Aviation Industry in India - Challenges for the Low Cost Carriers

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I. Growth and Development of Aviation Industry in India

A. Current Scenario

The liberalization of aviation industry in India has precipitated the boom for domestic and international passenger carriers. The domestic passenger and cargo traffic recorded a growth rate of 44.6% and 8.7%, and the international passenger and cargo traffic recorded growth rates of 15.8% and 13.8% respectively during 2006-07¹. The Airport Authority of India (AAI) manages total 122 airports in the country, which include 11 international airports, 94 domestic airports and 28 civil enclaves. Top 5 airports in the country handle 70% of the passenger traffic of which Delhi and Mumbai together account for more than 50%. The latest data compiled by Airports Authority of India (AAI) shows that all the airports handled 90.44 million passengers during the calendar year 2006

compared with 67.95 million handled during the same period in the previous year\(^2\). The substantial growth of Indian aviation industry is mostly due to: (i) low fares offered by Low Cost Carriers (LCC) like Deccan, Spicejet, GoAir etc; and (ii) Scheduled domestic air services are now available from 75 airports as against just 50 earlier.

**B. Reforms in Regulations and Air Transportation in India**

Prior to 1953, there were 9 private airlines in operation with too many surplus aircraft and the airline industry was sick. There was no competitive environment in the monopolized aviation market. The air transportation operations in India are governed under The Aircraft Act, 1934\(^3\), The Aircraft Rules, 1937\(^4\), The Air Corporation Act, 1953, The Air Corporation Act, 1953\(^5\), The International Airports Authority Act, 1971\(^6\), The Carriage by Air Act, 1972\(^7\), The Tokyo Convention Act, 1975\(^8\), The Anti-Hijacking Act, 1982\(^9\), The National Airports Authority Act, 1985\(^10\), The Airports Authority of India Act, 1994\(^11\), The Air Corporations (Transfer of Undertakings and Repeal) Act, 1994\(^12\).

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\(^2\) Ashwini Phadnis, *33% growth in air passenger traffic: AAI data*, Business Line, March 23, 2007, available at http://www.thehindubusinessline.com/2007/03/23/stories/2007032306470700.htm (last visited March 25, 2007). During January-December 2006, the domestic passenger traffic stood at 65.69 million, registering a growth of close to 42 per cent over the previous 12-month period. Among the airports that recorded high growth rates in passenger traffic right through the year include Coimbatore, Hyderabad, Chennai and Bangalore. In December 2006, the airports handled 9.48 million passengers including 6.93 million domestic and 2.54 million international passengers, whereas during the same month in the preceding year it was 7.24 million passengers including 4.99 million domestic and 2.25 million international passengers.

\(^3\) Act provides for provisions on the control of the manufacture, possession, use, operation, sale, import and export of aircraft.

\(^4\) The rules for the implementation of provisions under the Aircraft Act, 1934.

\(^5\) The Act nationalized all the private airlines and created national carriers: Air India and Indian Airlines, to cater to the needs of international and domestic air traffic.

\(^6\) Enacted to provide for constitution of International Airports Authority of India (IAAI) for management of certain airports whereat international air transport services are operated.

\(^7\) Enacted to give effect to the Warsaw convention on unification of certain rules relating to international carriage by air, as amended by the Hague Protocol, 1955 and also to make provision for applying the rules contained therein on international carriage by air and for matters connected therewith.

\(^8\) Enacted to give effect to the convention signed at Tokyo on offences and certain other acts committed on board aircraft.

\(^9\) Enacted to provide effect to the Convention on Suppression of Unlawful Seizure of Aircraft and matters connected therewith.
The first step towards liberalization was as early as in 1986 when private airlines were allowed to operate charter and non-scheduled services to all authorized airports under the Air Taxi Scheme and were also permitted to decide their fares and flight schedules. A major move towards liberalization was in the early 1990s when India implemented an open sky policy for cargo which allowed international airlines to operate cargo flights without restrictions and to charge rate without reference to Director General of Civil Aviation (DGCA). Under this policy, any foreign domestic airline or association of exporters or private operator’s could bring freight carriers to India for lifting cargo from any airport. However, there still remain restrictions on cabotage as international airlines are not allowed to carry domestic cargo on their flights within the country.

