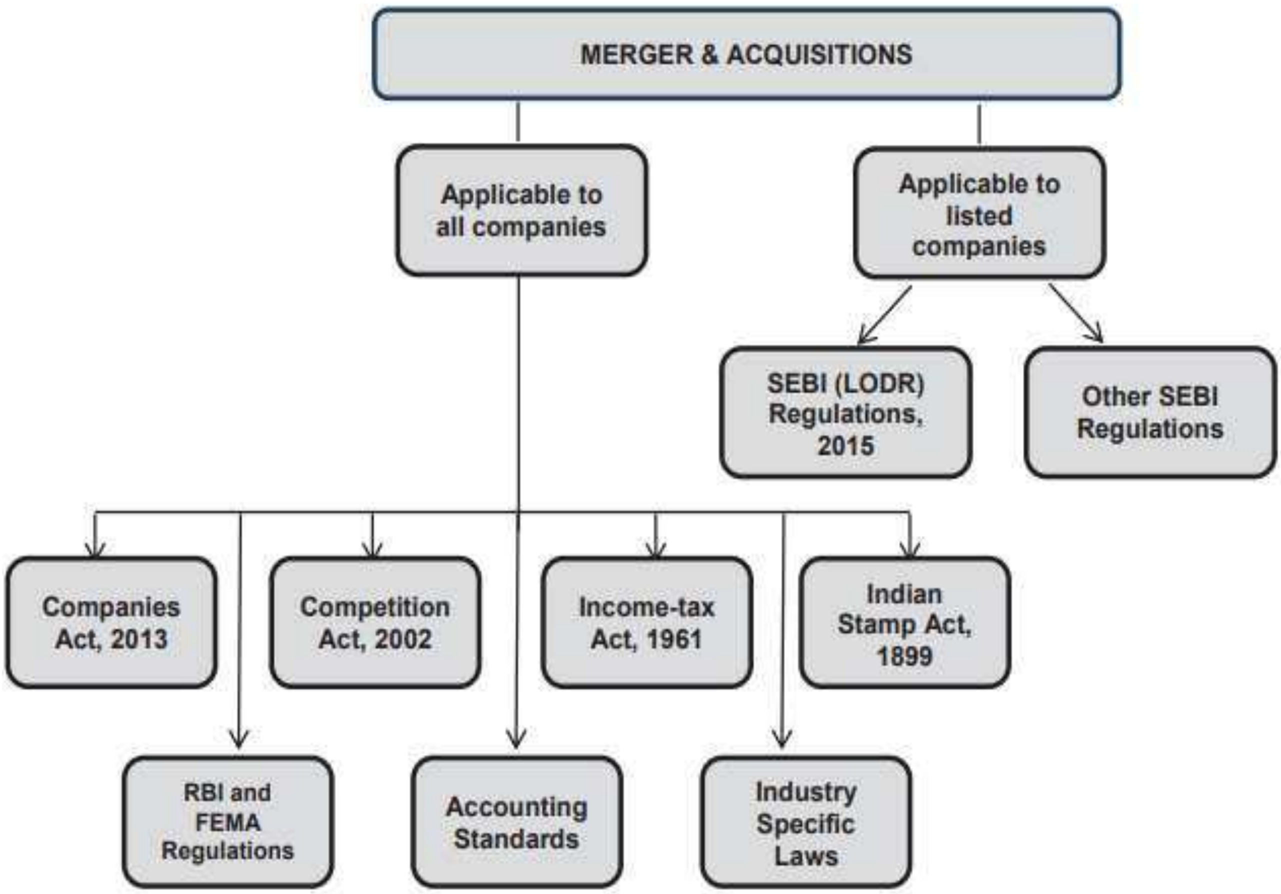
MODULE II

CORPORATE RESTRUCTURING & JOINT VENTURES IN AVIATION

LEGAL FRAMEWORK FOR MERGERS AND ACQUISITIONS



INTRODUCTION

Corporate Restructuring is an expression that connotes a restructuring process undertaken by business enterprise. It is the process of redesigning one or more aspects of a company. Hence, Corporate Restructuring is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives. A business may grow over time as the utility of its products and services is recognized, but it is a long drawn process. It may also grow through an inorganic process, symbolized by an instantaneous expansion in work force, customers, infrastructure resources and thereby an overall increase in the revenues and profits of the entity.

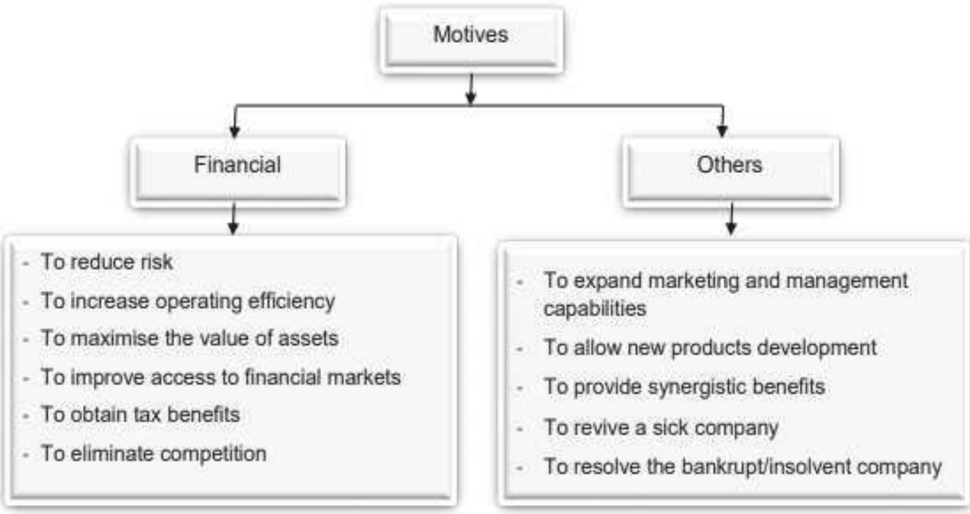
Corporate restructuring play a major role in enabling enterprises to achieve economies of scale, global competitiveness, right size, reduction of operational costs and administrative costs.

