SpiceJet and the Indian Airline Industry in 2013

Dr. Sudeep B. Chandramana

Associate Professor, Department of Management Studies,

Mar Athanasios College for Advanced Studies Tiruvalla (MACFAST), Kerala, India

Abstract

Aviation in India is the fastest-growing aviation market in the world according to International Air Transport Association (IATA) data. IndiGo, Jet Airways, Air India, Spicejet and GoAir are the major carriers in the Indian aviation industry.India is the world's third-largest domestic and overall civil aviation market. This case study analyses the airline industry structure till the year 2013 in general, and the performance of one of the player Spicejet in particular, during this period. It also provides certain pointers for improving the functioning and operations of Spicejet.

Keywords:*Airline industry,*Spicejet, Industry analysis

Introduction

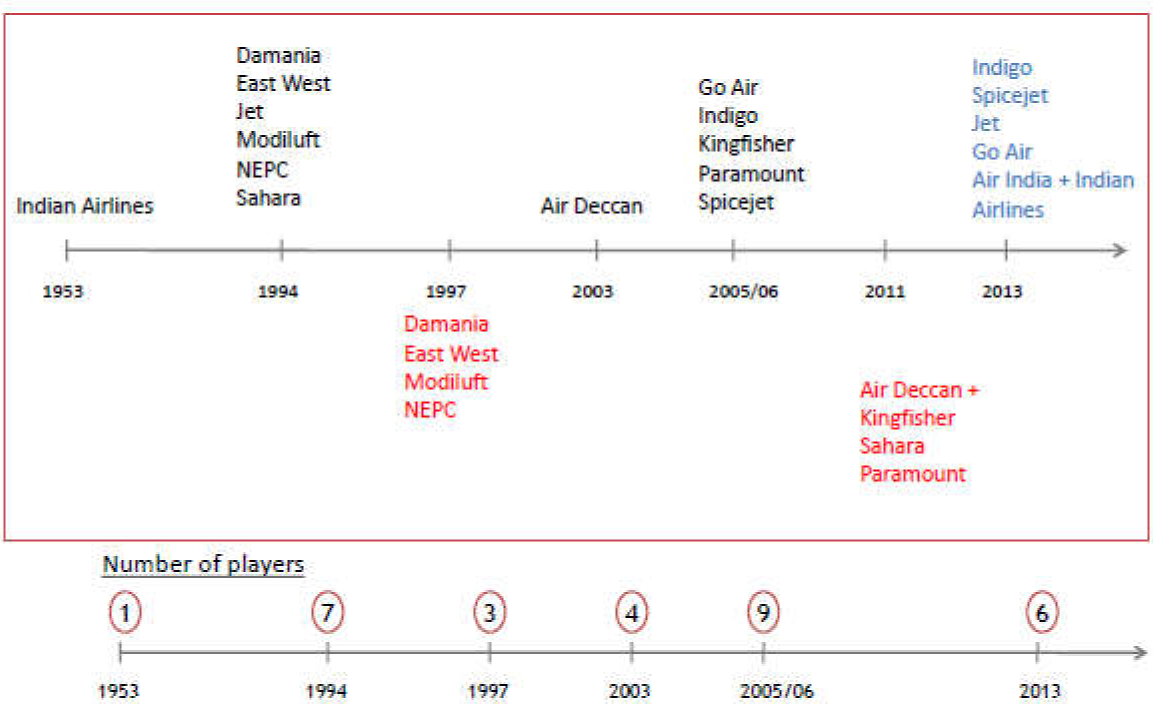
Over the last two decades, rise of India as an economic power and a country with long-term stability, has resulted in it being one of the preferred locations for the trade and commerce activities. This has resulted in development and expansion of various sectors, including the civil aviation. In 1990s, Indian government adopted the policy of "open sky" which resulted in the liberalization of the civil aviation industry and since then the industry has undergone a rapid and dramatic transformation. However, last couple of years has been very bad for the industry with all the players suffering huge losses primarily due to global recession, high fuel prices and lower fares due to market competition**(Exhibit 1)**. Center for Aviation, the industry research analyst, estimates that India's airlines posted a combined loss of USD1.65 billion in FY2013, down from approximately USD2.28 billion the previous year and it is believed that it will take three-four years for the sector to recover fully[1].

Competitive Position

At the time of India's independence in 1947, there were several regional airlines operating in the country. In 1953, Indian Government created two state owned airlines – Air India & Indian Airlines and the existing carriers were folded into these two organizations. As a corollary to the New Economic Policy of 1991, the Indian airline industry was deregulated in 1993 and several private players such as Damania, EastWest, Jet, Sahara, Modiluft and NEPC entered the market. These airlines positioned themselves differently. For example, Jet targeted the business sector with punctuality and quality of service whereas Sahara provided connectivity to new destinations at relatively cheaper prices. But high fuel cost, management inefficiency, and infrastructure problems soon caused a shake out. By the late 1990s Damania, EastWest, NEPC, and Modiluft were no longer in operation. After a temporary lull in activity in the airline industry, the healthy economic growth of India following economic liberalization again prepared the ground for the entry of new players. Most of these new entrants chose low fares as their selling propositions[2].

