GE-INTERNATIONAL JOURNAL OF MANAGEMENT RESEARCH
VOLUME -2, ISSUE -11 (November 2014) IF-3.142 ISSN: (2321-1709)

INDIAN AVIATION SECTOR: MERGERS AND ACQUISITIONS IMPLICATIONS

Dr.Smita Meena,

Assistant Professor, KNC, University of Delhi, India.

ABSTRACT

The mergers and acquisitions (M&A) are growing both in numbers and deal values. The objective of this paper is to study, why organizations take the mode of expansion. However, the main focus is on studying the implications of mergers and acquisitions in Indian aviation sector companies and comparing the benefits and disadvantages of M&A. Here an attempt has been made to understand the motives behind the airlines M&As in India and their consequences. Results show that there is huge difference between the motives and consequences. However on studying the cases, we conclude that as in previous studies, mergers do not improve financial performance at least in the immediate short term similarly synergies can't be gained in short term but for survival and expansion of firm in this competitive and globalised era it has to go for M&A.

KEYWORDS: Merger, Acquisition, aviation, Motives of mergers, Synergy

INTRODUCTION

Indian aviation sector witnessed a remarkable growth story in the last decade with rapidly expanding air transport network and opening up of the airport infrastructure to private sector participation have fuelled the growth of the air traffic in the country. Indian airport system is poised to handle 336 million domestic and 85 million international passengers by 2020, from the current level of 121 million domestic and 41 million international passengers, making India the third largest aviation market. According to International Air Transport Association's (IATA) Airline Industry Forecast 2012-2016, India's domestic air travel market would be among the top five globally, experiencing the second highest growth rate at CAGR of 13.1%. In pursuit of stimulating the air connectivity, India is planning to invest over US$ 120 billion in the development of airport infrastructure.

INDIAN AVIATION INDUSTRY: AN OVERVIEW

The airline was set up under the Air Corporations Act, 1953 with an initial capital of ₹ 32 million and started operations on 1 August 1953. It was established after legislation came into force to nationalise the entire airline industry in India. Two new national airlines were to be formed along the same lines as happened in the United Kingdom with British Overseas Airways Corporation (BOAC) and British European Airways (BEA). Air India took over international routes and Indian Airlines Corporation (IAC) took over the domestic and regional routes. Eight pre-Independence domestic airlines, Deccan Airways, Airways India, Bharat Airways, Himalayan Aviation, Kalinga Airlines, Indian National Airways and Air Services of India and the Domestic wing of Air India, were merged to form the new domestic national carrier Indian Airlines Corporation. International operations of Air India Ltd. were taken over by the newly formed Air India International. Indian Airlines Corporation inherited a fleet of 99 aircraft including 74 Douglas DC-3 Dakotas, 12 Vickers Vikings, 3 Douglas DC-4s and various smaller types from the seven airlines that made it up.

Vickers Viscounts were introduced in 1957 with Fokker F27 Friendships being delivered from 1961. The 1960s also saw Hawker Siddeley HS 748s, manufactured in India by Hindustan Aeronautics Limited, join the fleet. The jet age began for IAC with the introduction of the pure-jet Sud Aviation Caravelle airliner in 1964, followed by Boeing 737-200s in the early 1970s. April 1976 saw the first three Airbus A300 wide-body jets being introduced. The regional airline, Vayudoot, which had been established in 1981, was later reintegrated.By 1990, Airbus A320-200s were introduced.

The economic liberalisation process initiated by the Government of India in the early 1990s ended Indian Airlines' dominance of India's domestic air transport industry. Indian Airlines faced tough competition from Jet Airways, Air Sahara (now Jet Lite), East-West Airlines, Skyline NEPC, and ModiLuft. As of 2005, Indian Airlines was the second largest airline in India after Jet Airways while Air Sahara controlled 17% of the Indian aviation industry.