NEED AND SCOPE

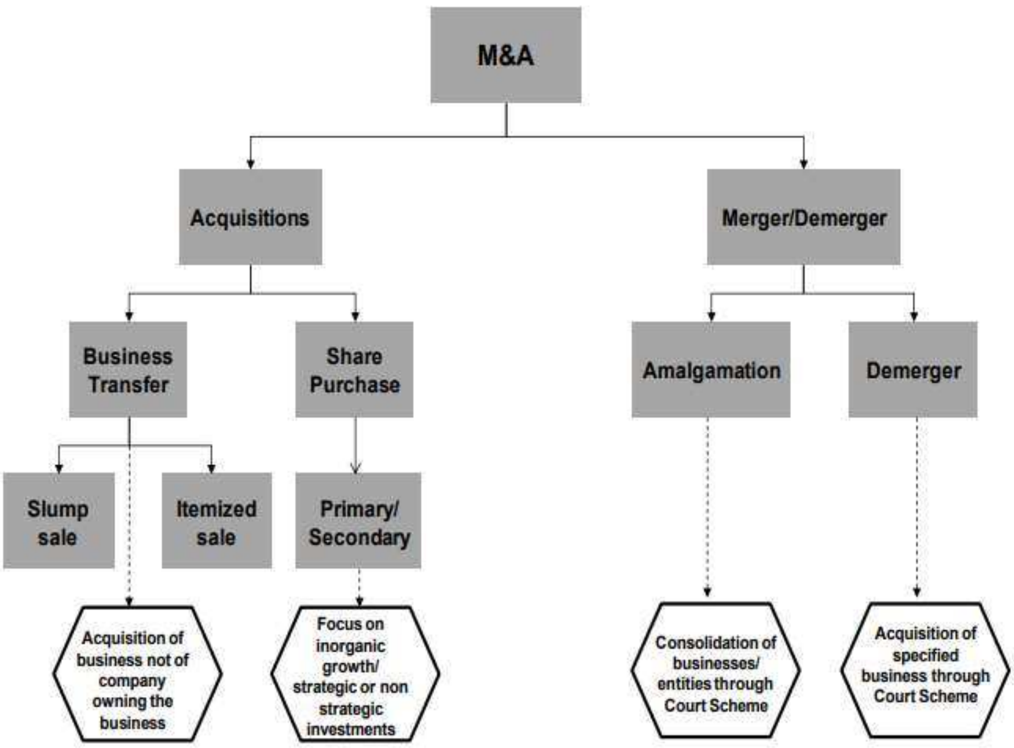
Corporate Restructuring is concerned with arranging the business activities of the Corporate as a whole so as to achieve certain pre-determined objectives at corporate level. Objectives may include the following:

- To enhance shareholders value
- Orderly redirection of the firms activities
- Deploying surplus cash from one business to finance profitable growth in another
- Exploiting inter-dependence among present or prospective businesses
- Risk reduction
- Development of core-competencies
- To obtain tax advantages by merging a loss-making company with a profit-making company
- To have access to better technology
- To become globally competitive
- To increase the market share

MOTIVES BEHIND CORPORATE RESTRUCTURING



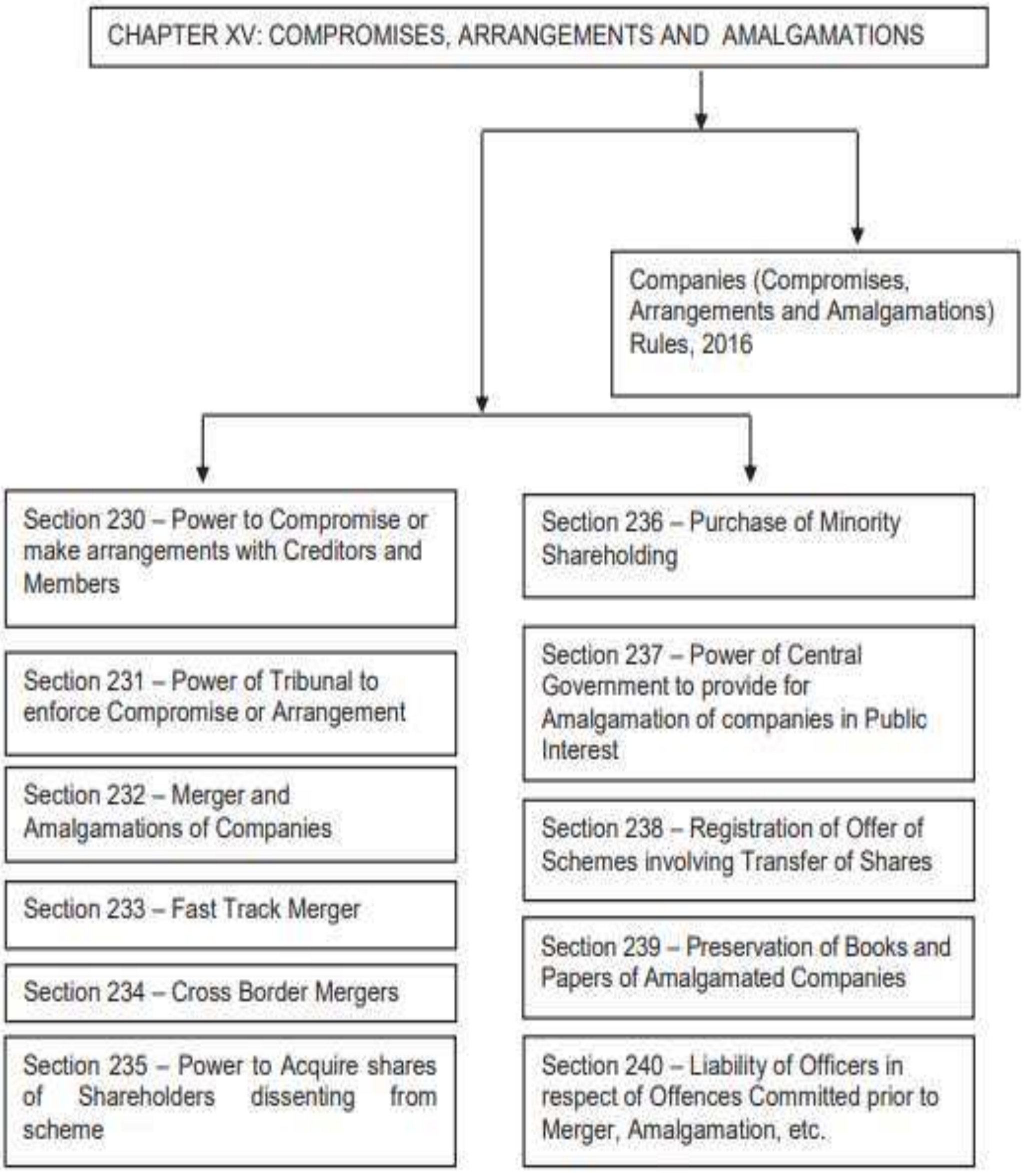
VARIOUS MODES OF CORPORATE RESTRUCTURING



LEGAL FRAMEWORK OF CORPORATE RESTRUCTURING

Corporate Restructuring in India is governed by the following Acts, Rules, etc.:

- Chapter XV of The Companies Act, 2013 (the Act)
- Buy Back of shares/purchase of own securities
- Reduction of share capital
- Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016
- Income Tax Act, 1961
- Accounting Standards
- Foreign Exchange Management Act, 1999 : The Foreign Exchange Management Act, 1999 (FEMA) is an Act of the Parliament of India "to consolidate and amend the law relating to foreign exchange with the basics of facilitating external trade and payments and for increasing the orderly development & maintenance of foreign exchange market in India".
- Competition Act, 2002: The law of M&A and Competition Law are intrinsically bound with each other as any combination including merger and acquisition has to undergo the regulatory stratagem as enumerated under the Competition Act, 2002.
- Intellectual Property Rights
- Indian Stamp Act, 1899
- Insolvency and Bankruptcy Code, 2016



Regardless of their category or structure, all mergers and acquisitions have one common goal: they are all meant to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on whether this synergy is achieved. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following:

Becoming bigger: Many companies use M&A to grow in size and leapfrog their rivals. While it can take years or decades to double the size of a company through organic growth, this can be achieved much more rapidly through mergers or acquisitions.