Air Deccan, led by Capt. Gopinath was the first player to emulate the Low Cost Carrier (LCC) model. It started its operation in August 2003. It offered single class point-to-point service, offered no meals and sold all its ticketsthrough the internet. It introduced several new concepts which were unprecedented in the then Indian market[3]. The entry of Air Deccan created a sort of revolution in the Indian sky. Air travelbecame affordable to the "common man" for the first time & demand increased at an unprecedented rate. Supply of aviation turbine fuel (ATF) toairlines was controlled by three public sector oil companies who saw ATF as a cash cow outsidethe politically sensitive arena of petrol and diesel. Airports were largely controlled by theAirports Authority of India, a government body that charged relatively high rates but was slowto create supportive infrastructure. Airlines were further hampered by routedispersal guidelines that required them to service non-metro and low demand destinations[4].Indian Airlines, Jet & Sahara couldnot ignore Air Deccan for long & they were forced to offer discounted fares. However, Air Deccan was plagued by several operational inefficienciesresulting in delays, baggage loss & customer dissatisfaction. It was never profitable, and faced cash flow problems. It was acquired by Kingfisher Airlines in June 2007.The growth of Air Deccan induced several other players to enter the market – SpiceJet, IndiGo,GoAir, Kingfisher and Paramount. While the first three followed the LCC model, the latter twopositioned themselves as full service carriers (FSCs) targeting business customers[5]. The major airlines operating in India and the evolution of Indian Airline industry is shown in **Exhibit 2 and 3** respectively.

Exhibit 2: Major Airlines operating in India



Source: DGCA, Ministry of Civil Aviation (MoCA), ICRA Research

Exhibit 3: Industry Evolution

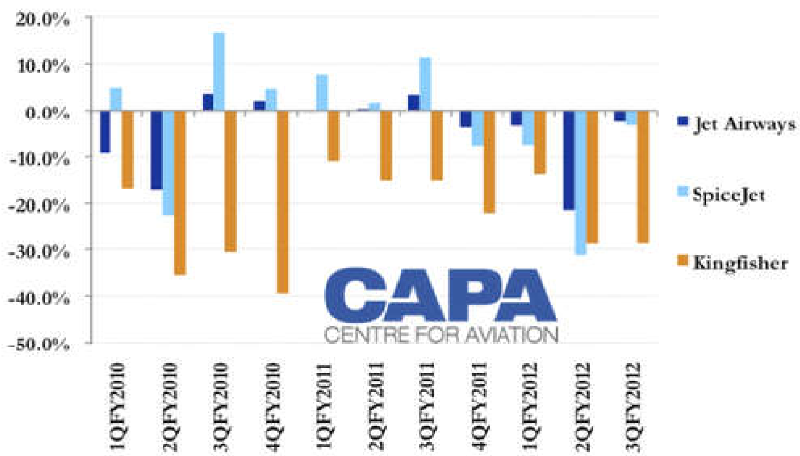
Year	Major Milestones
< 1953	Nine Airlines existed including Indian Airlines & Air India
1953	Nationalization of all private airlines through Air Corporations Act;
1986	Private players permitted to operate as air taxi operators
1994	Air Corporation act repealed; Private players can operate schedule services
1995	Jet, Sahara, Modiluft, Damania, East West granted scheduled carrier status
1997	4 out of 6 operators shut down; Jet & Sahara continue
2001	Aviation Turbine Fuel (ATF) prices decontrolled
2003	Air Deccan starts operations as India's first LCC
2005	Kingfisher, SpiceJet, Indigo, Go Air, Paramount start operations
2007	Industry consolidates; Jet acquired Sahara; Kingfisher acquired Air Deccan
2010	SpiceJet starts international operations
2011	Indigo starts international operations, Kingfisher exits LCC segment
2012	Government allows direct ATF imports, FDI proposal for allowing foreign carriers to pick up to 49% stake under consideration

Source: ICRA Research

SpiceJet airlines started its operations in May 2005 and by 2012, it was India's third largest airline in terms of market share, ahead of Air India, Kingfisher Airlines, and GoAir[6]. In legal terms, it is a reincarnation ofModiluft airlines originally promoted by the SK Modi Group. It is now owned by the Sun Group of India[7].

On 9 January 2012, the Directorate General of Civil Aviation (DGCA), reported that several airlines in India, including SpiceJet, have not maintained crucial data for the flight operations quality assurance or the FOQA. The Bombay stock exchange later announced that ever since June 2011, SpiceJet had been suffering losses in millions of rupees. BSE reported that SpiceJet suffered a loss of INR719.64 million (US$12 million) in March–June, INR2400.67 million (US$38 million) in June–September and INR392.60 million (US$6.3 million) in September–December**(Exhibit 4)**.