East-West Airlines, Skyline NEPC and ModiLuft discontinued flight operations but the entry of several low-cost airlines in India, such as SpiceJet, IndiGo, GoAir and others likeKingfisher Airlines along with its low cost arm Kingfisher Red continued to give competition in its market, forcing Indian to cut down air-fares. However, as of 2006, Indian Airlines was still a profit making airline; in fact during 2004-2005 it made a record profit of

Rs656.1 million. In dian Airlines Limited was partly owned by the Government of India (51% of share capital) through a holding company and has 19,300 employees as of March 2007. Its annual turn-over, together with that of its subsidiary Alliance Air, was well over ₹ 40 billions (around US$1 billion). Together with its subsidiary, Alliance Air, Indian Airlines carried a total of over 7.5 million passengers annually. In December 2007, Air India was invited to join the Star Alliance. On 26 February 2011, Indian ceased operating under its own brand and codes with the merger with Air India being complete.

The Indian civil aviation industry is among the top 10 globally with a size of around US$ 16 billion, according to a recent KPMG report. The aviation industry presently supports about 0.5 per cent of the India's GDP. This sector caters to about 150 million passengers daily, with the potential to grow further. By 2020, traffic at airports in India is anticipated to reach 450 million. The aviation sector today supports 56.6 million jobs and produces over US$ 2.2 trillion of the global gross domestic product (GDP). The Government plans to invest US$ 12.1 billion in the airport sector during the 12th Five-Year Plan period (of this US$ 9.3 billion is expected to come from India's private sector) towards construction of new, low-cost airports and development of existing ones.

According to Government of India, India would be the third largest aviation market by 2020. The foreign direct investment (FDI) inflows in air transport (including air freight) during April 2000 to March 2014 stood at US$ 495.24 million, according to data with Department of Industrial Policy and Promotion (DIPP).

RESEARCH OBJECTIVES

1. Study trends in civil aviation sector in India.
2. Discuss the merger and acquisition implications and challenges faced by the companies in civil aviation sector in India.

RESEARCH METHODOLOGY

The companies involved in Merger & Acquisition in Indian Airline sector from 2005-2012 are compiled from several sources like journals, investment web sites, and web sites of the BSE and NSE.Industry growth have been analysed based on data obtained from annual financial statements of airlines; web-sites of the Ministry of Civil Aviation, Directorate

General of Civil Aviation, Airport Authority of India and various airlines; observations of various committees, and other published as well as unpublished work of various professional bodies such as Centre for Monitoring Indian Economy (CMIE), National Council of Applied Economic Research (NCAER) and Indian Council for Research on International Economic Relations (ICRIER), airlines, newspapers and magazines.

SCOPE OF THE STUDY

The paper focuses on M&As activities in Indian context with special reference to Airline Industry in particular to analyze -Merger & Acquisition implications. The study will give an outline about M&As strategy are better for expansion and survival in competitive era or it has become a mandatory phenomena.

LITERATURE REVIEW

Mergers lead to monopoly power Gong & Firth, (2006) and generate more revenue by the way of charging more prices for the same product or service. Particularly in case of aviation it has been found that mergers lead to increased consolidation in the industry as they are mostly concentric in nature and witnessed higher prices for the same routes Kim and Singal). There is mixed result of M&A performance in the Indian aviation industry. Mahesh R. & Daddikar Prasad, (2012) report insignificant improvement in return on equity and earnings per share in the post-merger period, Joshi and Desai's, (2012) has witnessed non uniform results. This gives us a reasonable doubt on the performance of M&A in the Indian
Aviation sector and their motives. Saple V. (2000) in his research thesis on “Diversification, Mergers and their Effect on Firm Performance: A Study of the Indian Corporate Sector”, finds that the target firms were better than industry averages while the acquiring firms had lower than industry average profitability. Overall, acquirers were high growth firms which had improved the performance over the years prior to the merger and had a higher liquidity. Ahmed Dr. Salma & Yasser Mahfooz (2009) in their case study paper, “Consolidation in the Sky - A Case Study on the Quest for Supremacy between Jetlite and Kingfisher Airlines”, did an attempt to descriptively analyse the rationale for consolidation in the Indian airline industry. The paper also evaluates major changes in the business environment affecting the airline industry.