Pre-empted competition: This is a very powerful motivation for mergers and acquisitions, and is the primary reason why M&A activity occurs in distinct cycles.

Domination: Companies also engage in M&A to dominate their sector. However, since a combination of two behemoths would result in a potential monopoly, such a transaction would have to face regulatory authorities.

Tax benefits: Companies also use M&A for tax purposes, although this may be an implicit rather than an explicit motive.

Economies of scale: Mergers also translate into improved economies of scale which refers to reduced costs per unit that arise from increased total output of a product.

Acquiring new technology: To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.

Improved market reach and industry visibility: Companies buy other companies to reach new markets and grow revenues and earnings. A merger may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

MERGERS

The term merger and amalgamation has not been defined under the Act. M&A is often known to be a single terminology. However, there is a thin difference between the two. 'Merger' is the fusion of two or more companies, whereby the identity of one or more is lost resulting in a single company whereas 'Amalgamation' signifies the blending of two or more undertaking into one undertaking, blending enterprises loses their identity forming themselves into a separate legal identity. There may be amalgamation by the transfer of two or more undertakings to a new or existing company. 'Transferor Company' means the company which is merging also known as amalgamating company in case of amalgamation and 'transferee company' is the company which is formed after merger or amalgamation also known as amalgamated company in case of amalgamation. A merger is a legal consolidation of two entities into one entity which can be merged together either by way of amalgamation or absorption or by formation of a new company. The Board of Directors of two companies approve the combination and seek shareholders' approval. After the merger, the acquired company ceases to exist and becomes part of the acquiring company. Some recent examples are acquisition of eBay India by Flipkart, Vodafone-Idea merger and Axis Bank's acquisition of free charge, State Bank of India merger with all its subsidiary banks etc.

Types of Mergers

(A) Horizontal Merger

Horizontal Merger is a merger between companies selling similar products in the same market and in direct competition and share the same product lines and markets. It decreases competition in the market. The main objectives of horizontal merger are to benefit from economies of scale, reduce competition, achieving monopoly status and control of the market.

(B) Vertical Merger

Vertical Merger is a merger between companies in the same industry, but at different stages of production process. In another words, it occurs between companies where one buys or sells something from or to the other.

(C) Conglomerate Merger

Conglomerate merger is a merger between two companies that have no common business areas. It refers to the combination of two firms operating in industries unrelated to each other. The business of the target company is entirely different from the acquiring company. The main objective of a conglomerate merger is to achieve big 10 PP-CRILW size e.g., a watch manufacturer acquiring a cement manufacturer, a steel manufacturer acquiring a software company, etc.

(D) Congeneric Merger

Congeneric merger is a merger between two or more businesses which are related to each other in terms of customer groups, functions or technology e.g., combination of a computer system manufacturer with a UPS manufacturer.

ACQUISITION

Acquisition occurs when one entity takes ownership of another entity's stock, equity interests or assets. It is the purchase by one company of controlling interest in the share capital of another existing company. Even after the takeover, although there is a change in the management of both the firms, companies retain their separate legal identity. The companies remain independent and separate; there is only a change in control of the companies. When an acquisition is ‘forced’ or ‘unwilling’, it is called a takeover.

From a commercial and economic point of view, mergers and acquisitions generally result in the consolidation of assets and liabilities under one entity, and the distinction between a “merger” and an “acquisition” is less clear. A transaction legally structured as an acquisition may have the effect of placing one party’s business under the indirect ownership of the other party’s shareholders, while a transaction legally structured as a merger may give each party’s shareholders partial ownership and control of the combined enterprise. Contemporary corporate restructurings are usually referred to as merger and acquisition (M&A) transactions rather than simply a merger or acquisition. The practical differences between the two terms are slowly being eroded by the new definition of M&A deals. In other words, the real difference lies in how the purchase is communicated to and received by the target company’s board of directors, employees and shareholders.

Mergers and Acquisitions –

Primary Factors to be considered Merger or amalgamation is undertaken for acquiring cash resources, eliminating competition, saving on taxes or influencing the economies of large-scale operations. Therefore, there are host of factors, which require consideration before initiating a merger or amalgamation exercise. A detailed list of the primary factors requiring consideration before initiating a merger or amalgamation from the economic, commercial and legal perspective is explained as follows:

(i) Identification of Parties Will one or more businesses be transferred to an existing firm or a newly formed entity? Consider drafting heads of terms, do you require a confidentiality agreement? Do you require an exclusivity agreement? Review financial liability of the parties - undertake appropriate searches.

(ii) Due Diligence Carry out legal, commercial, tax and financial due diligence on the parties entering into the transaction. This will help in identifying risk areas along with any necessary consent you will need to obtain.

(iii) (Any third-party consents required? Ascertain if any third-party consents would be required such as from banks, business contracts, partner / shareholder consents. These should emerge from due diligence. Consider also regulatory consents / licences that may be required.

(iv) Taxation It will be necessary to ascertain the most suitable tax structure for the transaction and, in particular, the way in which the consideration should be structured, at an early stage, therefore consider consulting tax advisors.

(v) Risk Sharing of risk – What kind of indemnities / warranties be considered? Should there be a cap on such indemnities and warranties?

(vi) Will the transaction impact on existing loan/finance arrangements? Check loan documents and constitution documents to see whether any proposed borrowing would be a breach of any existing funding. What will happen in relation to third party funding of the Seller business? Confirm that there are no restrictions on the disposal of the target business or any of its assets. How will the merged business be funded?

(vii) Existing Charges / Modifications over the assets to be acquired Are there any mortgages, charges or debentures over any of the business assets? If yes, obtain copies and consider how they are to be discharged. If there are floating charges, obtain certificates of non-crystallisation / release. Obtain a Search Report from a Practicing Company Secretary.