The next major step was the termination of the state monopoly over scheduled air transport services with the enactment of the Air Corporation (Transfer of Undertaking and Repeal) Act, 1994. The main reasons for the deregulation were the decline in profitability of Air India and Indian Airlines owing to organizational and managerial inefficiencies and that the capacity of the national carriers was not enough to meet growing passenger demand. With the enactment of the 1994 Act, private operators were allowed to operate both scheduled and non-scheduled services in the domestic sector and there were no major restrictions on aircraft size and type. However, in order to ensure safety, security and orderly growth of air transport services and keeping in view the

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10 Enacted to provide for establishment of National Airports Authority of India (NAAI) for management of airports and civil enclaves whereat air transport services and all communication stations connected therewith.
11 Enacted for the constitution of Airport Authority of India (AAI) and for transfer and vesting of the undertakings of the IAAI and NAAI for better administration and co-ordinated management of airports and civil enclaves whereat air transport services are operated.
12 Air Corporation Act was repealed in March 1994 with the enactment of this act with objectives to: (i) remove monopoly of air corporations on scheduled services, (ii) enable private airlines to operate scheduled service, (iii) convert Indian Airlines and Air India to limited liability companies, (iv) enable private participation in national carriers.

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infrastructural constraints at a number of airports, the government permitted the addition
to capacity based on traffic projections. To support the growth of the airline industry the
Government in 1994-95 permitted direct import of aviation turbine fuel (ATF) under the
special import license scheme. In 1997-98, the privatization policy was further liberalized
and foreign equity participation of up to 40 per cent (100 percent in case of non-resident
Indians) was allowed in the domestic airline sector. Foreign airlines are, however, not
allowed to pick up the equity, directly or indirectly.

The air transportation services in India are controlled by DGCA, operating under
Ministry of Civil Aviation (MCA). DGCA, under the provisions of Rule 134 of the
Aircraft Rules, 1937, grants permission to persons to operate an air transport service to,
within and from India. The DGCA rules governing issuance of permits for air transport
services are prescribed under: (i) Scheduled Air Transport Services (Passenger) (Civil
Aviation Requirements Section 3 Series 'C' Part II); (ii) Non- Scheduled Air Transport
Services (Passenger) (Civil Aviation Requirements Section 3 Series 'C' Part III); (iii) Air
Transport Services (Cargo) (Civil Aviation Requirements Section 3 Series 'C' Part IV);
Non-Scheduled Air Transport Services (Charter Operation) (Civil Aviation Requirements
Section 3 Series 'C' Part V). The permits issued by DGCA are equivalent to the Air
Operator's Certificate (AOC) required to be granted by ICAO member States in
accordance with the provisions stated in Annex 6 of the rules. Permits for any other
special type of operation can be granted subject to the applicant showing satisfactory
capability to undertake the type of operations.
DGCA also decides on matters relating to: (i) commencement of Scheduled International Air Services by a Foreign Airline\textsuperscript{13}; (ii) import of Aircraft on Short term on wet lease basis\textsuperscript{14}; Open Sky Policy for Cargo Flights to India\textsuperscript{15}; (iii) foreign Equity Participation in the Domestic Transport Sector\textsuperscript{16}. The MCA creates enabling provisions for DGCA to sign agreements for technical and managerial expertise in civil aviation sector in the areas relating to: (i) providing technical and managerial expertise in developing, improving and operation of civil aviation infrastructure, standards, procedures, policies, training and equipment; (ii) co-operation in a range of aviation safety areas; (iii) Providing training for civil aviation personnel; (iv) inspection and calibration of our civil aviation equipment and air navigation facility; (v) assistance in aircraft certification in India; (vi) assistance in the field of helicopter operational safety initiative.