Exhibit 4: Spicejet getting into trouble from 4th Quarter of 2011



Source: CAPA, Ministry of Civil Aviation (MoCA), ICRA Research

The airline's quarterly income also went down in June–September 2011, but somehow the airline managed to pull its income up to INR11758.34 million (US$190 million) by December to recoup cumulative losses[8]. Despite the losses, the promoter, Kalanithi Maran doubled his stake in SpiceJet to 16% by investing INR1 billion (US$16 million) in the airline. Maran believed that SpiceJet was going through financial distress because of the steadily rising costs of Jet fuel. The airline's market share at the time was a little over 16% making it the fourth largest airline in India. He said that the airline was making preparations so as to directly import jet fuel reducing operational costs[9]. The total revenues, has seen a steady increase since 2006, in spite of all these challenges **(Exhibit 5)**.

Exhibit 5: Total revenue of Spicejet

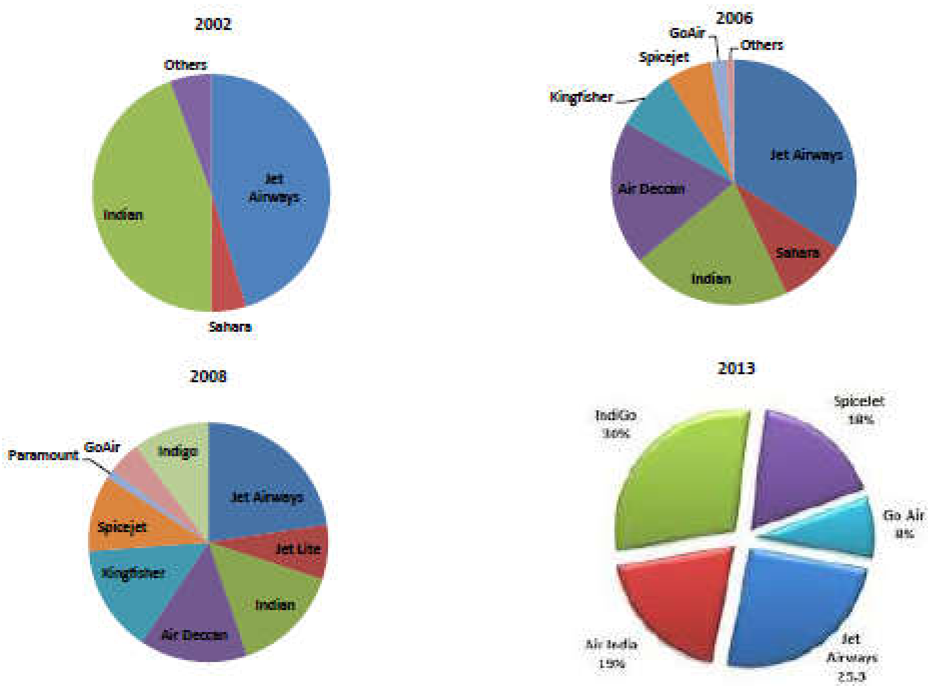
Year	Trend	Total Income
2000	–	₹5.37 million (US$86,000)
2001	▲	₹16.32 million (US$260,000)
2002	▲	₹37.6 million (US$600,000)
2003	▼	₹16.08 million (US$260,000)
2004	▲	₹41.46 million (US$660,000)
2005	▼	₹38.7 million (US$620,000)
2006	▲	₹4531.47 million (US$73 million)
2007	▲	₹7482.79 million (US$120 million)
2008	▲	₹14385.79 million (US$230 million)
2009	▲	₹18619.79 million (US$300 million)
2010	▲	₹22420.91 million (US$360 million)
2011	▲	₹29606.04 million (US$470 million)
2012	▲	₹40191.14 million (US$640 million)

Source: "Standalone Result – 31-Mar-12 – BSE". Bombay Stock Exchange

Competitor Analysis

SpiceJet faces a strong competitive environment with rivals including IndiGo (which, like SpiceJet, followed a "pure" LCC model, and was reputed to have an edge on certain factors such as customer handling and cleanliness), Jet Airways and Go Air.

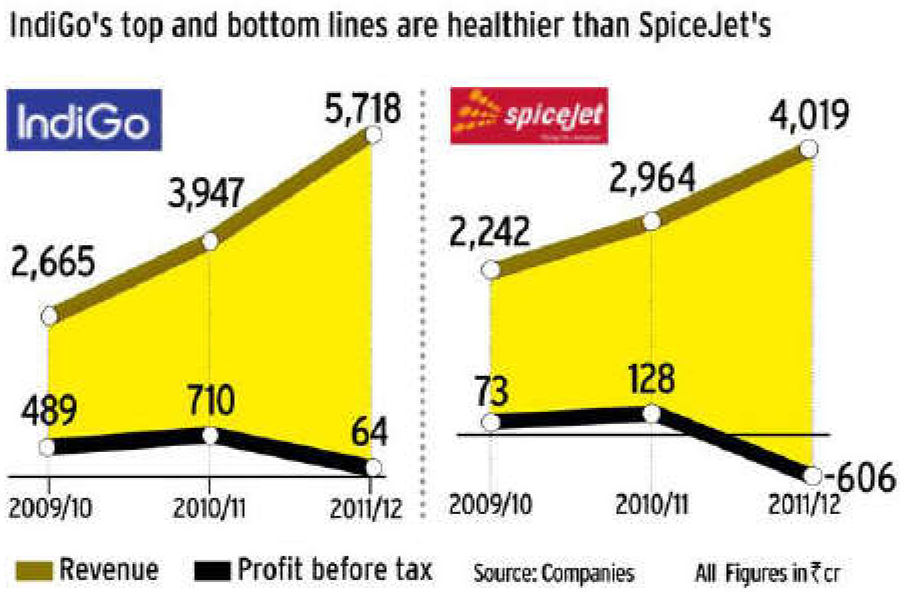
Exhibit 6: Market share of major airlines