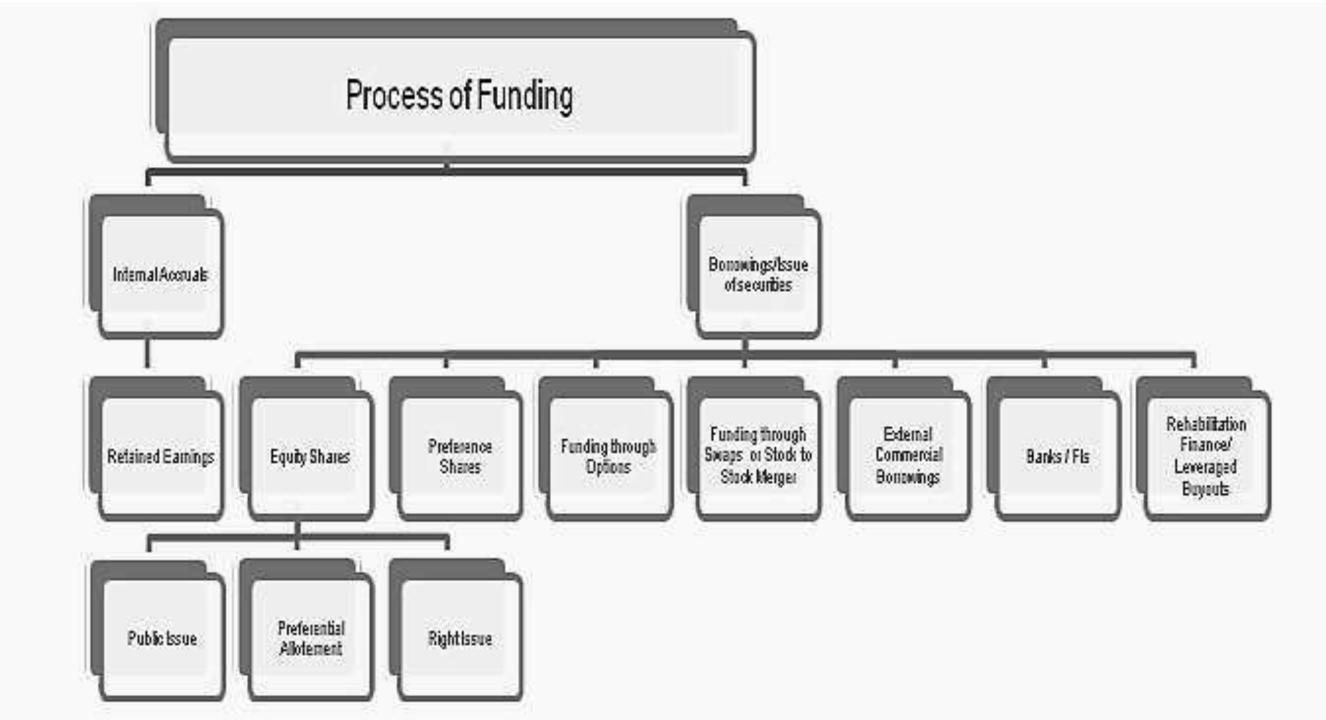
(viii) Guarantees and indemnities (bank or other) Has the Seller given or received any guarantees or indemnities in relation to the business? If yes, then obtain copies (including details of arrangements) and consider in particular, how to ensure the business continues to have the benefit of relevant guarantees.

(ix) Licences Will the Buyer have all other licences which it needs to operate the business?

(x) Supply contracts Will supply contracts be transferred or need to be terminated? How will this be done?

(xi) What IP is used in the business? Obtain a full list of trademarks, service marks, patents, designs, domain names, copyright and other registered and unregistered intellectual property used in the business. Carry out trade mark and patent searches as may be appropriate through an IPR Attorney.

PROCESS OF FUNDING:



AMALGAMATION

Amalgamation is defined as the combination of one or more companies into a new entity. It includes:

(i) Two or more companies join to form a new company.

(ii) Absorption or blending of one by the other.

Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or amalgamated company. In other words, property, assets, liabilities of one or more companies is taken over by another or are absorbed by and transferred to an existing company or a new company. Therefore, the essence of amalgamation is to make an arrangement thereby uniting the undertakings of two or more companies so that they become vested in, or under the control of one company which may or may not be the original of the two or more of such uniting companies.

The word "amalgamation" is not defined under the Companies Act 2013 whereas section 2(1B) of Income Tax Act, 1961 defines Amalgamation as: "amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that – (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation; (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation; (iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company. Amalgamation includes absorption. The Institute of Chartered Accountants of India has issued Accounting Standard (AS) 14 on Accounting for Amalgamations.

Reasons for Amalgamation:

(a) To acquire cash resources

(b) To eliminate competition

(c) Tax savings/advantages

(d) Economies of large scale operations

(e) To Increase shareholders value

(f) To reduce the degree of risk by diversification

(g) Managerial effectiveness

(h) To achieve growth and financial gain

(i) Revival of weak or sick or insolvent/bankrupt company

(j) Survival

(k) Sustaining growth

CONSOLIDATION

A consolidation creates a new company. Stockholders of both companies approve the consolidation, and subsequent to the approval, receive common equity shares in the new firm. Example: In 1998 Citicorp and Traveller's Insurance Group announced a consolidation, which resulted in Citigroup.

TENDER OFFER

One company offers to purchase the outstanding stock of the other firm at a specific price. The acquiring company communicates the offer directly to the other company's shareholders. Example: Johnson & Johnson made a tender offer in 2008 to acquire Omrix Biopharmaceuticals for $438 million.

ACQUISITION OF ASSETS

In a purchase of assets, one company acquires the assets of another company. The company whose assets are being acquired, obtain approval from its shareholders. The purchase of assets is typical during bankruptcy proceedings, where other companies bid for various assets of the bankrupt company, which is liquidated upon the final transfer of assets to the acquiring firm(s).

MANAGEMENT BUYOUT

A management buyout (MBO) is a transaction where a company's management team purchases the assets and operations of the business they manage. MBO is appealing to professional managers because of the greater potential rewards from being owners of the business rather than employees. According to global consultancy giant Grant Thornton, the overall deal activity -- including both mergers and acquisitions and PE (private equity) -- was about $59 billion in the January-November period of 2017, a 9 per cent rise from the previous year 2016.

PURCHASE OF COMPANY AS RESOLUTION APPLICANT UNDER IBC LAW

The basic objective behind the Insolvency and Bankruptcy Code 2016 is to revive the insolvent company by approving the effective resolution plan and maximization of assets of the corporate debtor. As per the Code, the company under insolvency can be purchased by the resolution applicant by participating in the bid process by submitting the most effective resolution plan. This way the insolvent company can be revived by some other company/group/individuals., Example: Tata Steel has taken over the bankrupt Bhushan Steel for ₹35,200 crore.

