Public Private Participation - A Viable Option for Air India

Jose Augustine
Associate Professor, Head, Dept. of Economics, Vivek College Commerce Goregaon, (West)Mumbai-62, Maharashtra, India.

Abstract

Air India, an airline in the public sector is continuously incurring losses for the last many years. The government of India, through its budget allocations had been financing its operations. Despite the various measures taken from time to time, there has not been any sign of recovery. Privatisation through disinvestment was suggested as a solution. However it has been rejected by the government on various grounds. Moreover, there is no reason to believe that this method is going to work for Air India. The capital market in India is witnessing an erosion of faith by investors, both domestic and foreign. This is truer of the Airline industry. Privatisation through other routes also has not found favour with the stakeholders. The study, therefore, suggests an alternative of public private participation for Air India. Under this the state can continue to be the owner but at the same time private sector money can be used to operate it. Two or three strategic partners with greater autonomy to run the management supported by helpful policy decisions by government can make this option viable. Many infrastructural industries in India and abroad have already adopted the path of public and private participation and found it to be successful.

KEYWORDS: Airline industry, disinvestment, privatization, Air India.

Introduction

The state of affairs with the airlines in India, especially the Air India, needs immediate attention of all the people concerned. The basic problem is that of lack of finance which is due to the continuous loss they have incurred. The major Airlines presently facing financial crisis are Air India and Kingfisher Airlines the former a public sector enterprise and the latter a private sector business. While the problems of the Kingfisher Airlines is of recent origin and due to mismanagement, the problem with the Air India is long standing and of more serious nature considering that the burden is faced by the country on the whole.

The two solutions suggested in the literature to bring a public sector company out of the red are privatization and disinvestment both with its own merits and demerits. Mine is an attempt to find out the possibility of a third option, that of public private participation that has been successfully tried and tested in many countries. The method of public private participation is different from privatization. Privatization is done through disinvestment or otherwise, partially or fully of the ownership of an enterprise. On the other hand, public private participation is a strategic partnership arrangement of a public entity with one or more private sector companies.

It is beyond any logic or business sense that the Air India which shows no chance of survival is being continuously pumped with public money. So it is imperative that a more acceptable option be considered, that of public private participation. There are cases where a similar exercise has helped other airlines to turn the corner. The discussion will therefore include the experience of one such Airline, the Kenyan Airways

" Public Private Partnership means an arrangement between a government / statutory entity / government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or public services, through investments being made and/or management being undertaken by the private sector entity, for a specified period of time, where there is well defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and pre-determined performance standards, measurable by the public entity or its representative." Draft national ppp policy 2011

The essential conditions of a public private participation (hence forth also mentioned as ppp)in the above definition are; i) it is an arrangement with private sector entity: The asset and/or service under the contractual arrangement will be provided by the Private Sector entity to the users. An entity that has a majority non-governmental ownership, i.e., 51 percent or more, is construed as a Private Sector entity. ii.)Public asset or service for public benefit: The facilities/ services being provided are traditionally provided by the Government, as a sovereign function, to the people. (Draft national ppp policy 2011)

Public–private partnership thus describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies. These schemes are sometimes referred to as PPP, P3 or P^3.

PPP involves a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project. (Wikipedia encyclopedia)

Statement of the problem

At the time of setting up Indian Airlines and Air India, it was the intention of the Government of India to keep a monopoly control over internal and international air service. So the entry of private companies into the Airlines sector was prohibited. With the help of the monopoly position and the special privileges it had enjoyed these airlines started earning huge profits. Till 1992-93, Air India was a successful profit-making public enterprise. However this did not last long.

The post liberalization era witnessed many policy changes in the field of civil aviation. The monopoly position of Indian Airlines was given up and new private airlines were permitted to operate. The air services within India became competitive and therefore, more efficient. However, the flag carrier of the country failed to adapt to the new environment.

In the last two decades they have been plagued by many ailments. The industrial relations and man management had been poor. Numerous strikes have reduced the operational efficiency and financial performance of both the airlines. Vayudoot which was set up to run feeder air services had also been running on losses. In the meantime in 1990, the government introduced the scheme of air taxi service by private sector. Indian and non-resident Indians, or even public sectors undertakings could apply for an air taxi operator's permit.