Source: DGCA, Ministry of Civil Aviation (MoCA), ICRA Research

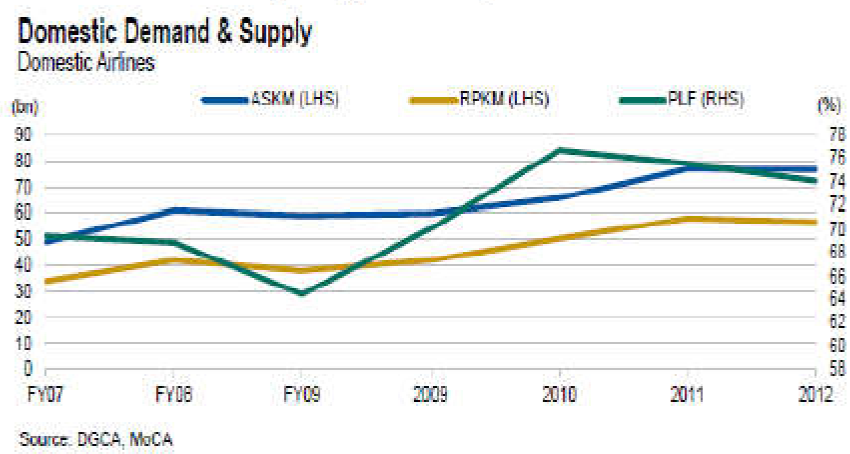
Exhibit 6 shows the market share of major airlines in the last 10 years. SpiceJet has been gaining market share over these years, but by 2013, is just able to survive at the 4th position in the market, after Indigo, Jet Airways and Air India. The market leader, Indigo, is way ahead of SpiceJet in terms of Profit and Revenues **(Exhibit 7).**

Exhibit 7: Comparison of Profit and Revenues of Spicejet with Indigo



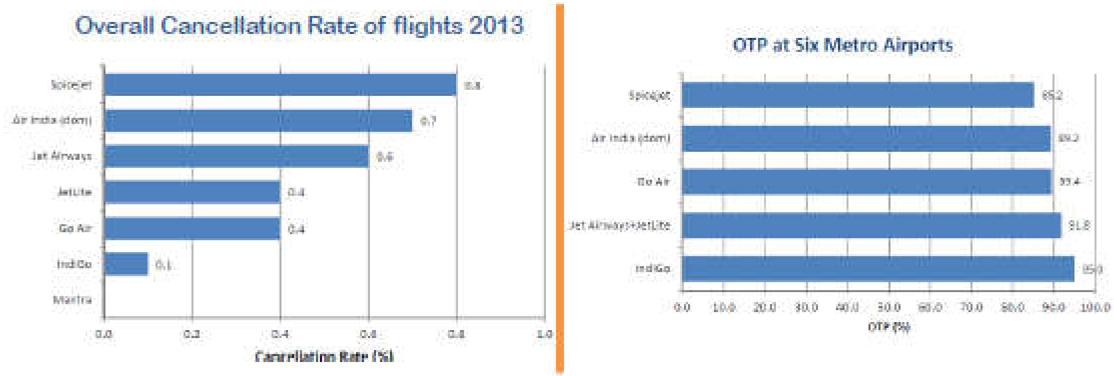
Full Service Carriers (FSC) has been offering some part of their capacity at low prices comparable to those of the LCCs[5]. Over-capacity and declining demand make competition worse than before**(Exhibit 8)**.

Exhibit 8: Over capacity, declining demand and load factor



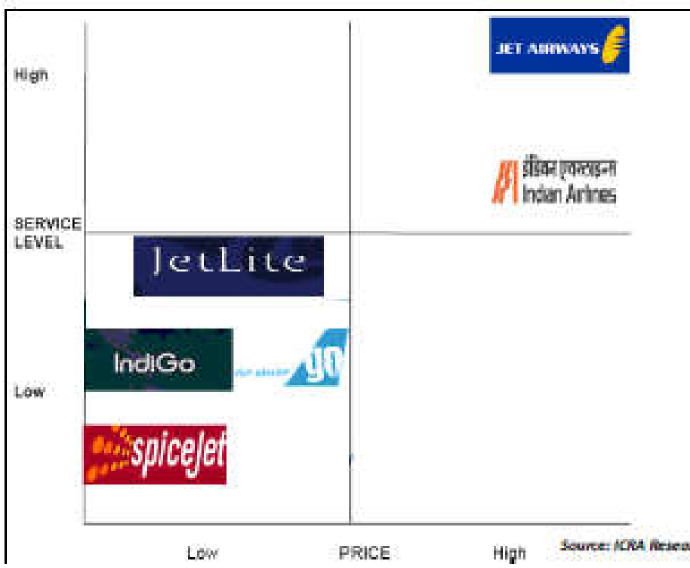
SpiceJet is also facing stiff competition in terms of quality of service compared to its competitors JetLite, Indigo and Go Air. It has the highest overall cancellation rate of flights and lowest on-time performance across six major airports in India **(Exhibit 9)**. This affects the overall quality of service to customers[10]. Price vs. Service level mapping, points towards the need for improving the service**(Exhibit 10)**of SpiceJet.