JOINT VENTURE

A joint venture (JV) is a business or contractual arrangement between two or more parties which agree to pool resources for the purpose of accomplishing a specific task may be a new project or any other business activity. In a joint venture (JV), each of the participants is responsible for profits, losses and costs associated with it. Company enters into a joint venture when it lacks required knowledge, human capital, technology or access to a specific market that is necessary to be successful in pursuing the project on its own.

For example, A Ltd. may own technology, manufacturing and production facilities that B Ltd. needs to create and ultimately distribute a new product. A joint venture between the two companies gives B Ltd. access to the equipment without purchasing or leasing it, while A Ltd. is able to participate in production of a product without incurring costs to develop. Each company benefits when the joint venture is successful, and neither is left to complete the project alone.

Types of Joint Ventures

(a) Equity-based joint ventures is a type of joint venture in which two or more parties set-up a separate legal company to act as the vehicle for carrying out the project. This new company would usually be located in the same country as one of the two partner companies, with the purpose of mutually establishing an activity with its own objectives: marketing and distribution, research, manufacturing, etc. It benefits foreign and/or local private interests, or members of the general public through capital.

(**b) Non-equity joint ventures** also known as cooperative agreements, seek technical service arrangements, franchise, brand use agreements, management contracts, rental agreements, or onetime contracts, e.g., for construction projects, non-equity arrangements in which some companies are in need of technical services or technological expertise than capital. It may be modernizing operations or starting new production operations.

STRATEGIC ALLIANCE

Nike, the world's largest producer of athletic foot-wear, does not produce a single shoe. Boeing, the giant aircraft company, makes little more than cockpits and wing bits. These organizations, like a number of other businesses nowadays, have created strategic alliances with their suppliers to do much of their actual production for them. A strategic alliance is an arrangement between two companies that have decided to share resources to undertake a specific, mutually beneficial project. It is an excellent vehicle for two companies to work together profitably. It can help companies develop and exploit the unique strengths. Organizations get an opportunity to widen customer base or utilize the surplus capacity.

TAKE OVER

Where an acquirer takes over the control of the 'target company', it is termed as takeover. When an acquirer acquires 'substantial quantity of shares or voting rights' of the target company, it results into substantial acquisition of shares. Takeovers and acquisitions are common occurrences in the business world. In some cases, the terms takeover and acquisition are used interchangeably, but each has a slightly different connotation. A takeover is a special form of acquisition that occurs when a company takes control of another company without the acquired firm's agreement. Takeovers that occur without permission are commonly called hostile takeovers.

Acquisitions, also referred to as friendly takeovers, occur when the acquiring company has the permission of the target company's Board of directors to purchase and takeover the company. Acquisition refers to the process of acquiring a company at a price called the acquisition price or acquisition premium. The price is paid in terms of cash or acquiring company's shares or both. As the motive is to takeover of other business, the acquiring company offers to buy the shares at a very high premium, that is, the gaining difference between the offer price and the market price of the share. This entices the shareholders and they sell their stake to earn quick money. This way the acquiring company gets the majority stake and takes over the ownership control of the target company.

KINDS OF TAKEOVER

Takeovers may be broadly classified into three kinds:

(i) Friendly Takeover: Friendly takeover is with the consent of taken over company. In friendly takeover, there is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company. This kind of takeover is done through negotiations between two groups. Therefore, it is also called negotiated takeover.

(ii) Hostile Takeover: When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management.

(iii) Bailout Takeover: Takeover of a financially sick company by a profit earning company to bail out the former is known as bailout takeover. There are several advantages for a profit making company to takeover a sick company. The price would be very attractive as creditors, mostly banks and financial institutions having a charge on the industrial assets, would like to recover to the extent possible.

LEGAL ASPECTS OF TAKEOVER

The legislations/regulations that mainly govern takeover are as under: 1. Companies Act, 2013 2. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (The Regulations) 3. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 As far as Companies Act, 2013 is concerned, the provisions of Section 186 apply to the acquisition of shares through a company. Section 235 and 236 of the Companies Act, 2013 lays down legal requirements for purpose of takeover of an unlisted company through transfer of undertaking to another company. SEBI (SAST) Regulations, 2011 lays down the procedure to be followed by an acquirer for acquiring majority shares or controlling interest in another company.

As per Regulation 31A(5) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, if any public shareholder seeks to re-classify itself as a promoter, such a public shareholder shall be required to make an open offer in accordance with the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

TAKEOVER OF UNLISTED COMPANIES

Section 236 of the Companies Act contains a compulsory acquisition mode for the transferee company to acquire the shares of minority shareholders of Transferor

Company. Where the scheme has been approved by the holders of not less than nine tenth (90%) in value of the shares of the transferor company whose transfer is involved, the transferee company, may, give notice to any dissenting shareholders that transferee company desires to acquire their shares. The scheme shall be binding on all the shareholders of the transferor company (including dissenting shareholders), unless the Tribunal orders otherwise (i.e. that the scheme shall not be binding on all shareholders). Accordingly, the transferee company shall be entitled and bound to acquire these shares on the terms on which it acquires under the scheme (the binding provision). The advantage of going through the route contained in Section 235 of the Companies Act is the facility for acquisition of minority stake. The transferee company shall give notice to the minority dissenting shareholders and express its desire to acquire their shares within a period of 4 months after making an offer as envisaged under Section 235 of the Act.

When a Company intends to takeover another Company through acquisition of 90% or more in value of the shares of that Company, the procedure laid down under Section 235 of the Act could be beneficially utilized. When one Company has been able to acquire more than 90% control in another Company, the shareholders holding the remaining control in the other Company are reduced to a minority. They do not even command a 10% stake so as to make any meaningful utilization of the power. Such minority cannot even call an extraordinary general meeting under Section 100 of the Act nor can they constitute a valid strength on the grounds of their proportion of issued capital for making an application to the Tribunal under Section 241 of the Act alleging acts of oppression and/or mismanagement. Hence the statute itself provides them a meaningful exit route.

The following are the important ingredients of the Section 235 route:

- The Company, which intends to acquire control over another Company by acquiring share, held by shareholders of that another Company is known under Section 235 of the Act as the "Transferee Company".
- The Company whose shares are proposed to be acquired is called the "Transferor Company".
- The "Transferee Company" and "Transferor Company" join together at the Board level and come out with a scheme or contract.
- Every offer or every circular containing the terms of the scheme shall be duly approved by the Board of Directors of the companies and every recommendation

to the members of the transferor Company by its directors to accept such offer. It shall be accompanied by such information as provided under the said Act. The circular shall be sent to the dissenting shareholders in Form No: CAA 14 to the last known address of the dissenting shareholder.