Air India has been financially bankrupt for several years. As a private company it would have been closed long ago. Its continued operation with access to virtually unlimited amounts of public resources is a source of major distortions in the industry and can effectively prevent any Indian airlines company from becoming globally competitive.

The government of India had given up its policy of privatizing Indian Airlines and Air India mainly due to political reason s than economic. Instead, it is going in a big way to expand the merged entity Air India and improve its efficiency

Objectives of the study

- To study the present condition of the airlines industry.
- Evaluate the feasibility of introduction of private participation.
- Suggest solutions to the problem of the study

Scope of the study

The study will include a brief analysis of the present condition of Air India. As it is a study concentrating on the financial aspects of the public sector airline industry, the problems faced by it will be covered.
The most feasible way out for the perennially lose making airlines is private public participation. This will be substantiated by explaining the limitations of the other alternatives and the advantages of this option, a brief discussion of the Kenyan Airline will be done to support the argument for private public participation.

Methodology

The study will be based primarily on secondary data. The data will be collected from books, various publications, magazines news paper reports and annual reports and balance sheets of the airlines

Findings

There has been a strong argument in favour of disinvestment in Air India. Such a step has many advantages. Introduction of private ownership will bring in such positive developments like accountability, improvement in efficiency, better management, reduced influence of trade unions, influx of more capital both from within the country

and from without etc. However the problem with disinvestment is that there would be no demand for its stocks as it has been long known as a terminally ill enterprise.

An analysis of the trends in the share prices of the three listed airlines- Jet Airways, Kingfisher Airlines and Spice Jet — shows that out of the three, two airlines, Jet Airways and Spice Jet which had succeeded in earning some profit or minimizing the quarterly losses have seen a reasonable stability in the price of their stocks. The Jet Airways` share prices varied only narrowly between Rs.380 and Rs 369 in the last one year ending August2012. During the same period the price of Spice Jet stocks varied between Rs.25 and Rs.34.90 ending on the higher side. However KFA the third in the list, a loss making company witnessed a substantial decline in their share prices, from Rs.27.51 in Sept 2011 to Rs. 8.63in August 2012. This clearly shows that Air India, which is in still deeper crisis, has no chance of attracting private investors.

Trends in the share price of Jet Airways, Spice Jet and Air India Sept2011 to Aug.2012

Trends in the share price of Jet Airways-Sept2011 to Aug.2012 (source: BSE)

`

Trends in the share price of Spice Jet Airways-Sept2011 to Aug.2012 (source: BSE)

Trends in the share price of Air IndiaSept2011 to Aug.2012 (source: BSE)

Another relevant observation is the decline in Foreign Institutional Investment in these three listed airlines companies. Jet Airways had seen a decline in FII stake from 5.77 per cent to 4.67 per cent in the second quarter of 2010-11. Kingfisher, also witnessed a less than one percentage point decline from 3.02 per cent to 2.11 per cent during the same period. This was but prior to the beginning of the problems with the KFA. In the case of Spice Jet, the fall is huge. The FII stake in the company fell from 10.16 per cent in the first quarter to 6.17 per cent in the second quarter in the last fiscal. These data also prove that disinvestment as a means to revive Air India is bound to fail.
Analysts say the stock of airline companies have become less lucrative because of rising operation cost and lower scope to pass it on to the consumers. “One reason for pulling out would be the trouble the aviation sector is in owing to high cost,” notes a Mumbai analyst. Thus the so called best option of privitisation through disinvestment again falls flat.

The government had been consistently following a policy of subsidization of Air India without any sense or logic. In an era where even the subsidies on essentials for the poor are objected to, there is no reason why a luxury industry should be given such a favour. The Group of Ministers formed to turn around Air India has recommended that the government should infuse equity of Rs 23,000 crores into the ailing national carrier by 2020-21. This includes Rs 6,500 crores this year. So, if the suggestion is accepted, the government will have to invest Rs 16,500 crores over the next eight years which works out to Rs.2062.505 crores per year.