Sinha Dr. Neena,Kausik Dr. K.P. & Chaudhary Miscma (2010) in their research article on "Measuring Post Merger and Acquisition Performance: An Investigation of Select Financial Sector Organizations in India", examines the impact of mergers and acquisitions on the financial efficiency of the selected financial institutions in India. The analysis consists of two stages. Mantravadi Pramode and Reddy Vidyadhar,(2007), "Relative size in Mergers and Operating Performance" they explains that This research study aims to study the impact of m & A on the operating performance of acquiring corporate in different periods in India, by examining some pre and post merger financial ratios with chosen sample firms and mergers between 1991-2003. The result suggests that there are minor variations in terms of impact on operating performance following merger in different intervals of time in India.

AIR TRANSPORT COMPANIES IN INDIA

Club One Air - It commenced its operations in 2005. It is one of India's oldest and largest air charter companies and the only Indian company with operational bases in Delhi, Mumbai and Vishakhapatnam. Club One Air owns a fleet of jets that cater to corporate India and individuals with exclusive taste. The fleet includes the likes of CRJ-100, Falcon 2000, Gulfstream G200, Cessna Citation Excel and Cessna Citation CII aircrafts. The professionals with extensive aviation experience provide unparalleled safety, and world-class ground and in-flight services. Club One Air has been certified by Wyvern and Hart aviation for aviation safety and service.

Air India - Air India is the flagship carrier airline of India and is owned by Air India Ltd. It began its operations in 1932. Presently, it is the third largest airline in India in terms of domestic market share. It mainly operates a fleet of Airbuses and Boeing aircrafts serving various domestic and international airports. It is headquartered in the Indian Airlines house at New Delhi. Air India has two major domestic hubs at Indira Gandhi International Airport, New Delhi, and Chhatrapati Shivaji International Airport, Mumbai, and secondary hubs at Chennai International Airport and Netaji Subhas Chandra Bose International Airport, Kolkata. It operates one of the youngest fleets in the world and regular upgrades ensure that they provide a superior flight experience to its customers.

Go air- Wadia Group owns Go Airlines (India) Ltd which operates its services under the brand name GoAir. GoAir launched its operations in November 2005. It is a low-fare carrier launched with the objective of commoditising air travel, and offering airline seats at marginal premium to train fares across India. The airline currently operates across 21 destinations with 140 daily flights and approximately 975 weekly flights.

GoAir is positioned as 'the Smart People's Airline'. Its captivating theme, 'Fly Smart' is aimed at offering passengers a consistent, quality-assured and time-efficient service through 'pocket-friendly' fares. The airline uses the state-of-the-art Airbus A320 aircraft fleet.

The GoAir route network spans prominent business metropolis as well as key leisure destinations across the Indian subcontinent. GoAir is currently servicing the airports at Ahmedabad, Bagdogra, Bengaluru, Chandigarh, Chennai, Delhi, Goa, Guwahati, Jaipur, Jammu, Kochi, Kolkata, Leh, Lucknow, Mumbai, Nagpur, Patna, Port Blair, Pune, Ranchi and Srinagar.

Jet Airways- Jet Airways is a major Indian airline based in Mumbai. It is the second largest airline in India, both in terms of market share and passengers carried. It operates over 3,000 flights daily to 76 destinations worldwide. Its main hub is Mumbai, with secondary hubs at Delhi, Kolkata, Chennai and Bengaluru. It has an international hub at Brussels Airport, Belgium.

Jet Airways was incorporated as an air taxi operator on April 1, 1992. It started commercial operations on May 5, 1993 with a fleet of four leased Boeing 737-300 aircraft from Malaysia Airlines. In January 1994, a change in the law enabled Jet Airways to apply for scheduled airline status, which was granted on January 4, 1995. Naresh Goyal – who already owned Jetair (Private) Limited, which provided sales and marketing for foreign airlines in India – set up Jet Airways as a full-service scheduled airline to compete against state-owned Indian Airlines.Jet began international operations from Chennai to Colombo in March 2004. In January 2006, Jet Airways announced that it would buy Air Sahara for US$ 500 million in an all-cash deal, making it the biggest takeover in Indian aviation history. Air Sahara was renamed JetLite, and was marketed between a low-cost carrier and a full service airline. In August 2008, Jet Airways announced its plans to completely integrate JetLite into Jet Airways.

