Executive Summary

1. Introduction

Air India Limited (AIL) and Indian Airlines Ltd. (IAL) dominated the Indian aviation industry till the mid-1990's, when as part of the open sky policy, the Government of India (GoI) ended their monopoly in air transport services, and allowed private operators to provide air transport services. The declining market share of IAL in domestic air transport services was further compounded by the GoI's liberalised policy on bilateral entitlements with foreign countries from 2004-05 onwards, and permitting private Indian carriers to fly on international routes, which put pressure on the international operations of AIL and IAL.

After IAL and AIL (as well as Air India Charters Ltd. (AICL), the Low Cost Carrier subsidiary of Air India) undertook massive fleet acquisitions of Airbus and Boeing aircraft respectively in 2005, a proposal for merger of the two airlines was initiated and completed in August 2007 with their amalgamation into the National Aviation Company of India Ltd. (NACIL); this Company was subsequently renamed as “Air India” in November 2010.

Almost immediately after the merger, NACIL faced significant financial problems, which continued to multiply manifold, resulting in acute cash flow and working capital problems. This forced Air India (AI) to approach the GoI repeatedly for financial support. Further, the actual merger of the operational activities of IAL and AIL took unduly long, and is still not complete in many respects.

2. What does our performance audit cover?

We took up the performance audit to ascertain:

- Whether the acquisition of aircraft by the erstwhile Air India Ltd. (AIL) and Indian Airlines Ltd. (IAL) was appropriately planned and effectively implemented, with due regard to economy, efficiency and accepted norms of financial propriety;
- Whether the merger of AIL and IAL into NACIL was properly planned and effectively implemented, and the effectiveness of merged operations of the two entities;
- the impact of the liberalised policy of the Government of India (GoI) from 2004-05 onwards on grant of air traffic rights to other countries through Air Services Agreements (ASAs)/ “bilateral” agreements, and permitting Indian private carriers to fly on international routes;

- The main reasons for the poor financial and operational performance of the pre-merger airlines and the merged entity; and
- Whether the Ministry of Civil Aviation (MoCA) exercised its oversight role adequately and effectively.

What are our major findings?

3. Acquisition of aircraft

3.1 Acquisition by erstwhile Air India Ltd. (AIL)

On 30 December 2005, AIL signed purchase agreements for supply of 50 Boeing aircraft (with GE engines) at an estimated project cost of Rs. 33,197 crore. We found that:

- The AIL's aircraft acquisition process had taken an unduly long time. The initial proposal was made in December 1996 and examination continued in fits and starts till January 2004. Once AIL revisited their earlier proposal and sent a plan for acquiring 68 aircraft (53 firm and 15 optional) the process gained momentum culminating in the contract being signed in December 2005.

  (Para 3.1.3)

- AIL's project report of January 2004 proposed acquisition of 18 small capacity short range aircraft (B737-800) and 10 medium capacity long range aircraft (A340-300) with a positive Net Present Value (NPV) on stand-alone basis. However, by November 2004, the AIL Board changed their fleet acquisition plan and submitted a revised proposal for acquisition of 50 medium capacity long range/ ultra long range aircraft (in addition to 18 small capacity short range aircraft for its subsidiary, Air India Charters Ltd. (AICL)). The sequence of events upto November 2004 clearly demonstrates that the erstwhile AIL hastily reworked its earlier acquisition plan and expanded its requirement. The revised plan saw a dramatic increase in the number of aircraft to be purchased in the period between January 2004 and November 2004. This increase in numbers does not withstand audit scrutiny, considering the market requirements obtaining then or forecast for the future as also the commercial viability projected to justify the acquisition. The acquisition appears to be supply-driven.

  (Paras 3.1.4.1 & 3.1.4.2)

- Audit is constrained to comment on the speed at which the acquisition process proceeded. A programme which was under consideration from 1996 and took eight years to progress upto the Government level for purchase of 28 aircrafts suddenly picked up speed. Between August 2004 and December 2005 the proposals were formulated by AIL, approved by its Board, examined and approved by MoCA, the Planning Commission, the Department of Expenditure, PIB, EGoM and also the CCEA. Government conveyed its approval on 30 December and the Contract was signed by AIL with Boeing on the same day. From receipt of the proposal by the government to the signing of contract with government approval, by AIL with Boeing took seven months.

