Chapter 7 Conclusions and Recommendations

Air India has enjoyed the unique position of being considered the National Carrier of the country. This is in spite of the fact that there are many other Indian Carriers today who are operating both domestic and international flights.

In spite of this advantage, it is also a fact that Air India is no more the favoured airline of passengers, both Indian as also International. The services and criteria that benchmark a favoured and popular airline are perceived to be absent in Air India. The discerning passenger who may be a corporate, businessman, tourist or civil servant who has to spend long hours in flight looks for a comfortable, luxurious and salubrious environment. Attentive, efficient, pleasant and courteous service from the crew on board is an added attraction.

The current dismal state of affairs of the merged entity "Air India" is a combination of a multiplicity of factors such as:

- risky acquisition of a large number of aircraft with the intention of vastly expanded operations and "footprint" and also, in the case of the erstwhile AIL, perceivably following a 'supply response' philosophy enunciated by MoCA.
- a liberalised policy on bilateral entitlements for international air travel introduced by GoI without affording adequate time to AIL/ IAL to set their houses in order and gear up for a highly competitive environment, & subsequent rights being liberally approved to foreign carriers without any quid pro quo to Indian Carriers.
- an ill-timed merger undertaken after separate aircraft acquisitions by AIL and IAL were completed, driven from the top, rather than by the perceived needs of both these airlines, with inadequate validation of the financial benefits from such a merger and without adequate consideration of the difficulties involved in integration (notably in terms of HR and IT, among other areas);
- chronic operational deficiencies;
- a weak financial position reflected in a grossly inadequate equity capital and undue dependence on debt funding, providing little or no cushion for the financial shock when it came; and
- external factors beyond the control of AI (high ATF prices, the 2008 economic recession etc.).

However, the merged entity "Air India" has since undertaken several positive measures, notably the following:

- A considerable amount of **route rationalisation** has taken place, especially in terms of loss making routes during 2008-09 and onwards;
- **Resource integration and network planning/ scheduling** activities of the erstwhile AIL and IAL has now largely stabilised;
- **A common code** for AIL and IAL passenger reservations has finally been implemented with effect from February 2011, although the full set of modules of the new Passenger Service System (PSS) is yet to be implemented and operationalised.
- Timely development of hubs in India (e.g. at Delhi and Mumbai Airports) will help Air India in getting significant volumes of 6th freedom traffic from India.
- The 43 narrow-bodied aircrafts ordered by the erstwhile IAL have been received by April 2010, while of the 50 aircraft ordered by the erstwhile AIL, 20 (8 B777-200LR – long range, and 12 B777-300ER – mid-range[60]) aircraft have been received; the delivery of the 27 B787-8 aircraft (which is termed as the "dreamliner" aircraft in popular parlance, and is projected to have substantially lower fuel consumption) is delayed to the 2nd half of 2011-12.

If the merged Air India is to regain its predominant position several positive remedial measures need to be urgently undertaken by all the major stakeholders. They would be the Government, in the Ministry of Civil Aviation and its attached office the Director General of Civil Aviation, the Board of Directors and senior management, and all personnel of Air India.

Accordingly our recommendations have been demarcated for each stakeholder as follows:

The Board of Directors, Senior Management and Employees of AI

- The Board of Directors should provide the necessary expertise to lead the turn-around of Air India from a downward spiralling airline to a profitable well run airline.
- **HR integration** (viz. harmonisation of HR) below DGM level (pilots, engineers and other staff) of the erstwhile AIL and IAL has not yet taken place. This is a critical issue, whose importance and associated difficulties were not fully appreciated pre-merger, more so in view of recent strikes and HR disputes. This needs to be handled swiftly, if the merger is to become a success.
- **Incentive structure** – In our view, the current structure of the Performance Linked Incentive (PLI) needs to be restructured, as it does not adequately incentivise or disincentivise actual performance on the ground:

[60] Out of 15 777-300ER aircraft ordered, delivery of 3 aircraft was subsequently deferred at AI's request.