- Every offer shall contain a statement by or on behalf of the Transferee Company, disclosing the steps it has taken to ensure that necessary cash will be available. This condition shall apply if the terms of acquisition as per the scheme or the contract provide for payment of cash in lieu of the shares of the Transferor Company which are proposed to be acquired.

VARIOUS MODES TO BE CONSIDERED FOR TAKEOVER

The acquiring company is always interested in the financial aspects, human aspects, assets and liabilities of the target company. The following due diligence checks may help in carrying out the process:

Financial Aspects:

- Read the auditor's report and qualifying remarks, if any and director's responsibility statement. Whether the company is profit making, dividend paying company
- Calculate financial ratios and compare it with the previous year(s) figures of the company and also compare with the industry trend.
- Whether the Balance sheet have any fictitious assets?
- Whether any assets have been re-valued (particularly of real estates) in current year or in past. Calculate Net worth and its components and compare it with the previous year(s) figures.
- Whether any penalty from Revenue Authorities, Stock Exchanges/ SEBI/ CCI/ FEMA levied in the current / past years?
- Whether any litigation against the company, is pending before any court of law?
- Amount of contingent liabilities

Debtor's aspects:

- Study the demographic profile of the customer
- Study the type of customer base
- Whether sales are made in concentration / very few buyers are available in the market.

Creditor's aspects

- Who are the suppliers?
- What are the terms and conditions for purchase on credit?
- Whether the supplier is unique or discattered or no single supplier can mis-match the supply?

Material Control Aspect

- Make a review of all material contracts and commitments of the target company
- Study various issues pertaining to guaranties, loans, and credit agreements
- Study the Customer and supplier contracts, Equipment leases, Indemnification agreements, License agreements, Franchise agreements, Equity finance agreements, Distribution, dealer, sales agency, or advertising agreements, Non-competition agreements, Union contracts and collective bargaining agreements, Contracts the termination of which would result in a material adverse effect on the company.

Human Aspect

- Study the organization chart and biographical information,
- Type of workforce and expertise involved.
- Summary of any labour disputes, information concerning any previous, pending, or threatened labour stoppage,
- Employment and consulting agreements, loan agreements, and documents relating to other transactions with officers, directors, key employees, and related parties,
- Schedule of compensation paid to officers, directors, and key employees for the three most recent fiscal years showing separately salary, bonuses, and non-cash compensation (e.g., use of cars, property, etc.)

Regulatory Aspects

- Study the revenue returns filed by the company and its assessment orders.
- Whether any penalty has been imposed for contraventions of the provisions of the law and such penalty is still due.
- Whether the company is abiding with the company law compliances.

- Check the various returns filed with the RoC and is there any specific laws applicable and compliance of such laws are regular.

MERGERS AND ACQUISITIONS IN INDIAN AVIATION INDUSTRY

In the present era of liberalization and globalization, questions relating to the impact of mergers and takeovers on the economy of a country, warrant our immediate attention. During the past few years, India has followed the worldwide trends in consolidation amongst companies through mergers and acquisitions. Mergers and industrial restructuring have raised important issues both for business decisions and for public policy information. The daily newspapers are filled with case studies of mergers and acquisitions, tender offers (both friendly and hostile), spin-offs and corporate restructuring, changes in ownership structures, units being hived off and struggles for corporate control.

Mergers are like a marriage in the romantic jargon. Usually there is a period of courtship leading to the joining of two or more separate entities into one, after which the parties hope to live happily ever after, i.e., to say a Merger is said to occur when two or more companies combine to form a new company. Mergers in aviation industry are also very relevant to the present economy because it affects directly the life of large number of people who frequently use airway for commuting from once place to the other place. The direct affect involves the frequency of the number of flights being operated by different airlines in a specific route and the cost that has to be paid by the customer to avail such facility. Mergers in aviation industry would definitely affect both these concerns of the prospective or frequent customer.

Airline mergers and alliances can allow airlines to lower cost and enhance demand by rationalizing the combined networks, and expanding the scope of seamless service. On the other hand, airline mergers and alliances can reduce competition and enhance market power, especially on non-stop routes to and from hub airports. The relative balance of the efficiency benefits and the competition effects depends on a number of factors, including the degree of overlap in the airlines' networks prior to the merger.

The promotion and protection of competition in the airline industry requires attention to both competition and regulatory issues. In particular, competition in the airline industry could be preserved and enhanced through:

- Further liberalization of regulatory constraints on competition, especially at the international level, including for example, the application of international trade principles of transparency and non-discrimination within multilateral context;
- Attention to the mechanisms for investment in and allocation of scarce airport capacity including investment in new airports, expansion of existing airports and mechanisms for ensuring that facilities are available to entrants at key times;
- Careful review of proposals for mergers and alliances, careful use of remedies to offset anticompetitive effects and consideration of divestiture or separation in cases of dominance;
- Close review to frequent- flyer programs and other loyalty schemes;
- Careful control over predatory behaviour and other anti competitive practices.

Jet-Sahara Merger: Heralding the Consolidation in Civil Aviation Industry:

It seek to examine the significance of Jet–Sahara merger against the backdrop of liberalization and privatization of civil aviation sector. Having witnessed a tumultuous journey interspersed with legal hurdles owing to which it was held in abeyance, the resurrected merger has triggered the market driven consolidation of aviation industry. Secondly, it uncover the ramifications of this merger on the health of low cost carrier in the proposed paper. The Jet–Sahara combine will re-assert the leading private airline's supremacy in the Indian skies and empower it to fight the low fares offered by low cost carriers. This deal has erected a conspicuous entry barrier as evidenced by the changing dynamics of low cost carriers with Jet acquiring dominant market share and enhanced airport infrastructure.

Thirdly, it made an attempt to explore the legal underpinnings of this deal to understand the role of mergers and acquisitions in the aviation sector. This deal is saddled with monopolistic traces making Jet the largest player in Indian airspace and the sole private airline to possess international flying rights. (In the current scenario, Kingfisher has attained clearance from the civil aviation ministry to operate international flights courtesy the Kingfisher-Deccan deal). The MRTP Commission gave the green signal to deal silencing all analysts claiming abuse of dominance. The probe was in a way restricted as clauses relating to monopoly, mergers and acquisitions in the MRTP act had been deleted in 1991. With establishment of the new competition regime addressing legal concerns exhaustively, the aviation industry can expect stricter vigilance in future consolidation advances.

Fourthly, it undertakes an analysis of regulatory obstacles that have been exposed through this deal. The transfer of assets such as parking and landing slots were being governed by land lease agreements and couldn't change hands through merger. The civil aviation ministry settled the dust by charting guidelines regulating transfer of airport infrastructure in all merger schemes.