Indigo- Indigo has begun its operations in 2006 and has a fleet of 61 A320s today. It is India's largest airline with total market share of 24.9 per cent as of May 2012. It is the fastest growing low cost carrier in the world provides hassle-free travel experience. IndiGo's on-time performance is one of the best in India. Its technical dispatch reliability is 99.91 per cent making it the airline with the least number of cancellations in India. The company has registered a passenger growth of 27 per cent in 2012-13.

IndiGo continues to outperform on every single benchmark due to high customer ratings, consistent service delivery, and best operating and financial measurements. The company ended fiscal year 2012 with 55 aircraft, 2012-13 with 66 aircraft and now has 70 planes. It is likely to end the fiscal year 2013-14 with 75 planes.

Spice jet- SpiceJet is India's second largest low fare airline and with more than 20.4 per cent market share. It operates 330 flights daily to 41 Indian cities and 7 international destinations (figures as on April, 2013). Indian cities and international destinations are connected using new generation fleet of 38 Boeing 737-800/900ER aircraft.

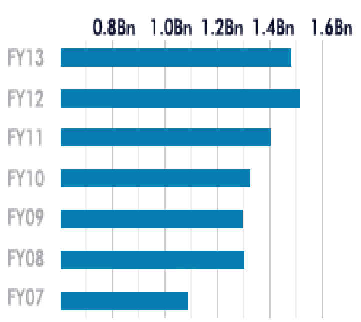
FIGURE- 1. PRESENT STATUS

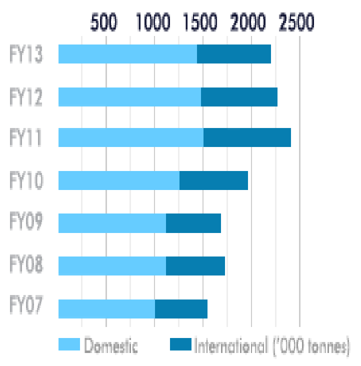
Aircraft movement in India

Total aircraft movement recorded a CAGR of 8.4 per cent over FY06-13.

Freight traffic in India

Total freight traffic registered a CAGR of 6.6 per cent over FY06-13; it stood at 2.19 million tonnes in FY13





MERGERS AND ACQUISITIONS IN INDIAN AVIATION SECTOR

AIR INDIA- the Government of India, on March 1, 2007, approved the merger of Air India and Indian Airlines to improve operational synergy and increase productivity. The company became registered on March 30, 2010. The merger was to help the new entity compete with large global airlines. Since Air India was a globally and nationally recognized brand name, the operational brand name of the company remained Air India

The key benefits to Indian Airlines and Air India on account of this merger were
1. The merger had created a mega company with combined revenue of Rs. 15000 crores.
2. The new entity had seen a number of changes in its operating model. It was much less restricted by government control and is therefore much more agile.
3. Since the two companies had come together, they had also been able to bring together their best practices and reduced the overall operational cost as well as administrative cost by a considerable margin.
4. Air-India would have a combined fleet of 112 aircraft and would be among the top 10 airlines in Asia and among the leading 30 airlines globally.

Disadvantages- The merger between Air India and Indian Airlines made perfect sense on paper for over a decade. Successful implementation required robust guidance and a capable execution team to handle such a complex undertaking. More attention was devoted to discussion around non-core issues such as long term fleet acquisitions and establishing subsidiaries for ground handling and maintenance, than to addressing the state of the flying business. Air India has continued to see its domestic market share decline. The situation was compounded by the cultural chasm between Air India and Indian Airlines, leading to an increase in internal politics, a potentially messy situation in an entity with 35,000 employees. A bloated workforce, unproductive work practices and political impediments to shedding staff made the creation of a viable business model extremely challenging.