C. Applicability of International Conventions and Agreements

The international conventions governing air transportation to which India is a signatory include: The Chicago Convention, 1944; International Air Services Transit Agreement, 1944, International Air Transport Agreement, 1944; The Warsaw Convention, 1929; The Guatemala City Protocol, 1971; The Additional Protocol No. 1, 1975; The Additional Protocol No. 2, 1975; The Additional Protocol No. 3, 1975; The Guadalajara Convention, 1961; The Geneva Convention, 1948; The Rome Convention, 1952; The

\textsuperscript{13} Aeronautical Information Circular (AIC) 3 of 2000
\textsuperscript{14} AIC 3 of 1998
\textsuperscript{15} AIC 18 of 1992
\textsuperscript{16} AIC 4 of 2004

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To increase connectivity between India and other countries and facilitate travel for passengers, India has entered into Air Service Agreements (ASA) with 100 countries till date. These bilateral Agreements provide the basic legal framework for operation of air services between the two contracting parties. The number of flights each country can operate and the destinations that could be served are also specified in these Agreements. The traffic rights available under an ASA could be utilized by the airlines designated by respective Governments. The ‘Open Sky Policy’ with US replaces an antiquated agreement signed in 1956 that placed restrictions on services between the two countries, including limits on cities that could be served and restrictions on pricing. The Open Skies agreement provides for open routes, capacity, frequencies, designations, and pricing, as well as opportunities for cooperative marketing arrangements, including bilateral code-sharing with domestic Indian carriers. The deal also allows all-cargo carriers to operate in either country without directly connecting to their homeland. India’s ATA with US provides for unlimited frequency and unlimited seat limit to the operating airlines of US: Delta and Northwest, and Air India.

India and US have entered into Aviation Cooperation Program (ACP) whereby a public-private partnership has been established to provide a forum for unified

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communication between the Government of India and U.S. public and private sector entities in India. The ACP is designed to work directly with the Indian Government to identify and support India’s civil aviation sector modernization priorities. The specific objectives of ACP are to: (i) promote enhanced safety, operational efficiency and system capacity in the Indian aviation sector; (ii) facilitate and coordinate aviation industry training and technical ties between the U.S. and India; and (iii) strengthen overall U.S.-India aviation cooperation. USTDA is providing funding for training and technical assistance programs and the FAA and U.S. aviation companies are providing in-kind support and co-operation in matters relating to promotion of aviation industry.

D. Eligibility for Scheduled Passenger Transport Services

The Civil Aviation Requirements (CAR), Section 3, Air Transport, Series C, Part II, prescribes the minimum requirements for grant of permit to operate scheduled passenger transport services. Scheduled Operator’s Permit is granted only to: (i) a citizen of India; or (ii) a Company or Corporate, provided that (a) it is registered and has its principal place of business within India, (b) its chairman and atleast two-thirds of its directors are citizens of India; and (c) its substantial ownership and effective control is vested in Indian national.

The applicant is required to apply for an initial No-Objection Certificate (NOC) with the MCA after obtaining approval from Foreign Investment Promotion Board (FIPB), if foreign investment is envisaged and security clearance of Directors and Chairman of the firm is essential. Foreign equity in air transportation services is permitted upto 49%. Non Resident Indian (NRI) / Person of Indian Origin (PIO) is

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permitted to invest up to 100% in domestic air transport services; (iii) equity from foreign airlines is not allowed in domestic air transport services. The operator is required to intimate any change in the Board of Directors / Chairman / CEO at any time to the Ministry of Civil Aviation and DGCA along with details of new Chairman or Director. Any changes in the name, management and matters relating to mergers and acquisitions are required to be carried out only after obtaining approval from DGCA. The MCA grants approval for purchase of aircraft. The operator is required to provide all details of the pilots and engineers recruited by them and also required to impart training as per program approved by DGCA.22

In a move to keep small players at bay and discourage new entrants to an overcrowded market, the civil aviation ministry has raised the minimum equity capital requirement for carriers to start or continue operations.23 A notification from the ministry has raised the minimum equity capital requirement for a five-fleet carrier that wants to fly Airbuses and Boeings (or aircraft above 40,000 kg weight) from Rs 30 crore to Rs 50 crore. There is also an equity requirement of Rs 20 crore for addition of every five aircraft to the existing fleet. For carriers operating smaller aircraft like the Dornier (less than 40,000 kg), the government has doubled the minimum equity capital requirement from Rs 10 crore to Rs 20 crore (for a fleet of five aircraft). For addition of every five aircraft, these airlines will have to infuse equity capital of Rs 10 crore. Existing carriers have been given a year to abide by the new rules. MCA has put an overall limit of Rs 100 crore as total equity capital. The move will affect over half a dozen carriers which have