Exhibit 9



Source: DGCA, Ministry of Civil Aviation (MoCA), ICRA Research

Exhibit 10: Price vs. Service Level Map

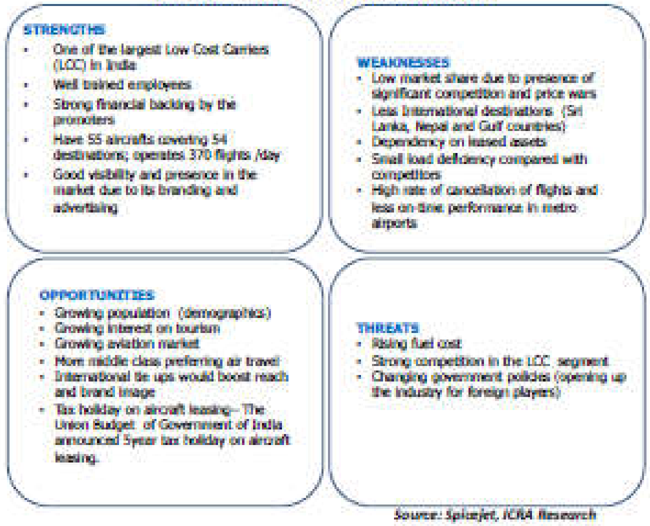


Source: ICRA Research, CAPA

SWOT Analysis

SpiceJet is one of the largest LCCs in India with a strong financial backing by the Sun Group of companies. It has high visibility and has 55 aircrafts, covering 54 destinations and operating 370 flights per day with 5252 employees as on March 2013[11]. But, due to intense competition and operational challenges, it stands only at the 4thposition in terms of market share. Although the rising fuel cost and threat of new entrants (foreign airlines as well) are concerns, a growing interest on tourism and more middle class preferring air travel could provide more opportunities for SpiceJet to gain more market share[12]. A detailed SWOT analysis is shown in **Exhibit 11.**

Exhibit 11: SWOT Analysis of Spicejet

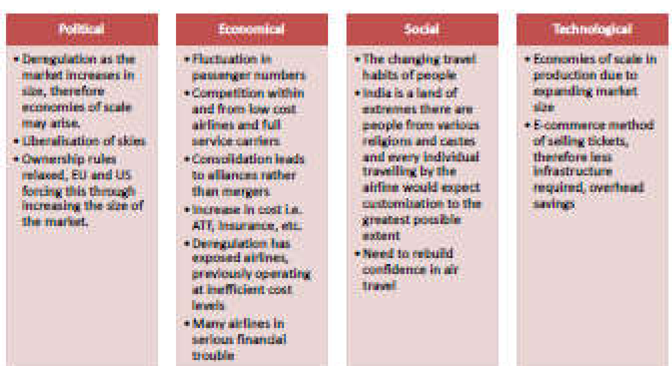


Source: Spicejet, ICRA Research

Analysis of Macro environment – PEST Analysis

As shown in **Exhibit 12,** the airline industry is very susceptible to changes in the political environment as it has a great bearing on the travel habits of its customers. Business cycles too have a wide reaching impact on the industry along with fluctuating numbers of passengers and increasing operational cost. In a country like India, there are people from varied socio-cultural background and income groups. The airlines have to recognize these individuals and should serve them accordingly. At the technology front, the increasing use of internet has provided many opportunities for airlines in terms of offering online ticket booking, updating flight information and handling customer complaints[12].

Exhibit 12: PEST Analysis



Source: DGCA, Ministry of Civil Aviation (MoCA), ICRA Research

Porter's Five Forces analysis

The five forces analysis reveals that Indian domestic airlines industry is unattractive despite being a growth industry[13]. A detailed analysis of each force is provided in**Exhibit 13**.