Most of the policy analysts fail to believe it to be a policy to turnaround the enterprise. If the government means business, it will have to look at each and every item of cost, and see where efficiencies can be achieved. It is said that smart airlines the world over even see if the paint on the exterior can weigh less so that the aircraft burns less fuel and every second is scraped off in preparing the aircraft for another flight. Nobody does believe that the government is intending to put in similar efforts with the vested interest dominated Air India. In the absence of such an effort, the proposal put forward by the ministers would be just another example of good money being thrown after bad.

Even the current policy of subsidising Air India is adversely affecting the overall performance of the Airline industry in India. It has denied a level playing ground for other airlines in the industry. It precludes a rationalisation of capacities and market shares which would allow other competitors to take advantage of economies of scale and scope. Further, other airlines are unable to rationalise their workforce, and are forced to manage with less than globally acceptable levels of efficiency, safety and customer care requirements. With the airline traffic growing at 20 per cent or more annually the various private airlines have the opportunity to challenge globally established majors. However, this opportunity will be lost if government policy remains exclusively focused on saving and reviving Air India. The government should be more concerned with the global competitiveness of Indian airlines industry as a whole.

The extent of loss incurred by the Air India over the years is mind boggling. The Union Civil Aviation Minister , in November 2011, stated in the parliament that "before the merger in 2006-07, the losses reported by erstwhile Air India and Indian Airlines were Rs 447.93 crore and Rs 240.29 crore, respectively. But the merged entity incurred a loss of Rs 2,226.16 crore during 2007-08. "The cumulative losses at the close of financial year 2009-10 were Rs 13,326.86 crore." At the same the minister said that the government has no plans to refer the company to the Board for Reconstruction of Public Sector Enterprises (BRPSE)

Latest estimates show that Air India was facing a net cumulative loss of Rs. 20,320 crore between April 2007 and March 2011. Its debt burden stood at Rs. 46,950 crore—Rs. 20,185 crore worth of aircraft loans, Rs. 22,165 crore working capital loans and over-dues of Rs. 4,600 crore. Its cumulative loss and debt burden comes to a whopping Rs. 67,270 crore. Should the public money be allowed to be drained off in this manner without any guarantee of recovery?. The government is hoping to revive it through unlimited budgetary allocations. Its net worth, despite repeated capital to infusion by the government was negative to the tune of Rs. 4,481 crore in 2009-10. It is keeping this history of heavy losses and mounting debt in mind that this study recommends a more viable alternative, that of privitisation through PPP.

The method of ppp is used increasingly by many countries. Over the past two decades more than 1400 PPP deals were signed in the European Union, which represent an estimated capital value of approximately €260 billion. The main motivation for governments considering public private partnerships is the possibility of bringing in sources of financing for funding .In the model of Public-private partnership there will neither be an ideological bias in favour nor prejudice against either of the two sectors. This is also different from the public sector dominated mixed economy model and the private sector dominated post liberalization period. As the public sector has decided to withdraw from all the non-essential operations it is all the more essential that it leaves airlines service to more efficient hands.

The most notable aspect of the public-private partnership is that this provides distinct gains to public policy and economic decision-making. A partnership of that nature is

collaborative and, as otherwise feared, is not anti-public sector but is pro-competition. Literature on the subject abounds with the tangible benefits from such an arrangement the world over. At the most basic level, as is now evolving in India, public-private partnership implies a co-existence of the public and private sectors in producing goods and services.

In India a beginning has been made by the railways to invite greater private participation. Certain capital-intensive roadways built by government agencies have had substantial private sector presence as sub contractors. Closer home, many airports have been built under this model. A third way in which the partnership has evolved in the developed world is to engage corporations in their non-traditional areas such as primary education, garbage clearance and in providing civic amenities. Thus the concept of PPP is nothing new to India.

Kaul, a noted aviation analyst says "The airline needs a financial restructuring plan, but a credible and comprehensive business plan, spread over five to 10 years, must come first." All turnaround efforts have been either silent or have not addressed the business plan adequately. Such a plan can come only from a serious and determined effort of a PPP arrangement.

Kenya Airways was a fully government owned company with a similar story of large losses like that of Air India. However with the right policy approach of a partnership alliance with the International Finance Corporation, a subsidiary of World Bank and KLM an airline turned it into a profit making company in a short span. Therefore my study is concluded with a discussion of the basic policy approach followed by Kenya Airways.

