Strategic Management: Porter Analysis for Civil Aviation Industry

Ajay Kr. Dhamija *(N-I/MBA PT 2006-09)*

Abstract

"The air transportation system has become essential to the economic progress for the citizens and businesses of this nation"

The airline industry must:

- Be efficient and technologically superior
- Have the financial strength to respond to rapid change and opportunity.
- Efficiently move people, products and services to markets, wherever they exist

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We present here the porter five force analysis of Civil Aviation Industry and hence try to find out whether it would be advantageous to enter into this industry or not.


Introduction

Aviation Industry in India is one of the fastest growing aviation industries in the world. With the liberalization of the Indian aviation sector, aviation industry in India has undergone a rapid transformation. From being primarily a government-owned industry, the Indian aviation industry is now dominated by privately owned full service airlines and low cost carriers. Private airlines account for around 75% share of the domestic aviation market. Earlier air travel was a privilege only a few could afford, but today air travel has become much cheaper and can be afforded by a large number of people.

The Air Corporations Act, 1953 ensured that IAC and AI had a monopoly over the Indian skies. A third government-owned airline, Vayudoot, which provided feeder services between smaller cities, was merged with IAC in 1994. These government-owned airlines dominated Indian aviation industry till the mid-1990s. In April 1990, the Government adopted open-sky policy and allowed air taxi-operators to operate flights from any airport, both on a charter and a non-charter basis and to decide their own flight schedules, cargo and passenger fares. In 1994, the Indian Government, as part of its open sky policy, ended the monopoly of IA and AI in the air transport services by repealing the Air Corporations Act of 1953 and replacing it with the Air Corporations (Transfer of Undertaking and Repeal) Act, 1994. Private operators were allowed to provide air transport services. Foreign direct investment (FDI) of up to 49 percent equity stake and NRI (Non Resident Indian) investment of up to 100 percent equity stake were permitted through the automatic FDI route in the domestic air transport services sector. However, no foreign airline could directly or indirectly hold equity in a domestic airline company.
By 1995, several private airlines had ventured into the aviation business and accounted for more than 10 percent of the domestic air traffic. These included Jet Airways Sahara, NEPC Airlines, East West Airlines, ModiLuft Airlines, Jagsons Airlines, Continental Aviation, and Damania Airways. But only Jet Airways and Sahara managed to survive the competition. Meanwhile, Indian Airlines, which had dominated the Indian air travel industry, began to lose market share to Jet Airways and Sahara. Today, Indian aviation industry is dominated by private airlines and these include low cost carriers such as Deccan Airlines, GoAir, SpiceJet etc, who have made air travel affordable.

Airport infrastructure needs to be upgraded rapidly if Indian aviation industry has to continue its success story. Some steps have been taken in this direction. Two of India’s largest airports-Mumbai and New Delhi-were privatized recently. Two greenfield airports are coming up at Bangalore and Hyderabad in southern India. Investments are pouring into almost all aspects of the industry, including aircraft maintenance, pilot training and air cargo services. The future prospects of Indian aviation sector look bright.

This airline industry is classified into four categories

1. International
2. National
3. Regional
4. Cargo

Airport capacity, route structures, technology, and costs to lease or buy the physical aircraft are significant in the airline industry. Other large issues are:

1. **Weather:** The problem is that weather is variable and unpredictable. Extreme heat, cold, fog, and snow can shut down airports and cancel flights (which costs money). Weather is also the second-largest cause of flight accidents.

2. **Fuel Cost:** On average, fuel can make up 14-16% of an airline’s total costs, although efficiency among different carriers can vary widely. Short haul airlines typically get lower fuel efficiency because take-offs and landings consume high amounts of jet fuel.

3. **Labor:** It is estimated that 40% of an airline’s expenses are used to pay pilots, flight attendants, baggage handlers, dispatchers, customer service, and others.

Airlines also earn revenue from transporting cargo, selling frequent flier miles to other companies, and ‘up-selling’ in flight services. But by far, the largest proportion of revenue is derived from regular and business passengers. For this reason, it is important that we take consumer and business confidence into account on top of the regular factors that one should consider like earnings growth, debt load, etc.