(Para 3.1.7)

- Many of the key assumptions underlying the revised project report (for 50 long range aircraft) were flawed. The assumption that increase in capacity share would automatically lead to a substantial increase in AIL's market share, was not adequately validated. Similarly, the assumptions of yield increases (at constant cost), especially the yield increase of 10 per cent (at constant cost) of non-stop USA flights, were unduly optimistic. This sector on which American/Canadian airlines were already operating non –stop flights and based on which fact AIL was made to reconsider its fleet requirement, turned out to be a loss making sector right from the date of commencement of such services.

(Para 3.1.4.2)

- To enable effective price negotiations, it is normal (and was also necessary) to make an assessment through commercial intelligence gathered globally, to assess a reasonable or threshold price (based on comparable prices paid by other buyers and other factors). However, no benchmarks for the cost of the aircraft were set (either for the AIL acquisition or for the IAL acquisition) before negotiations were initiated with the manufacturers at various levels. Consequently, in the absence of such benchmarks, the effectiveness and efficiency of negotiations and the reasonableness of the price arrived at is difficult to ascertain.

(Para 3.1.7)

- The post-bid change in the seat configurations during the negotiation process was irregular, and adversely affected the transparency of the negotiation process. The assumption of further yield increase was also of doubtful reliability, considering the caveats attached by the then Commercial Director of AIL.

(Para 3.1.8)

- The entire acquisition (for both AIL and IAL) was to be funded through debt (to be repaid through revenue generation), except for a relatively small equity infusion of Rs. 325 crore for IAL. This was a recipe for disaster ab initio and should have raised alarm signals in MoCA, PIB and the Planning Commission.

(Para 3.4)

3.2 Acquisition of aircraft by erstwhile Indian Airlines Ltd. (IAL)

- In February 2006, IAL signed purchase agreements with Airbus/ CFM for supply of 43 Airbus aircraft (with CFM engine) at an estimated cost of Rs. 8399.60 crore. We found that:

- The Net Present Values (NPVs) of all the considered sets of aircraft (including the L-1 combination of Airbus aircraft) were all negative, even assuming constant cost and revenue yield at 2001-02 levels. Consequently, IAL projected an increase of 6 per cent in domestic fares in the first year, with further annual increases of 2 per cent for four years, evidently to make the negative NPV positive. This unrealistic assumption of dramatic increases in yield at constant costs (i.e. while assuming costs – fuel, staff, interest and other costs etc. to be constant throughout the project life) was critical to projecting an optimistic picture of positive project cash flows on NPV basis, and to the approval of the acquisition project.

  (Para 3.2.4)

- In fact, even assuming constant yield at constant costs would have been a major challenge for IAL, given the cost profiles and trends of the organisation and future uncertainties. This could not, in fact, be achieved.

  (Para 3.2.4)

- If indeed, GoI/ MoCA was keen on, or agreeable to, a full-scale aircraft acquisition by IAL in the public/ national interest, it should have acknowledged that such an acquisition would involve substantial negative cash flows (based on realistic and reasonable assumptions) and considered and approved appropriate arrangement(s) for funding the resulting cash deficit.

  (Para 3.2.4)

- Concerns regarding potential difficulties of IAL in successfully funding the acquisition process with a positive NPV had been raised within MoCA, but were ignored. The file notings indicate an undue haste to push through the pre-PIB meeting. Such haste evidently rendered it difficult for MoCA officials to express their concerns or reservations.

  (Para 3.2.5)

- The Planning Commission and the Department of Expenditure, MoF raised concerns on several key and critical issues at different stages, but finally concurred with the acquisition proposal. The subsequent AS&FA, MoCA repeatedly expressed serious reservations about the acquisition proposal. However, his views did not cause a re-think on the aircraft acquisition process.

  (Para 3.2.6)

- The commitments made by the manufacturers to the EGoM regarding creation of Maintenance, Repair and Overhaul (MRO), training facilities, warehouse facilities for aircraft spares etc. were quite open-ended. These commitments were not included in the purchase agreements in respect of the IAL fleet acquisition. There has been no tangible progress towards setting up the MRO and warehouse facilities.

  (Para 3.2.9)

4. Merger of AIL and IAL into NACIL

- Based on available records, we are unable to ascertain the detailed justification for, or the background to the 'in principle' approval of GoI for 'working towards the merger' of AIL and IAL.