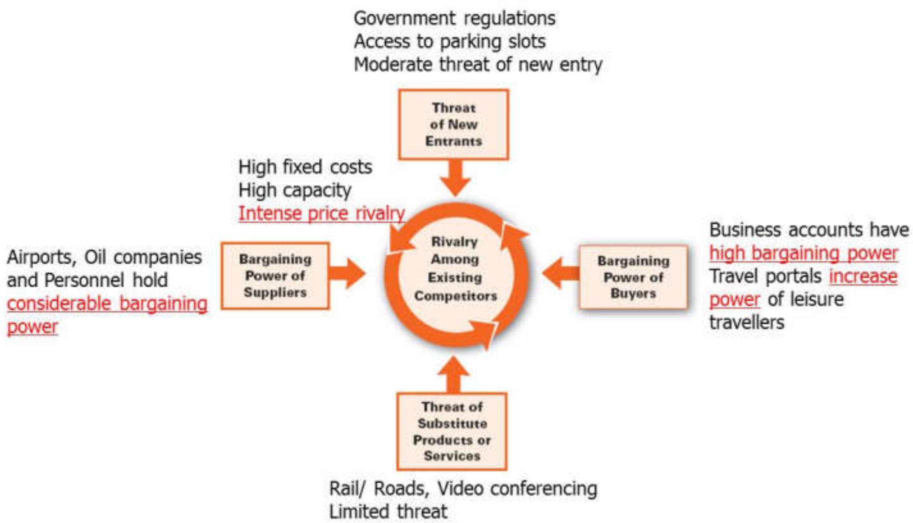
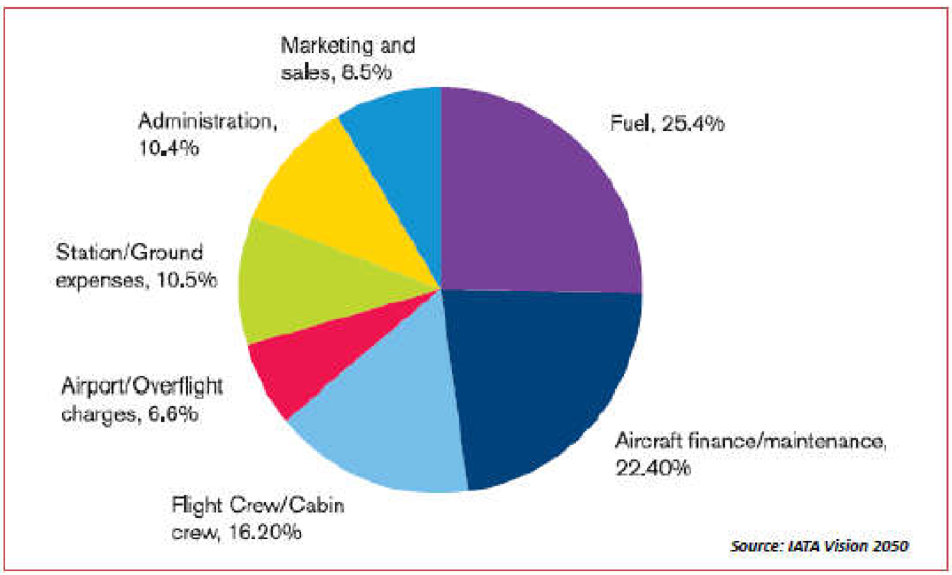


Exhibit 13: Porter's Five Forces Analysis

There is intense rivalry among the existing airlines due to high fixed costs **(Exhibit 14)** and high capacity. Moreover, the bargaining power of buyers and suppliers are high and this leaves the company in a helpless situation.

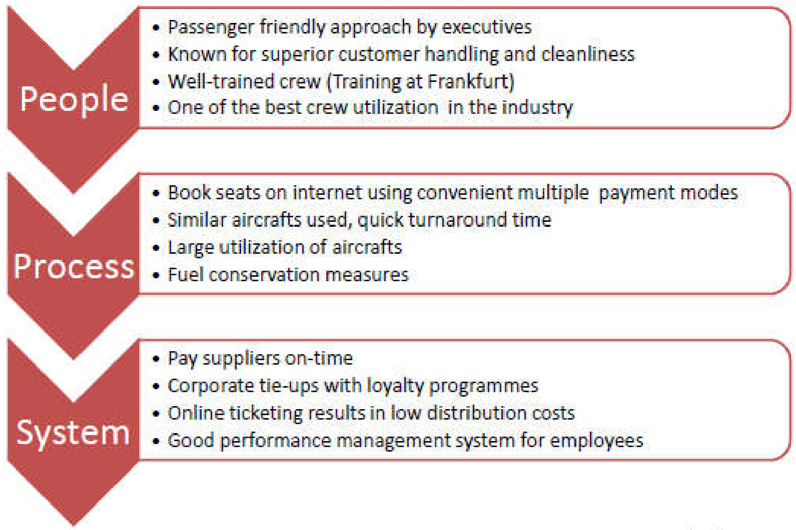
Exhibit 14: Airlines Cost Structure



Capability Analysis

SpiceJet has in place systems and processes, commensurate with its size and nature ofbusiness so as to ensure adequate internal control while ensuring smooth conduct of operations andcompliance with statutory requirements under all applicable legislations**(Exhibit 15)**.The core capability lies with the well trained employees of SpiceJet. It believes that the success of Company is deeply embedded in the success of its human capital and hence provides continuous training programs for team building and soft skills[11].

Exhibit 15: Capability Analysis



Source: Spicejet, CAPA

How to improve the current competitive position?