Business travelers are important to airlines because they are more likely to travel several times throughout the year, and they tend to purchase the upgraded services that have higher margins for the airline. On the other hand, leisure travelers are less likely to purchase these premium services and are typically very price sensitive. In times of economic uncertainty or sharp decline in consumer confidence you can expect the amount of leisure travelers to decline.

It is also important to look at the geographic areas that an airline targets. Obviously, more market share is better for a particular market, but it is also important to stay diversified. For example, an airline that sends a high number of flights to the Caribbean might see a dramatic drop in profits if the outlook for leisure travelers looks poor.

A final key area to keep a close eye on is costs. The airline industry is extremely sensitive to costs such as fuel, labor, and borrowing costs. Some of the major players in the airline industry attribute 10-20% of their costs to jet fuel. Airline Industries operators need to factor fuel costs into their cost structures. Fuel prices have been known to fluctuate 5-10% or more on a month basis, so paying close attention to these costs is crucial.

Low-cost airlines are mushrooming in India, and the traveler has become the king. "The Fare Well" carriers are putting a smile on the face of the Indian air passenger.
In Nutshell, we can conclude about Aviation sector in India as under

- Huge Potential
- Under penetration market
- Total Passenger Market: 50 million
- Passenger trip per annum : (India: 0.05, USA: 2.02)
- Untapped Cargo market

Further this Industry is considered **All Pain, NO Gain Industry** on the World due to various reasons.

*Low cost Industry is the future of Aviation Industry in India.*

**Key Ratios:**

1. **Available Seat Mile** = \((\text{total no of seats available for transporting passengers}) \times \text{no of miles flown during period})

2. **Revenue Passenger Mile** = \((\text{no of revenue paying passengers}) \times \text{no of miles flown during period})

3. **Revenue per Available Seat Mile** = \(\text{Revenue}/(\text{no of Seats Available})

4. **Air Traffic Liability (ATL):** An estimate of the amount of money already received for passenger ticket sales and cargo transportation that is yet to be provided. It is important to find out this figure so you can remove it from quoted revenue figures (unless they specifically state that ATL was excluded).

5. **Load Factor** : This indicator, compiled monthly by the Air Transport Association (ATA), measures the percentage of available seating capacity that is filled with passengers. Analysts state that once the airline load factor exceeds its break-even point, then more and more revenue will trickle down to the bottom line. Keep in mind that during holidays and summer vacations load factor can be significantly higher, for that reason it is important to compare the figures against the same period from the previous year.

**Analyst Insight:** Airlines also earn revenue from transporting cargo, selling frequent flier miles to other companies, and 'up-selling' in flight services. But by far, the largest proportion of revenue is derived from regular and business passengers. For this reason, it is important that you take consumer and business confidence into account on top of the regular factors that one should consider like earnings growth, debt load, etc. Business travelers are important to airlines because they are more likely to travel several times throughout the year, and they tend to purchase the upgraded services that have higher margins for the airline. On the other hand, leisure travelers are less likely to purchase these premium services and are typically very price sensitive. In times of economic uncertainty or sharp decline in consumer confidence you can expect the amount of leisure travelers to decline.

It is also important to look at the geographic areas that an airline targets. Obviously, more market share is better for a particular market, but it is also important to stay diversified. Try to find out where a majority of an airlines flights are departing to. For example, an airline that sends a high number of flights to the Caribbean might see a dramatic drop in profits if the outlook for leisure travelers looks poor.

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**Porter Analysis**

1. **Threat of New Entrants** : As of now it is very easy to enter into the aviation sector in India since there are very few entry barriers. Government is also promoting the Local Players in the sector. Various low cost carriers, both domestic and foreign are entering the Indian skies with the increase in FDI limit to 49% from 40%. We need to look at whether or not there are substantial costs to access bank loans and credit. If borrowing is cheap, then the likelihood of more airliners entering the industry is higher. The more new airlines that enter
the market, the more saturated it becomes for everyone. Brand name and frequent flier point also play a role in the Airline industry. An airline with a strong brand name and incentives can usually be enough to lure a customer (even if their prices are higher).

Since Choppers/Airbus grab more Air space, the demand for helicopters is growing with the rise of heli-tourism, adventure sports, point-to-point heli-services connecting remote areas, islands and religious locations. The helicopter segment of the aviation sector is expected to grow further in the coming years.