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applied for fresh licenses to operate scheduled airlines -- like Easy Air, Air One, Yamuna Airways etc. Most of these carriers have proposals in which their equity capital is much lower than the stipulated Rs 50 crore. The government has also withdrawn the concession available to scheduled airline operators to have only 10 per cent of the paid-up capital when the initial Non Objection Certificate (NOC) is issued, another step to get small operators keep away from the business. During the year 2006, Jet Airways finally got clearance from the United States authorities for launching flights between India and US. The airline's plans for operating to the US had been pending with US authorities as issues had been raised about the funding of Jet Airways.

**E. Government Initiatives on Promotion of Aviation Industry**

The significant steps taken by the Indian government on liberalization of Indian aviation industry include: (i) The Foreign Direct Investment limit in Air Transport Services (Domestic Airlines) has been increased from 40% to 49% and is soon expected to be increased further. However, the NRI's and Persons of Indian Origin (PIO) have been allowed 100% FDI; (ii) Private scheduled carriers with five years experience in domestic sector and having fleet size of twenty aircraft permitted to operate on international routes; (iii) Liberal policy in the exchange of capacity entitlement / traffic rights paved the way for more foreign airlines to operate to / from India; (iv) Amendment of the various outdated provisions of Aircraft Rules to keep the provisions abreast with the international standards and developments in the civil aviation sector; (v) Tourist charter guidelines liberalized; (vi) Fleet expansion plans of Air India/Indian Airlines approved; (vii) Restructuring of Delhi and Mumbai airport and

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work on development of Greenfield airports at Bangalore and Hyderabad undertaken\(^\text{25}\); (vii) Up gradation/ expansion/ development of airports undertaken depending upon traffic potential, requirement of airline operators and need of air passengers.

During the last three years two of the existing private scheduled domestic operators Jet Airways and Air Sahara were permitted to operate to foreign destinations\(^\text{26}\) and six new airlines were permitted to start operations in the domestic sector: Kingfisher, Spicejet, Go-Air, Paramount, Indigo and Indus. The Indian government decided to merge Air India and Indian Airlines to improve operational efficiency\(^\text{27}\). The new entrants have cornered 44\% of Indian aviation market and made considerable dent in the market share of erstwhile operators: Indian Airlines, Jet Airways and Sahara airlines, and LCC’s constitute 34\% of market\(^\text{28}\).

II. Challenges for Low Cost Carriers (LCC)

A. Current LCC Operations in India

The LCC boom in India started with Low Price Tags, Apex Fares, Internet Auctions, Bulk Purchases and Last Day Fares. The factors that contributed to enormous growth of LCCs are: (i) Low Entry barrier; (ii) Attraction of Foreign Shores; (iii) Increased permitted Foreign Equity; and (iv) Rising income levels and demographic profile, have contributed significantly to the unprecedented growth of LCC’s in India. India has a population of 1.1 billion of which the middle income group constitutes around


400 million, which is more than the population of USA and that of EU countries. 15 million people travel by train of which around 700,000 people travel in air condition (AC) coaches. There does not exist much price difference between travel by AC and travel by LCC. Within 3 years of operations in India, LCC’s have taken the domestic market share of 49% and the factors contributing for such unprecedented market capitalization are: (i) Highest load efficiency; (ii) Flies to destinations in the Hinterland; (iii) A Lean-and-Mean approach to staffing; (iv) Expansion of operations to Sri Lanka; (v) Successfully targeted the increasing middle class population of India. The growth of LCCs in India could be attributed to the recent reforms in Indian aviation industry and also the instantaneous acceptance of air travel when it was provided at rail travel rates.

B. Challenges for LCC’s in Indian Aviation Market

The challenges facing LCC are: (i) crippling oil shock; (ii) absence of Institutional Funding; (iii) acute shortage of trained Pilots, severely limiting growth prospects; (iv) unplanned location of Airports; (v) competition amongst the LCC’s; (vi) image plagued by frequent breakdowns and freak accidents; (vii) LCC’s already reached the threshold of cost efficiency; (viii) limited advertising. The aviation industry loses approximately Rs 2000 crores annually due to underpricing of tickets and increasing fuel costs.