Project Finance in Airlines

In the last few years major structural and organizational changes have been occurring within the air transport industry. Major airlines have been consolidating their services by forming international alliances whilst a new generation of low cost carriers has entered the market. At the same time, a growing number of airports have been privatized which has allowed airport groups, which control a number of airports in different countries, to develop. In the era of globalization, the aviation industry is booming very much and low cost operating airlines are coming up and project financing or we can say that financing in the airlines or like mergers or take over of major carriers in aviation are taking place. If we take the example Kingfisher is a major airline and it took over the small and budget carrier Deccan airways, so many low cost airlines are coming up and investment in this field is very much as we have seen the changes in the recent decade that the purchasing power parity of a common man has increased many times folded, so for increasing demand in the aviation industry so many low cost airlines or we can say budget airlines came up and huge money is being invested in this field, if we look at the past few years only few airlines were there and they were even not permitted by the aviation ministry to fly internationally but now many private airlines are there which are flying internationally. Now financing of the airlines or venturing up the capital in starting the new airlines is booming up, every day we hear of some or the other airline coming up in the market, competition is so high that financing in the aviation sector or like in airlines is a new phenomenon which has been seen in the recent days. Project financing involves various aspects like, first of all the attention required as such the latest techniques in airport traffic forecasting, revenue and cost projection, airport charges regulation, project finance and risk assessment. Key market trends will be evaluated, including the growth in global airline alliances, low cost airlines and increasing concern over environmental issues, together with their potential implications for future airport growth. In the same decade airports have transformed from a public service to a value creator in a transport network. Deregulation of air transport markets has shown that the introduction of competition may have drastic impacts on network configurations of airlines, because of free route entry and exit; airlines will use their route networks to achieve traffic economies and maintain spatial monopolies in a competitive environment, so the major thing is that project finance in airlines is increasing day by day, economy is growing, as the number of growth of airports is also growing, so financing projects related to the aviation industry is seen as a profitable venture. Predatory Pricing is assumed, when an incumbent airline responds to market entry by greatly expanding capacity and low-fare seats. Summing up project finance in airlines is now a seen as a profitable venture as the market trends are changing in the developing country like India, so financing the airlines is also seen as a new phenomenon.

Air France and KLM Merger:

In September 2004, the boards of directors of KLM and Air France announced the merger of the two airlines forming Air France-KLM, the biggest airline in the world in terms of revenues. This paper investigates the effect of the merger on the stock price and operational performance of the merging firms, using three different methods outlined later. An analysis of mergers and acquisitions (M&A) in the airline industry is done to examine the effect that M&A generally has in this industry. While mergers and acquisitions are widely discussed in the economic literature, M&A in the airline industry are generally overlooked, despite their relevance for finance and their big impact on stakeholders of the airlines.

FACTORS THAT INFLUENCE THE SUCCESS OF THE AIR FRANCE-KLM MERGER

Firm size

The firm size has a negative impact on short-term and long-term AR, according to Moeller et al. (2004) and Franks et al. (1991). Dickerson et al. (1997) find the same results for operational performance, although they find that the firms in the 1st quintile (the smallest firms) perform worse than those in the 2nd and 3rd quintile. Although these papers do not directly provide an explanation for the negative correlation between firm size and AR, it is reasonable to assume this is due to the ‘firm size effect’; the larger the firm, the harder it is to find investment opportunities that improve overall company performance significantly. Because Air France-KLM is in the 5th quintile when all airlines are ranked from small to big, the firm size might have a negative influence on the success of the merger in all 3 methods.

Method of financing

In many studies on the effect of mergers, a distinction is made between stock-financed M&A and cash-financed M&A. Healy et al. (1992), Fuller et al. (2002) and Heron and Lie (2002), among others, analyzed the difference in CAR and operational performance between these two ways of financing. On this subject, the literature does not seem to reach a single conclusion. Looking at the short-term stock price effect, Healy et al. (1992) find that cash-financed M&A outperform stock-financed M&A in terms of short-term CAR, especially when looking at the acquiring firms. An explanation could be that acquirers using cash take on more debt, for which they are rewarded by shareholders. Heron and Lie (2002) reach the same conclusion. Fuller et al. (2002), however, find that stock-financed M&A outperform cash-financed M&A.

Looking at the long-term stock price effect, significantly better results for cash-financed M&A are found by Abhyankar et al. (2005). The explanation they offer is that when an M&A is financed with stock, this is a signal that the stock price is too high. This explanation is consistent with the findings of Myers and Majluf (1984). Opposed to the Abhyankar et al. results, Franks et al. (1991) find no significant difference between the two methods of financing.

Two studies expand on the impact of the method of financing on long-term operational performance. Heron and Lie (2002) find that stock-financed M&A outperform cash-financed M&A, even though they find opposite returns when looking at the short-term CAR. Unfortunately, they do not provide the reader with possible explanations. A different conclusion is reached by Ghosh (2001), who finds evidence that cash-financed M&A outperform stock-financed M&A, and uses the same reasoning as Abhyankar et al (2005).

Air France acquired KLM by offering 11 Air France shares and 10 Air France call options for 10 KLM shares. According to the majority of the studied literature, this might have a negative impact on the CAR and the operational performance of Air France-KLM.

However, since there is no unanimous conclusion, it is a weaker expectation than was the case for both CARs.

Mergers and Acquisitions in the airline industry

In 1978, deregulation of the airline industry started in the US to spread to the rest of the world in the following years. One consequence of this deregulation was the rise of low-cost carriers (LCCs) and increased competition. This triggered many airlines to merge in order to achieve economies of scale. This consolidation is thought to be crucial in an industry that is still fractioned. Notably, the top five European airlines had a combined market share of only 31% in 2008, four years after the Air France-KLM merger (Buettner and Burger, 2008).

It is surprising how little attention the specific area of airline mergers has received, especially compared to the number of studies addressing effects of M&A in general. Whereas most studies that do address this topic focus on problems related to Industrial Organization, especially market power and price levels, this paper focuses on financial performance. The papers that did focus on financial performance are discussed in the next section. How the possible factors of success relate to the Air France-KLM merger is discussed later.

Short-term stock price effect

As with M&A in general, the literature is fairly conclusive regarding the short-term stock price effect. Singal (1996), Knapp (1990), Slovin et al. (1991) and others report significant AR for target airlines and zero to slightly positive AR for acquiring airlines. Factors that are discussed include firm size, method of payment and overlap of cities serviced by the merging airlines.
Since mergers in the airline industry did not occur frequently before 1978, there was not enough data to analyze airline M&A until the end of the 1980s. One of the first to dive deeper into the airline industry from this point of view was Knapp (1990). Taking the period between 20 days before and 10 days after the merger announcement, he finds significant CARs for target firms of around 25% and significant CARs for acquiring firms between 6% and 12%. The author suggests that a possible explanation is the network overlap between acquirers and targets, but provides no evidence to support this. An article that partly reaches the same conclusion when looking at the short-term stock price effects is Singal (1996). He finds significant CAR for target airlines of up to 22% when using a period between 5 days before and 1 day after the merger announcement, and insignificant

AR for acquiring airlines. This seems to confirm the research findings on M&A in general. Singal (1996), too, suggests that a high overlap in the airlines' network results to higher gains, and shows that the coefficient on route overlap is in fact positive, confirming the suggestions made by Kim and Singal (1993).