  (Para 4.1)

- Inexplicably, synergised / integrated operation between AIL and IAL (even though this was recommended / recognised in 2004) was not factored in as part of the acquisition project analysis either for AIL or IAL. The initiation of action towards the merger in March 2006, less than a few months after completion of independent large scale acquisition of aircrafts by IAL (Airbus) and AIL (Boeing) in late 2005 (after long drawn out procedures/ negotiations) appears somewhat ill-timed, with loss of significant synergistic opportunities. Had the possibility of merger (with attendant route rationalization, network integration, common maintenance/ overhauling facilities and other synergies) been considered – even at a late stage – in the process of fleet acquisition, the underlying economics could have been significantly altered; perhaps, even a common acquisition process for AIL/ IAL could well have been considered. **In our view, the potential benefits for the merger would have been far higher, had this been undertaken before finalization of the massive and separate fleet acquisition exercises undertaken by AIL and IAL.**

  (Para 4.1)

- The financial case for the merger was not adequately validated, prior to the merger. Detailed item-wise financial analysis was not available, so as to assess the reasonableness and robustness of the projected benefits (on account of revenue synergies and cost and capital productivity synergies). The proposed revaluation of fixed assets had no operational or cash flow benefits.

  (Para 4.3)

- There were huge delays in actualisation of the merger/ operational integration. The single code passenger reservation system (which was a critical element in network integration) was activated only in February 2011.

  (Para 4.4)

- HR factors in any merger process are the most complicated. Even in March 2006, apprehensions with regard to HR problems due to a potential merger were expressed. **HR integration below the level of DGM, representing 98 per cent of the staff, has still not taken place.**

  (Para 4.4.3)

- 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.

  (Para 4.4.2)

5. Role of MoCA

Liberalised policy towards bilateral agreements on international entitlements

From 2004-05 onwards, there was a substantial liberalisation by the Government of the policy on bilateral agreements on entitlements for international operations between India and other countries, as well as in allowing private Indian airlines to operate on international routes. In our view, while the liberalised policy towards bilateral entitlements benefited the Indian traveller considerably in terms of choices (and lower tariffs), the timing of the liberalisation (given the timing of AIL/IAL aircraft acquisition, upgraded Indian airport with infrastructure with hub-spoke capabilities etc.) did not provide a level playing field to AI (and to a lesser extent other Indian private airlines). At this stage, Indian carriers (including AI) will have to tackle renewed and serious challenges to compete effectively with established international "mega carriers" specialising in 6th freedom traffic.

The massive expansion of bilateral entitlements in respect of several countries (notably in the Gulf, South East Asia and Europe) has facilitated several foreign airlines (predominantly Emirates) in tapping the vast Indian market and funnelling such traffic over their hubs (e.g. Dubai) to various destinations in the USA, UK, Europe and elsewhere, through what is termed as "6th freedom traffic". Although the bilateral agreements do not explicitly provide for exercise of 6th freedom rights, the entitlements exchanged are vastly in excess of "genuine" flying requirements between the two countries (termed as 3rd/ 4th freedom traffic based on Origin-Destination data) and implicitly allow "mega-airlines" with giant hubs to exploit 6th freedom traffic.

- As an illustrative case of the liberalisation of bilateral entitlements, the sequence of events relating to the Dubai sector, covering the period from May 2007 to March

2010, (when the seat capacity was increased from 18,400 seats/ week to 54,200 seats/ week and points of call in India were increased from 10 to 14), clearly demonstrates the one-sided nature of benefits to Emirates/ Dubai (through enhancement of entitlements and additional points of call in India). This evoked repeated protests from Air India on the lack of reciprocity and the funnelling of 6th freedom traffic by Emirates through Dubai from interior locations in India. Even change of gauge facility at Dubai International Airport, which would at least have provided an opportunity for Indian carriers to funnel traffic in smaller capacity aircraft from interior Indian locations and take them onward to UK/ USA/ Europe and other destinations in larger capacity aircraft was not adequately pursued, nor linked to grant of additional benefit. Repeated requests from AIL resulted in vague commitments from UAE Authorities for such facility, not at Dubai Airport but at the upcoming Jebel Ali Airport (an impractical option for AIL and other Indian carriers) and that too with distant timeframes between 2012 and 2018! Clearly, while Dubai actively protected the commercial interests of its airlines, MoCA failed to obtain appropriate quid pro quo while granting concessions.