Demand for air travel in India has grown substantially over the past decade, thanks to increasing economic activity and rising disposable incomes. Indian economy's GDP grew by 5%. However due toinflation and reduced consumer spending on travel, Indian aviation witnessed a negative growth in passenger demand in 2013. This is also due to the fact that this year the fares were reflective of the underlyingcosts and as such is a good sign as it is shows the true demand. In the last fiscal, the demand wasalso due to dumping of fares by some airlines. The concerns still remain as the Indian fuel prices refuse to come down and the currentvery high levels of exchange rate. In the normal course, as is commonly witnessed in most industries,these costs ought to have been passed on to the customers. This becomes difficult in India due to theextreme price sensitivity of pricing on demand.**Exhibit 16** gives a detailed analysis on the factors favoring and against aviation industry.

Exhibit 16: Factors in favor and against Aviation Sector

Factors in favor of Indian Aviation Sector	Factors not in favor of Indian Aviation Sector
Strong growth prospects Passenger traffic growth has grown at a CAGR of 16% in India over the past 10 years	**Aviation economics are not favorable in India** Higher taxes on ATF and airport charges continue to be key headwinds for the sector; besides higher cost base, airlines in India are also mandatorily required to fly on certain unviable routes
Relative underpenetrated market Penetration of air travel at <3% is significantly below benchmarks in other markets	**Inadequate Infrastructure** Development of airport infrastructure has not kept pace with demand, thereby resulting in delays and higher costs for airlines
An opportunity to create India as an hub An opportunity for foreign airlines to create India as their hub for international traffic between Europe and South East Asia; Additionally offer better connectivity within India with international destinations	**Poor financial health of most airlines** Intense competition, sharp fluctuation in ATF prices and high debt burden continue to weigh on the financial performance of Indian airlines; foreign exchange fluctuation and lack of adequate hedging mechanism (for fuel) have added to the woes
An opportunity to create India as an MRO centre Foreign airlines could also look at leveraging on India's low-cost arbitrage by setting up MRO facilities in India	**Highly competitive & Price Sensitive traveler base**
Low Valuations Market valuation of listed airlines in India has suffered due to poor performance	

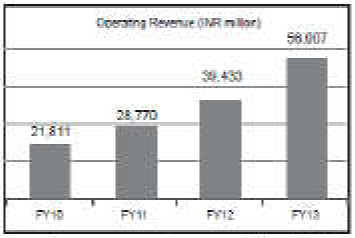
Source: ICRA Research

The key success factors in Indian airline industry are

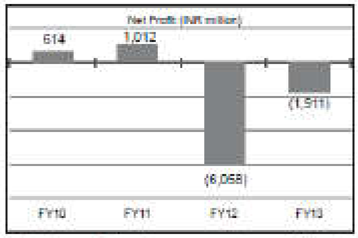
- ✓ Strict leash on capacity
- ✓ Operational efficiency
- ✓ Consolidation

The operational and financial highlights of SpiceJet for the year 2012-13 is shown in **Exhibit 17**. It has been buying aircraft in small tranches, and of different kinds. The small purchases mean discounts would have been lower, and maintenance and training expenses higher. SpiceJet employs 140 people per aircraft compared with 100 at IndiGo, the market leader and the only airline who have made profits in the last five successive years. **Exhibit 18** shows a comparison of profits of SpiceJet, Indigo and Jet Airways), indicating that Indigo utilizes its staff more efficiently. SpiceJet could add more international destinations and routes. This will result in additional aircraft utilization, higher Passenger Load Factor (PLF) and secure better yields. This will also offset the risk of infusion of additional capacities into domestic sectors.

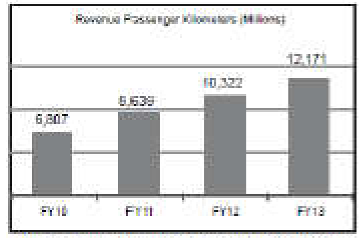
Exhibit 17: Operational and Financial Highlights (2012-13)



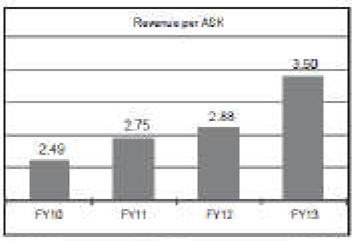
Operating revenue increased by 42.03% due to addition of aircraft and new destinations introduced.



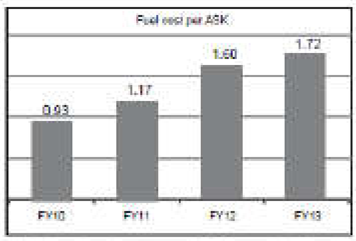
Net loss of the Company reduced due to increase in operating revenue however the weakness of Rupee and fuel prices could not be passed on to the customers in totality due to increased pricing pressure and competetion.