As the first step the government appointed a new board of directors and a high caliber management team was recruited. Under its leadership the Kenya Airways was incorporated in 1977 as the country's national flag carrier and was fully owned by the Government. Over the next 15 years, the airline accumulated massive financial losses, along with crippling debt arrears due to its failure to service its loans. The country went for a massive nationwide privatization program in 1992, and Kenya Airways was one of the 45 companies to be privatized in the first stage of the process.

company underwent a process of restructuring and commercialization: routes, fares and fleets were rationalized, management was overhauled and the entire staff was put through training. The next step was to help bring about private ownership of Kenya Airways. The Government's main objectives were to ensure the continued operation of Kenya Airways as the country's national airline, to transfer the bulk of ownership of the airline to the private sector, and to allow the airline to build on its improved operating performance and profitability with support from the private sector.

To achieve these objectives it took technical advice and financial assistance from the International Finance Corporation. The strategy adopted for privitisation was the sale of a minority stake to a strategic partner followed by a public offering. As a result the

Government sold 26% of the company to KLM and offered the remaining 51% to the public. The results were doubling of passenger traffic and cargo between 1995 and 2003 and a boost to tourism ,the Government received more than US$70 million from the sale of shares, the service standards and reliability of Kenya Airways improved dramatically, the airline has been profitable ever since the transaction closed. The contention is, if a country like Kenya can bring about such a dramatic change in a short span of 8 years there is no reason why an economy which enjoys nearly 20 per cent annual domestic passenger growth rate, should goble up thousands of crores of rupees every year.

Conclusions

Air India is running on heavy losses and there is no reason to believe that the situation will change in the near future. The Government of India has adopted a policy of pumping more and more of taxpayer`s money into this loss making enterprise. This belies all sense of business logic. Experience in India of other private airlines has proved that this business can be done more competitively by them. Moreover, public sector had been increasingly withdrawing from non-essential services operations in the recent times. Even if the Air India is allowed to function under the present system of state ownership, it should be working on a self financing basis.

This study therefore makes the following recommendations

The state should withdraw from airlines industry as it is a nonessential service.

Privitisation of Air India through disinvestment may not be a viable option as major investors especially the foreign equity investors are shying away from the capital market. Further, the other loss making airlines operator, the KFA, is in a seller`s market as far as the equity market is concerned.

The proposed policy of the government of pumping thousands of crores of rupees in to this sector is ill advised and will prove to be a national waste.

The national pride of owning an airlines company can better be satisfied if it generates some profit, now it is a national shame.

A better alternative is to go for public private participation where the airlines can continue to be owned by the government and at the same time a strategic alliance with a private company, preferably domestic, who will put in the working capital needed for its operation.

Public private participation can remove the problems related to disinvestment and at the same time bring in the advantages of private sector efficiency and public sector credibility.

Experience of a similar model of public private participation adopted by Kenya Airways has proved to be a big success.

Taking all the facts mentioned above in to consideration, this study recommends the path of Public private participation for the revival of Air India.

References

Das. Pradyumna Kumar(2007) Geography of Air Transport in India, Vista International Publishing House.

Singh Ratandeep Singh, (2008) Aviation Management Global and National Perspectives, Kanishka Publishers and distributors.

Kumar Rajiv: thehindubusinessline.com/opinion/column/rajiv.kumar/article2211447.ece

Kumar Rajiv: Privatising Air India is the only option. mailonlineIndia.

Kenya Airways Privatisation wwwiifc.org/wps/wem/conn

www.thehindu.comnews/national/article/2350467.ece

Kaul S.India Today, June15,2012. India Todat.intodayin200862.html

Business Standard / New Delhi November 2, 2011

Business Standard / New Delhi November 3, 2011

Mahalimkam T.V. (June 3, 2007) On a wing and a prayer, Business today.

Mehra P. Article (September, 2007) Nose Driving, Business World.

Pallavi S. Article, Paramount Preposition, Business Today, May, 2007.

Mitra K. and Mahalimkam T.V, Article, a Battle of Two, Times of India, 4th February, 2008.

Mitra K. and Mahalimkam, T.V.Article, Wanted Better Infrastructure, Business Today, September, 2007.

The mint 15, july, 2012

BSE https://www.google co.in

www.managementparadise.com

www.flykingfisher.com

www.jetairways.com

www.airindia.com