(Para 5.1.4.2.1)

- The notings on MoCA files while processing proposed entitlement liberalisation refer to the demand from the “labour class/ working class” Indians for more seats to/ from India (as projected by several agencies – Ministry of External Affairs (MEA), Ministry of Tourism (MoT), Ministry of Commerce and Industry (MoCI)). These, however, are in a sense, misleading, since the “labour class/ working class” Indians would be interested only in point-to-point connectivity, largely to the Gulf/ Middle East.

(Para 5.1.8)

- It is certainly not our case that AI should benefit from a protected environment, cloistered from competition from foreign airlines (and other Indian carriers), especially in the current era of economic liberalisation. However, the timing of the liberalisation of bilateral entitlements (notably the Gulf/ SE Asia/ Europe) from 2004-05 onwards left much to be desired:

  - The delivery of AIL/ IAL's new fleet acquisitions, approved by GoI in December 2005, was scheduled only between 2006 and 2011. Giving a reasonable timeframe of 2 to 3 years post-aircraft delivery for stabilisation of the expanded “footprint” could have provided AIL/ IAL a “level playing field” for competition. Substantially enhanced fleet acquisition, in fact, justified AIL to operate larger number of routes.

  - It is only now (November 2010 onwards) that India finally has an international class airport terminal at Delhi capable of large scale hub and spoke operations (domestic/ international and international/ international); large scale development of other international airports in India facilitating hub and spoke operations (at the minimum where domestic and international terminals are co-located) will follow later. Again, giving a reasonable timeframe of 2 to 3 years after full-scale operationalisation of Delhi would have provided a level playing field to all Indian airlines (not just AIL/ IAL) to compete with the mega carriers specialising in 6^{th} freedom traffic.

- Many of the countries in the Middle East have only one, or maybe two major airports or "points of call" to offer, while the vast Indian market has numerous attractive interior locations with good commercial potential. The element of "reciprocity" or "give-and-take", if any, in exchange of bilateral entitlements, except to an extent in the case of Qatar, which was apparently guided by politico-economic considerations), could not be ascertained

(Para 5.1.8)

Monitoring role of MoCA

- The Memorandum of Understanding (MoUs) signed between the erstwhile IAL and AIL and MoCA were flawed. The non-financial parameters included in the MoU included minor or insignificant parameters or gave undue weightage to such parameters, at the cost of critical traffic and operating parameters in the airline industry (such as those being monitored by Directorate General of Civil Aviation). This skewed the MoU ratings of IAL and AIL unduly to present a "rosy" picture of performance. The overall combination of financial and non-financial parameters devised for the MoUs were such as to ensure that the MoUs became a meaningless exercise, rarely (if ever) reflecting poor performance, and ensuring lack of effective accountability for all parties concerned.

(Para 5.2)

- The issue of the MoCA order of 2010 granting additional facilities for upgradation of tickets, subject to availability, for former Secretaries, MoCA and their immediate family members at this time of AI's financial crisis indicates that MoCA is not acting as a responsible stakeholder. These decisions granting freebies to retired airline staff and officials needs to be reviewed.

6. Financial and operational performance of the erstwhile IAL/ AIL and AI

- There was a significant deterioration in operational performance on most parameters such as; passenger/cargo revenues, Available Seat Kilometres (ASKM), Available Tonne Kilometres (ATKM), Revenue Passenger Kilometres

(RPKM), passenger revenue per RPKM and Passenger Load Factor (PLF) for the two airlines (pre/ post merger) between 2005-06 and 2009-10.

(Para 6.1.1)

- As regards the erstwhile IAL: route economics revealed that most of the services were not meeting cash costs or total costs, both in domestic and international sectors.

(Para 6.1.2.1)

- The performance of IAL vis-a-vis its competitors on various parameters (PLF, domestic market share, Passenger Revenue per RPKM) was consistently poor. IAL's On-time Performance – a critical parameter of service – was dismally low, compared to both full service carriers and low cost carriers. Further, the market share of IAL in cargo operations dropped dramatically, despite conversion of five B737 aircraft into freighter aircraft.