Jet Airways, which commenced operations on May 5, 1993, has within a short span of 14 years established its position as a market leader. The airline has had the distinction of being repeatedly adjudged India's 'Best Domestic Airline' and has won several national and international awards.jet Airways and the Shareholders of Sahara Airlines Limited had concluded a Share Purchase Agreement on January 18, 2006 whereby Jet Airways was to acquire the 100% shares of Sahara Airlines Limited for a Total Consideration of Rs. 2,000 crores. The original 65 day Term of the Agreement expired in March 2006. This was mutually extended to 21st June 2006, at which time Jet Airways also paid an advance of Rs.

500 Crores. On 20th April, 2007, Jet acquired 100% stake in Air Sahara 15 months after signing the original purchase agreement. Jet purchased its arch rival for 1,450 crores which was 35 % less than the price agreed in 2006. Jet rebranded Sahara as "Jetlite" and announced that the new entity would offer reduced frills but would be over and above low cost carrier (LCC) in terms of service. The private sector Jet-Sahara combine ended the dominating role of the public sector with the new corporate commanding as much as 32% of the domestic market space.

The key benefits to Jet Airways on account of this acquisition were as under:

1. A strong platform and a larger operational base for future growth.
2. A wider and a more effective coverage of the Indian market and giving the two airlines a very strong position especially in the metro markets.
3. Increased prime time departures and frequencies through a subsidiary.
4. Obtain access to skilled personnel such as Pilots and Engineers, categories of which there was a significant shortage in India.
5. Unit cost savings and improved levels of productivity due economies of scale and common utilization of facilities and resources, arising particularly from common maintenance and training facilities, airport handling facilities, enhanced purchasing power, finance and administrative set-ups, etc.
6. Clear value proposition for the customers in the form of wider network coverage, enhanced and convenient connections and better service levels on a larger scale of operations.
7. Increased availability of airport infrastructure facilities and availability of a larger operational base for future expansion.
8. Sahara Airlines would operate as an independent carrier with its own Operating Permit, it would have access to available traffic rights for international operations.

Disadvantages- Jet incurred a high acquisition price and has been funding operating losses ever since. The process of integration has been difficult and costly and continues to negatively impact Jet Airways. It is reported that Jet Airways has yet to settle the full purchase price for the carrier, reflecting the state of its financial situation. Jet Airways' bottom line has been further impacted by an aggressive international expansion which stretched the carrier's resources and damaged investor confidence. The airline has since been forced to cut a number of existing routes and halt new services as it consolidates its overseas network. To address the overcapacity in its long haul fleet, Jet Airways has leased a number of wide body aircraft to Gulf Air and Oman Air.

Kingfisher Airlines, a premium Full-Service Carrier, is a private airline based in Bangalore, India. Currently, it holds the status of India's largest domestic airline, providing world-class facilities to its customers. Owned by Vijay Mallya of United Beverages Group, Kingfisher Airlines started its operations on May 9, 2005, with a fleet of 4 brand new Airbus - A320, a flight from Mumbai to Delhi to start with. The airline currently operates on domestic as well as international routes, covering a number of major cities, both in and outside India. Air Deccan is India's first LCC. It was founded and operated by Deccan Aviation Ltd. by Captain Gopinath in 2003 with regular scheduled flights from Bangalore to Mangalore and Hubli. In 2007, Kingfisher Airlines acquired a 26% equity stake in Air Deccan and became the largest single shareholder in Deccan Aviation Ltd. It was agreed that Kingfisher would continue to serve the corporate and business travel while Air Deccan would focus on serving the low fare segment but with improved financial prospects for both carriers. Kingfisher later increased its stake to 46%, and took control of the management of Air Deccan, upgrading it to a value-based airline with higher airfare and repositioned it as 'Simplifly Deccan'.Air Deccan airlines merged with Kingfisher Airlines and decided to operate as a single entity from April, 2008. Following the merger of Deccan with Kingfisher, in August 2008, Kingfisher renamed Deccan as Kingfisher Red. After the merger, the company has a combined fleet of 71 aircrafts, connects 70 destinations and operates 550 flights in a day. The combined entity has a market share of 33%.