- **PLI should focus on On-time Performance (OTP)**, as this is the most critical parameter in the airline industry, from a service perspective. However, the base level for OTP for performance incentive should not be set at an unduly low level, based on AIL's past performance, but should be linked to the performance of its competitors (Jet Airways and Kingfisher, the leading full service carriers, – in respect of domestic operations, and Jet Airways/ Emirates/ Singapore Airlines etc. in respect of international operations). **At the very least, the OTP baseline for performance incentive should be set close to the performance of its competitors (say no more than 3-5 per cent below its competitors – Jet Airways/ Kingfisher)**.
- **Impact of first flight(s) on OTP** – The impact of the first flight on On-Time Performance throughout the day is critical. Consequently, the incentive for OTP of the first flight should be set at a substantially higher level than for subsequent flights.
- **The PLI paid to various categories of employees should have distinct components** – one component linked to the overall performance of NACIL as a whole (again relative to its competitors) and the other component linked to the specific performance of the division/ department/ sector to the most granular level possible (so as to ensure incentives are as closely linked as possible to performance at the grassroots level). The structuring should be such that different categories of employees do not get incentives merely for completing activities within their limited sphere of work, without consideration of how such work contributes to the overall efficiency of the organisation. For example, the departure of any flight on time depends on the contribution of several sets of employees from different departments (Engineering, Operations, Commercial etc.) at different levels.

- **Relocate operations from city offices** – Ultimately, the success or failure of an airline will depend on the extent of close supervision/ oversight by top and middle management on operational activities on site, rather than in city offices. As has been reflected in the CMD, NACIL's testimony to COPU[61], attempts to shift officers and staff from city offices to airports have been met with stiff resistance. Unless senior level officers at the level of DGM/ GM and above (and not merely at the level of Duty Manager[62]) are available onsite to obtain real-time feedback on the status of operations, significant improvements in operational performance are unlikely to take place.
- **Increased proportion of web-based/ technology-based ticket sales –** In order to ensure cost rationalisation, AI must ensure a substantial increase in ticket sales through web based channels, rather than agents/ front offices. The current proportion of ticket sales

[61] Para 3.21 (pg. 45) of the 4th Report of Committee on Public Undertakings (COPU) (2009-10) – Fifteenth Lok Sabha

[62] Typically of the rank of Manager/ Sr. Manager

through AI's website is abysmally low. Further, anecdotal evidence of the poor response of AI's Internet website ticketing vis-a-vis that of competing airlines sites also abounds. AI should also leverage IT more effectively to ensure maximum use of technology for operations – e.g. web/ mobile check in, check-in kiosks/ scanned security checks etc. In particular, it is not enough to set up technological solutions; it is necessary to ensure that these are fully utilised.

- **Real-time revenue management** –AI's record of implementing revenue management solutions has been, at best, mixed. In addition to full scale implementation of the latest generation revenue management systems to enable real-time dynamic pricing, AI also needs to ensure adequate availability of skilled analysts who could make use of such granular data, with appropriate delegation of powers and empowerment of officials.

The airline is in a crisis situation. Salary payments and ATF obligations are becoming difficult. If the airline has to survive, the management and employees will have to set personal interests aside and undertake some harsh decisions, till the health of the airline improves.

- **Maximisation of PLF in Business/ First Class** – Even more than overall PLF and PLF in economy class, **AI's PLF (in terms of revenue-generating seats) for business/ first class - which is far more critical to a full service carrier's financial health than economy class PLF - is abysmal**. Rigorous controls need to be put in place to ensure that there are no vacant seats in Business/ First class, allowing for **"upgrades on availability basis"** from economy class:

  - ❖ All free travel by AI officers (on duty/ leave) in business/ first class should be prohibited; all existing facilities offered in this regard should be withdrawn till AI's financial conditions improve dramatically. Given the life-threatening crisis that AI is currently facing, top and middle management in AI should set an example in this regard.

- Even four years after the merger, AI is yet to join the Star Alliance, mainly due to the delay in setting up a single code passenger reservation system. In fact, as per the press release of 31 July 2011 available on the Star Alliance website, AI's application for membership of the Star Alliance has been "put on hold", and the integration of Air India into the global airline alliance "will be suspended". This raises the likelihood of indefinite delays as also serious uncertainties on AI's prospects for joining the alliance. Therefore, the AI board should take immediate steps to ensure that AI is accepted in the Star Alliance at the earliest.

Government / Ministry of Civil Aviation

- **Freeze on bilateral entitlements to countries/airlines predominantly utilising 6th freedom traffic** – Most of the liberalised entitlements for bilateral rights granted to foreign airlines (especially in Dubai, Bahrain, Qatar and other Gulf/ SE Asian countries) has been utilised for 6th freedom traffic and not for genuine traffic to the other country. AI and other private Indian airlines are handicapped by the lack of adequate hub facilities and other factors (e.g. lack of agreement for change in gauge at Dubai Airport) from competing effectively with other predominantly 6th freedom carriers (e.g. Emirates). Till India has its own effective and efficient hubs and AI/ other Indian carriers are able to exploit them effectively (say within 3 to 5 years), entitlements for airlines/ countries predominantly dependent on 6th freedom traffic **(notably Dubai, Bahrain and other Gulf countries in the first instance)** should be strictly frozen by MoCA; if possible, subject to diplomatic and other considerations. Options for rollback of excess entitlement granted beyond genuine traffic requirements may also be explored by MoCA.