(Paras 6.1.2.2 & 6.1.2.4)

- With regard to the erstwhile AIL: even earlier, most routes (North America, UK, SE Asia etc.) were incurring losses, **and only the Gulf/ Middle East and Far East Asia routes made profits till 2005-06. By 2009-10, all routes were loss-making**. The single largest loss-making routes being the India/ USA route, which contributed between 41 to 90 per cent of AIL's total operating losses during the period 2005-06 to 2009-10. This clearly revealed the grossly exaggerated nature of assumptions relating to increased yield on account of non-stop operations (projected in the revised fleet acquisition report). Besides this, the main reasons for low route profitability were the liberal increase in bilateral entitlements, which benefited foreign carriers with large volumes of 6^{th} freedom traffic and the failures of AIL to contain losses, especially on the India/ USA route, through appropriate route rationalisation and other measures etc.

(Paras 6.1.3.1 & 6.1.3.1.1)

- AIL's PLF suffered drastically vis-a-vis its competitors. In particular, the PLF of AIL flights in first class and business class declined from already low figures of 14 per cent and 31 per cent (2004-05) to abysmal levels of 12 per cent and 28 per cent respectively. Considering the widely recognised view that occupancy of a single seat in business/ first class can financially offset several vacant seats in economy class, these abysmally low PLFs in business/ first class are unsustainable. Similarly, AIL's On-time Performance for arrival and departure was significantly low at 62 and 52 per cent respectively during 2009-10.

(Paras 6.1.3.2, 6.1.3.3 & 6.1.3.4)

- Market surveys of customer perception revealed that Air India was no longer a preferred brand, and that it was not adequately oriented towards customer satisfaction. Expenditure on publicity and sales promotion was negligible.

(Paras 6.1.3.5 & 6.1.3.6)

- Dedicated cargo freighter operations started in June 2007/ August – December 2008 by converting four passenger aircraft (two owned and two leased) into freighters at a cost of Rs.168.30 crore. This ended up incurring losses of Rs.270.62 crore and were suspended from September 2009.

(Para 6.1.3.10)

The overall financial position of IAL/ AIL and the merged entity has been abysmally poor during the period from 2004-05 to 2009-10:

- Revenues showed a static trend. Expenditure increased dramatically. Interest burden, which was nominal in 2004-05, increased 36 times to Rs. 2434 crore in 2009-10. Working capital loan went up nearly 21 times from 2004-05 to Rs. 18524 crore in 2009-10;

(Para 6.2.1)

- In our opinion, the Directors on the AI Board (especially the Government Directors) should have been aware much earlier that such enormous increases in working capital loan limits (without a corresponding increase in operational revenues) were indicative of a major liquidity problem.

(Para 6.2.4)

- Cash profits and marginal net profits in 2004-05 and 2005-06 turned into substantial cash losses and net losses. The net worth of the entities, which was negative in 2004-05, was made positive in 2008-09 through a revaluation of fixed assets by Rs. 8,028 crore. Even such revaluation could not reverse the trend and it became hugely negative in 2009-10;

(Para 6.2.1)

- As of 2009-10, the total borrowing was 2.87 times the total revenue. Even the working capital loan was 1.38 times the total revenue. GoI's equity infusion of Rs. 325 crore in 2005-06 into the erstwhile IAL and Rs. 800 crore in 2009-10 to AI represented a mere drop in the ocean.

(Para 6.2.1)

We had pointed out in earlier audit reports that Productivity Linked Incentive (PLI) paid to officials amounted to rewarding employees for less than average achievement, since the base levels for incentive payment were set lower than the average performance achieved prior to introduction of the PLI scheme. During 2004-10, huge amounts continued to be paid as PLI to different categories of staff without appropriate linkage to operational and financial performance, at a time when the entity can ill afford such payments.

(Para 6.4)

In sum, while the liberalised approach to bilateral agreements on international entitlements, as well as external factors (Aviation Turbine Fuel (ATF) prices, and economic recession from late 2008 onwards) were important contributory factors leading to the dismal financial and operational performance of the erstwhile IAL/ AIL and the merged entity, chronic operational deficiencies in their functioning cannot be ignored.