With the airline industry cruising deeper into red zone and losses mounting, government is planning to erect a host of checks and balances on entry barriers to permit only serious and financially sound aviation ventures to take off. Under these fresh regulations, government intends to make it mandatory for all wannabe aviators to first tie-up finances; aircraft leasing deals and recruits pilots and engineers before seeking a scheduled airline license.

2. **Bargaining Power of Suppliers**: All suppliers have tremendous bargaining power with the airline industry. There are few fuel providers and no reliable alternative to fuel. There are very few pilots in the job market and planes cannot be flown without pilots. Mechanics for airplanes are in short supply and planes cannot be flown without being serviced. Flight attendants provide services that cannot easily be replaced and customer satisfaction without flight attendant would be detrimental. Finally airports are in limited supply and we need airports to land planes and board passengers.
The airline supply business is mainly dominated by Boeing and Airbus. For this reason, there isn’t a lot of cutthroat competition among suppliers. Also, the likelihood of a supplier integrating vertically isn’t very likely. In other words, we probably won’t see suppliers starting to offer flight service on top of building airlines. There is a trend of Global contraction of Material Supplies in this sector. So Companies are trying to take steps towards Achieving Self-Sufficiency in Raw Material Supplies.

3. **Bargaining Power of Buyers** : The bargaining power of buyers in the airline industry is quite low. Obviously there are high costs of switching airplanes, but taking a look at the ability to compete on service, the seat in one airline is probably not more comfortable than another, unless we are analyzing a luxury liner. Generally speaking, consumers, business or regular travelers, have little bargaining power with airlines. Either they buy the ticket or not, one traveler does not hurt the airline. The demand for more affordable air travel is quite robust.

4. **Availability of Substitutes** : What is the likelihood that someone will drive or take a train to their destination? For regional airlines the threat might be a little higher than international carriers. When determining this we should consider time, money, personal preference, and convenience in the air travel industry. No other product domestically competes directly with airlines in terms of cost and speed of travel. Bus services may cost less but travel speed extremely slow and tedious with many stops before your destination. Train services
are generally less expensive than airplane and only have select stations/stops. Generally charter planes are much more expensive than commercial airlines. Taxis are tremendously expensive for long distance and are constricted to speed limits and road layouts. Low cost carriers are mainly aiming to compete with Indian Railway’s AC segment.

5. **Competitive Rivalry**: Competition among major players is extremely intense in many aspects. Switching costs are generally low, even though companies have tried to increase switching costs with the use of “frequent flyer” programs. Highly competitive industries generally earn low returns because the cost of competition is high. This can spell disaster when times get tough in the economy.

### Entering into the industry

1. **Threat of New Entrants**: Since borrowing is cheap due to falling rate of interest and the Airlines market is not saturated yet, an entry into market is quite feasible. Heavy expenditure regarding advertisements and incentives like frequent flyer points etc would be needed to be put in place aggressively.

2. **Bargaining Power of Suppliers**: There isn’t a lot of cutthroat competition among suppliers. Also, the likelihood of a supplier integrating vertically isn’t very likely. So this point is of lesser relevance to the decision.

3. **Bargaining Power of Buyers**: The bargaining power of buyers in the airline industry is quite low, since ability to compete on service, the seat etc in all airlines is almost similar.

4. **Availability of Substitutes**: Advantage in terms of time, money, personal preference, and convenience can be thought of to ward off threat of substitutes.

5. **Competitive Rivalry**: There are not many competitors in the market, which could cut the returns. Also, Pricing policy can be devised properly to be in the vantage position.

So based on above analysis and based on the fact that the market is expanding exponentially, we would certainly like to invest in the industry at this point of time. We would do heavy investment in advertisements to create a brand image. We would introduce incentive schemes to entrench into the market. This may probably dig a hole into the returns of other airlines particularly Public airlines. Or it might result into mergers/agreements of some kind to remain profitable in the industry. The merger and buyout, however, would lead to large domestic airlines being created, and this could squeeze out the smaller players. Air India, which is being created through the merger of Air India and Indian Airlines, would have a fleet strength of 111 aircraft, while the merger of Air Deccan and Kingfisher will create an airline with close to 70 aircraft.

### References