- **Prompt payment of Government dues** –Air India's services are frequently used for VVIP and other Government duties; yet, reimbursement of costs incurred by AI is often not done in a timely basis. Given the financial crisis in which it finds itself, AI cannot afford such delays, even if interest were to be hypothetically leviable by it for delayed payment. MoCA should ensure that such dues are paid to Air India in a timely manner (say within 30 days of provision of services).

- **Infusion of Government Equity** – Both the erstwhile AI and IA and the merged entity have been unduly dependent on debt funding with a very narrow equity basis, which has dramatically increased the financial burden on AI. GoI should consider prompt infusion of additional Government equity in a timely fashion to ensure that the D/E ratio reaches tolerable levels. **However, such infusion has to be clearly and categorically linked to demonstrable, realistic operational improvements (in line with the performance of competitors) according to specified timelines, and also undertaking necessary reforms (e.g. PLI), such as those delineated in this report. Else, there is a possibility of "untied" GoI funding going into a "black hole" without any long-lasting benefit, but merely postponing the inevitable.**

- AIL has to function in a level playing field. While it may be a Public Sector Undertaking with Government infusing equity into the entity yet, they should be allowed the same autonomy with regard to commercial and operational decision as those enjoyed by any private airline. The Government must in this regard have a total "hands off" approach from the day to day professional management decisions of the airline. It is also imperative that Air India therefore should be headed by a professional who has a stake in the success of the airline. The best person should be selected in a transparent manner by professionals having the requisite experience to know what is required in a person who is to head a large national airline who should also perhaps have the experience to turn around an airline which is not doing well.

- The Government has to acknowledge that at this point of time Air India requires some time to recover their financial health. The decisions taken by the Ministry of Civil Aviation which have adversely impacted AIL and to some extent, other Indian Carriers have been discussed in detail in this Report. The Government today has to review the policy regarding bilateral agreements to safeguard the interest of the Indian carriers. The Government has to also acknowledge that the debt burden imposed on Air India is a consequence of the purchase of aircrafts and has contributed predominantly to its financial downturn. The Government has to make a realistic assessment of the present level of debt, the likely burden which will accrue if the acquisition programme were to continue and the present capacity of the airline to service the debt with its own resources. The Government has to make an immediate intervention in the form of a bail-out package which would consist of equity infusion, outright grant and soft loans as per the requirements of the airline.

In response, the Ministry indicated that the conclusions and recommendations had been noted for appropriate action as necessary.

We believe that AIL had inherent strengths. A multitude of factors which were internal and external have rendered it in a very critical situation. There is also no evidence of MoCA having provided it with positive support in the last few years. If the Airline has to be nursed to commercial viability, Government has to consciously attend to the following:

(i) The Airline has a debt liability of Rs. 38,423 crore as on 31 March 2010. Aircraft acquisition has contributed predominantly to it. Government must lay down a road map for liquidating the liability within a short span after making a realistic assessment of revenue generation capacity. Piecemeal infusion of small amounts is merely going to at best delay the certain closure of the Airline.

(ii) Accountability in the Airline, its Board, Government nominated Directors and the MoCA has to be clearly established and transparently dealt with. Grant of routes to private carriers, Bilateral Agreements (of which there appears to be no further scope as there is saturation already) must factor in interests of the national and other private carriers. Concluded agreements need to be reassessed.

(iii) A critical assessment of the Airlines profitable sectors, if any, is required. On other sectors attempt to remove infirmities including bilaterals to support the Airlines may be made.

(iv) MoCA and Government must recognise that Air India is the National Carrier. In very many ways, it is a symbol of the State. Even if Ministers and officials in MoCA, profess not to be Ministers/Officials for AI alone, the fact remains that it has to be given a more than level playing field now, which it has not been given. All decisions to allot routes, alter timings, provide first refusal rights on domestic and international routes must be made taking into account the interests of AI. This should be done in a transparent and demonstrable manner placing it in public domain. Accountability at the decision making level has to be established.

(v) A total hands-off approach with regard to the management of the airline is required.

Audit is of the firm view that unless the Government takes cognisance of the above mentioned factors and decisions thereupon, the Airline does not have a future as a vibrant Public Sector entity.

Dated: 16 August, 2011 — **(ANAND MOHAN BAJAJ)**
Place: New Delhi — **Principal Director of Audit (Economic and Services Ministries)**

Countersigned

Dated: 17 August, 2011 — **(VINOD RAI)**
Place: New Delhi — **Comptroller and Auditor General of India**


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AIR-INDIA