The key benefits to Kingfisher Airlines and Air Deccan on account of this were :
1. Legally, if an airline wants to operate overseas it must have a domestic status of having operated for 5 yrs and therefore in case of kingfisher operating overseas became easier.
2. Besides, operational synergies (engineering, inventory management and ground handling services, maintenance and overhaul), the management and staff of both the airlines would be integrated. They would be stronger vis-a-vis lessors, aircraft manufacturers, and will also spend less on training and employees. Costs would also reduce which is associated with maintenance of aircraft. The savings in cost would be lower by about 4-5% (Rs 300 crores).
3. The merger would create a more competitive business in scale and there would be scope to emerge as market leader.

Disadvantages- The Kingfisher Airlines acquisition of Air Deccan is a venture that has proved to be costly. Removing Air Deccan as an independent operator took out the airline that was most responsible for the irrational fares in the market place . However, integrating such different carriers (one, a classic low cost airline and the other a 5 star carrier), has proven to be extremely difficult. The huge combined network and distinct inflight products of the two carriers, has created duplication and confusion about the brand. Other anticipated benefits included network expansion, access to scarce airport slots and infrastructure, and costs savings through scale economies. At that time, the market was reporting growth of 25% year-on-year and the acquisition strategy appealed to investors. But this consolidation, aimed at creating a more viable business model, took place against the background of an industry that was beginning to exhibit the first signs of distress.

1. The bullish fleet orders placed by Indian carriers saw capacity being introduced at the rate of 6 to 6.5 aircraft a month, whereas the actual growth in demand was closer to 3 aircraft equivalents;
2. Aside from the mis-match between supply and demand, the rate of growth was simply too great for the industry to handle from a management and capital perspective.
3. In a fragmented market, with multiple start-ups chasing market share, loss-leader pricing was widespread and Air Deccan in particular was responsible for setting fares well below cost as it fought to retain its first mover market share;
4. The rapid increase in capacity at a time when the airport modernisation program was yet to deliver upgraded infrastructure, meant that airports and airways were highly congested, increasing airline operating costs;
5. With the inadequate surface access and airport (and airways) infrastructure, airlines were unable to secure a significant competitive edge over other means of travel, thereby excluding huge parts of the still-untapped leisure market;

SUGGESTIONS

1. Leadership- Appoint a professional CEO backed by a strong board of directors and give him a free hand (Accenture, the consultant at the time of the merger, had recommended a minimum five year tenure). In effect, the government will have to cede control of day-to-day running of operations and appoint independent directors.

2. Bloated headcount- Carry out the planned spin-off of the ground handling and maintenance, repair and overhaul operations. Offer a voluntary retirement scheme if still necessary.
3. HR Integration- Airlines should cut layers of management, align staff by role, bring in lateral hires, overhaul customer facing functions, and implement a massive training exercise.

4. Aircraft, Ticketing- There are airlines that run successfully with two or more aircraft types. But India is a price-sensitive market, and a model built around a single aircraft-type makes compelling sense. Airline mergers the world over have had abysmal success rates.

5. Leaky Financials - Turning Air India around will be a long haul. The government and the airline should be clear that the odds of its survival are slim. But together with incentives, a charismatic leader and conditional support from the government, Airlines could fly again.

CONCLUSION

Indian aviation sector has witnessed a remarkable growth story in the last decade with rapidly expanding air transport network and opening up of the airport infrastructure to private sector participation have fuelled the growth of the air traffic in the country. "The decision to merge Air India & Indian Airlines was taken in haste, without required homework & consultations. As a result the entire process has been unduly delayed. It has given rise to many problems concerning financial, administrative & operational." Two major objectives of merger 'economies of scale' & 'increased leverage' couldn't be achieved without proper synergies and a proper process of merger and acquisition.

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