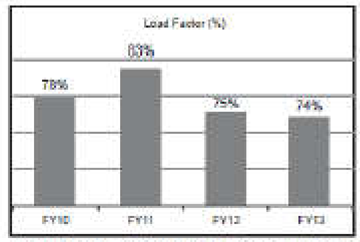
RPK's grew by 17.91% and this growth was impacted by marginally lower load factors during the financial year and deployment of the aircraft on relatively shorter sectors.



21% increase in Revenue per ASKM deployed due to better yield.



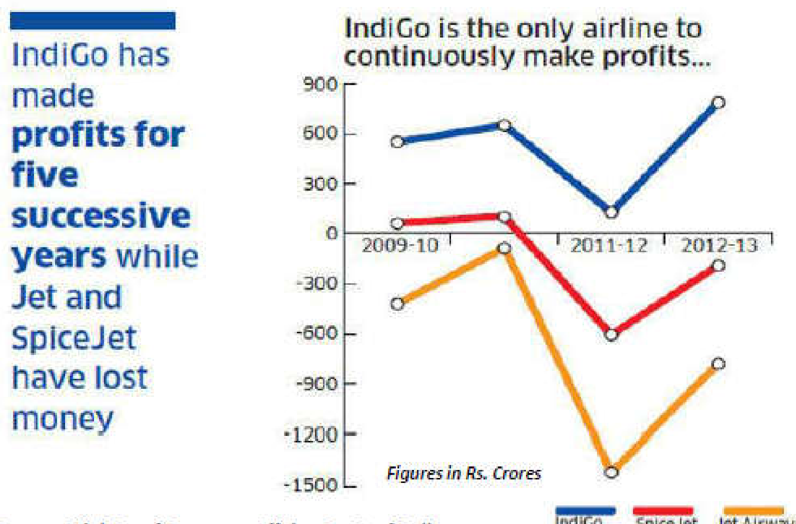
Effective fuel cost per ASK was higher by 7.50% due to rise in fuel price.



Load factors marginally decreased due to general state of economy and the Company increasing fares to offset costs.

Source: Spicejet Annual Report (2012-13)

Exhibit 18: Comparison of profits (2009-13) - Spicejet Vs. Competitors



Source: Ministry of Company Affairs, Govt. of India, Annual Reports of Companies

It could also provide connectivity to Tier II &Tier III cities. These airports due to its infrastructure constraints could give SpiceJet a distinct competitiveadvantage. If SpiceJet goes for a single type of aircraft (instead of the three types now), it would result in cost-saving efficiencies, in terms of training the mechanics, on-board and ground crews, extra parts inventory, making the fleet totally interchangeable. This would also helpthe company to have high bargaining powerwhile negotiating with the aircraft manufacturers as the order size would be large. It could, thus generate profits from sell and lease back transactions thereby bringing down the operational costs.

Affordable fares coupled with quirky advertising campaigns with could help to gain mindshare. But, as a passenger, advertising and smart-looking stewardesses count for nothing if flights are late or worse cancelled. SpiceJet should improve the on-time performance for customers to come back to it.It should go for further fuel-conservation measures and also consolidate its destinations to attain more capacity utilization.

Incorporating these “Best Practices” and achieving better operational efficiency by putting brakes on capacity expansion and going for consolidation of aircrafts and destinations, SpiceJet could improve its competitive position in the airline industry and emerge as the industry leader in the near future.

References

[1.] Center for Aviation, CAPA websitehttp://centreforaviation.com/analysis/indias-airlines-lost-usd165-billion-in-fy2013-capa-india-aviation-outlook-201314-part-4-111778

[2.] Chatterjee, Indranil, Sharan, Sumit, “SpiceJet: Becoming the McDonald’s of Indian Aviation”, 2011

[3.] Wolfgang Prock-Schauer “Airline Developments, State of the Industry and Way Ahead” Presentation at the South Asia Aviation Finance conference, 5th February 2007. Downloaded from www.jetairways.com

[4.] Directorate General of Civil Aviation – DGCA - website http://www.dgca.nic.in/manuals/man-ind.htm

[5.] Wolfgang Prock -Schauer “ Full Service Carriers: Adapting to the New Environment” Presentation at CAPA Conference, September 2006. Downloaded from www.jetairways.com

[6.] Nair, Vipin V. "SpiceJet Rises in Mumbai on Report of Kingfisher Deal (Update2)".Bloomberg website.Retrieved 30 August 2010).

[7.] http://www.spicejet.com/SharePattern.aspx

[8.] "Standalone Result – 31-Dec-11". Bombay Stock Exchange

[9.] http://zeenews.india.com/business/news/companies/indian-carriers-owe-rs-17-25-billion-to-airports-authority_44773.html

[10.] Directorate General of Civil Aviation - DGCA - website http://www.dgca.nic.in/reports/otp-ind.htm

[11.] “29th Annual Report 2012-13”, SpiceJet Limited, http://corporate.spicejet.com/Content/pdf/2012-13Annual%20Report.pdf

[12.] “Indian Aviation Industry: Through turbulent times, FDI relaxation alone not a game changer”, ICRALimited, March 2012

[13.] Krishnan, Rishikesha T, “Indian Airline Industry in 2008”, Indian Institute of Management, Bangalore, 2008