7. What do we recommend?

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

- risky acquisition of a large number of aircraft with the intention of vastly expanded operations and "footprint". In the case of the erstwhile AIL, the large acquisition was clearly driven under the influence of the MoCA;
- a liberalised policy on bilateral entitlements for international air travel introduced by GoI. These agreements, besides not affording adequate time to AIL/ IAL to set their houses in order and gear up for a highly competitive environment, very evidently worked to the detriment of the National and Indian private carriers.
- an ill-timed merger undertaken strangely 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); and
- chronic operational deficiencies;
- a weak financial position, grossly inadequate equity capital and undue dependence on debt funding providing little or no cushion for the financial shock when it came;
- external factors beyond the control of AI, such as 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;

- **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. The next critical milestone to be fulfilled is **admission to the Star Alliance**, which is yet to happen. The importance of joining the Star Alliance cannot be overemphasised, as failure to do so by this deadline could allow other competing private carriers (e.g. Jet Airways) a window of opportunity and, thus, result in AI losing first entry advantage to other competing private Indian carriers.

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 ordered by the erstwhile IAL have been received by April 2010, while of the 50 aircraft ordered by the erstwhile AIL, 20 (8 777-200LR – long range, and 12 777-300ER – mid-range[1]) aircraft have been received. However, 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.

In order to maximise the chances of a positive outlook for the merged Air India, further measures need to be taken:

- **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:

    - **PLI should focus on On-time Performance (OTP),** as this is the most critical parameter in the airline industry, from a service perspective. The base level for OTP for performance incentive should not be set at an unduly low level, based on AIL/ IAL's past performance. It 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).**

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

- **Impact of first flights on OTP** – The impact of the first flights on On-Time Performance throughout the day, especially for short haul flights is critical. Consequently, the incentive/ disincentive for OTP of the first flights 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 AI as a whole and the other component linked to the specific performance of the division/ department/ sector to the most granular level possible. This will ensure that 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.

- **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, AI's testimony to COPU[2], 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[3] are available onsite, and on a round-the-clock basis, 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/ technology based channels, rather than agents/ front offices (which result in enhanced costs). The current proportion of ticket sales through AI's website is abysmally low. Further, anecdotal evidence of the poor speed/ response of AI's Internet website ticketing vis-a-vis that of competing airlines/ travel 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 latest generation, revenue management systems to enable real-

[2] Para 3.21 (pg. 45) of the 4th Report of COPU (2009-10) – Fifteenth Lok Sabha
[3] Typically of the rank of Manager/ Sr. Manager

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, unless the health of the airline improves. PLI, incentives, salary hikes and allowances merit major restructuring in the long term interest of the employees and the airlines.

- **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, which is subject to exploitation.

    - All free travel by AI officers, on duty or leaves 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.

- **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, typically to destinations like USA/ UK/ Europe and not for genuine traffic to the other country. AI and Indian carriers are handicapped by the lack of adequate hub facilities and other factors 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, entitlements for airlines/ countries predominantly dependent on 6th freedom traffic, notably Dubai, Bahrain and other Gulf countries, 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 should also be considered by MoCA. MoCA has in the past five years very obligingly bowed to ostensible pressures from Ministry of External Affairs, Ministry of Tourism and Ministry of Commerce. Whilst these Ministries no doubt recommended the need to liberalise international air services based on their mandate, MoCA yielded to them ignoring the interest of the Indian carriers including that of AI, the national carrier.

- Prompt payment of Government dues – AI's services are frequently used for VVIP and other Government duties. Reimbursement of costs incurred by AI is never done in a timely manner. Given the financial and liquidity crisis in which it finds itself, AI cannot afford such delays. MoCA should ensure that such dues are paid to AI in a timely manner.
- Infusion of Government Equity – Both the erstwhile AIL and IAL and the merged entity have been unduly dependent on debt/ loan funding with a very narrow equity basis, which has dramatically increased the financial risk/ burden on AI. GoI should consider prompt infusion of additional Government equity in a timely fashion to ensure that the Debt-Equity (D/E) ratio reaches levels prevalent in the Industry. However, such infusion has to be linked to a package which the company must accept in advance viz. restricting of incentives at all levels, reassessment of additional aircraft acquisitions, on time performance, rationalisation of routes with MoCA maintaining a hands off approach, critical relook at Bilateral Agreements, especially those linked with 6th freedom traffic and cutting down on staff/officers posted abroad in countries where the Airline does not operate.

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 AI 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 above mentioned factors and decisions thereupon, the Airline does not have a future as a vibrant Public Sector entity.