers	001
Flight Operations Officers	055
General Category Officers	482
Officers (AM to Senior Manager and Above	
Cabin Crew Officers	**851**
Flight Operations Officers	**136**
General Category Officers	**3591**
Workmen (AM to Senior Manager and Above	
Line Pilots	**1642**

Cabin Crew	**3085**
Technicians	**57**
Clerical/Unskilled	**6504**
Foreign Clerical/Unskilled	**236**
Grand Total*	**16834**

*Excludes 2658 employees on deputation from AASL, AIATSL, and AIXL. However the figures include 3 employees on deputation from the government

Source: Air India EoI Documen, DGCA; Air India EoI Documen, DGCA)

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