Slovin, Sushka and Hudson (1991) have the same expectations regarding the explanations for excess returns to target and acquiring airlines around merger announcements, which is that they are significantly positive for both but higher for target firms, and that market power is an important determining factor. While the former seems to be confirmed by their empirical analysis, the latter is not. The authors do indeed find significant CARs of 10.8% for target airlines and 5% for acquirers in the period from 4 days before the merger announcement to the day of the merger announcement itself. A satisfactory reason is not provided. Their tests on the influence of market power (of which overlap of network is a strong indicator) show that this does not have a significant impact on the AR. This could be due to the small sample size that is used and/or the fact that very small mergers are included. In the case of very small mergers, the market power of both parties is unlikely to change even when their networks overlap well, but this overlap could still have a positive effect on the AR. The effect of overlapping networks will in this case be neglected.

Long-term stock price effect

Unfortunately, there is no research done yet on the long-term stock price effect of mergers in the airline industry. The authors that researched the stock price effect looked only at the short-term effect. A predicted effect can still be derived from the existing literature, however, by combining the conclusions of various papers. Singal (1993) draws the important conclusion that the stock price and the operational performance are correlated in the short term. Based on this it can be assumed the long-term stock price is also correlated with the long-term operational performance. The literature on the long-term operational performance is discussed in the next paragraph and is used to support hypotheses that involve both the long-term operational performance and the long-term stock price.

Operational performance effect

Investigating the effect of mergers on the operational performance of the companies, researchers often focus on the higher market concentration caused by the mergers. The general theory is that a higher market concentration results in higher prices and higher profit margins, and thus higher returns on assets (RoA) and returns on equity (RoE). The effect of mergers on the RoA and RoE of airlines is not studied in the existing literature. However, market power is assumed to have a strong correlation with both metrics (Bruner, 2000). Therefore the outcomes found by the studies on the effect of mergers on the market power are used as an indication. Several papers, for example Jordan (1988), Slovin et al. (1991) and Kim and Singal (1993) study the effect of mergers in the airline industry on the market power of the merging companies and the profit margin.

Jordan (1988) finds that market concentration and market power of the merging airlines does not increase after the merger. A reason for this is that merging airlines terminate part of the created overlap on existing routes. However, Jordan does find that operating costs are lower after the merger, which is an indicator for increasing RoA and RoE, and that prices are also lower after the merger, which is an indicator for decreasing RoA and RoE.

As does Jordan (1988), Carlton et al. (1980) find that mergers in the airline industry do not have a significant effect on the market power of the merging airlines, and thus do not impact the long-term operational performance from this point of view. Their theory is that the higher a firm's market power, the higher the price level is and the higher the profit margin. They find that the product is superior after the M&A but that the price level remains the same.

An author that does find significant average improvement in profit margins is Merkert (2012). An important conclusion from his study is that the success of M&A in the airline industry is strongly influenced by firm size. This relationship seems to be stronger than is the case in mergers in other industries. Merkert (2012) argues that there is an optimal firm size, and that a merger hurts the profit margins if the merged firm becomes too big. The firm size is measured in terms of available seat kilometres (ASK) and the optimal firm size is 34-52 billion ASK.

Kim and Singal (1993) find that market power of merging airlines does increase after M&A. They provide evidence in the form of a significant increase in fares as a result of increased market power. A separate study by Singal (1993) supports these findings and shows that the stock price reaction anticipates on this increase in fares (see above). The increased market power and fares is considered to be an argument for airlines to merge. Possible determinants of the degree of increase are not discussed.

Factors that influence the success of the Air France-KLM merger

The literature on mergers in the airline industry provides little explanation around the drivers of success. Consensus is reached on the influence of market power, but not on firm size and overlap of network. All three factors are discussed in the following section.

Market power

All studies that are discussed above see market power as a critical determinant of success of M&A. They argue that increased market power leads to higher prices and higher profit margins, thus higher RoA and RoE. A possible weakness of the literature is that it does not explain if this relationship is linear, which is probably is not, and what the optimal market share is. It is obvious that the market share and the market power of Air France-KLM was greater than that of Air France and KLM separately. Because no optimal market share is given, the increased market share is considered to have a positive effect on the AR and the operational performance of Air France-KLM.

Firm size

As shown by Merkert (2012), firm size is an important factor for the success of an M&A in the airline industry. He argues that the optimal firm size is 34-52 billion ASK, and that airlines with a capacity of more than 200 billion ASK are too large to operate efficiently. Because Air France-KLM had a capacity of 201 billion ASK in 2004 and 215 billion ASK in 2005, the merger is expected to generate diseconomies of scale.

Overlap of network

There is a big overlap of the network of Air France and KLM. One reason for this is that the hubs of both airlines, Paris and Amsterdam respectively, are only 400 kilometres apart. Before as well as after the merger both airlines serviced many cities in Europe, North America and Asia, which creates an overlap and thus market power and higher profits (Singal, 1993). Termination of a big part of the overlap as suggested by Jordan (1988) is not applicable to Air France-KLM. The overlap of the network is expected to have a positive effect on both the CARs and the operational performance of Air France-KLM.

The Air France-KLM merger

Short-term stock price effect

For the short-term stock price effect for the Air France-KLM merger, the expectation was that the abnormal return (AR) of Air France would not have been influenced significantly by the merger. The expectation was that the AR of KLM would have risen significantly in the 5 days surrounding the announcement of the merger. As can be seen in table 2, the two parts of the first hypothesis are accepted based on the empirical research conducted. The AR on the stock price of Air France was on average 0.007% in the control period before the merger and - 0.875% in the (-2,+2) period, but the test statistic is -0.621 > -1.64. Because -1.64 (or 1.64) is the critical value for the two-sided test with a significance level of 10%, it can be concluded that the change was negative but not significant. The average AR on the stock price of KLM was 0.025% in the control period and 3.056% in the (-2,+2) period with a test statistic of 2.759, which makes the change significantly positive at the 1%-level. The combined effect, where the stock price of both firms is weighted by the value of the total assets, shows a positive effect on the average AR of 0.331%, which is small but significant at the 5%-level.

JOINT VENTURE IN CIVIL AVIATION SECTOR: EMERGING LEGAL ISSUES

The Indian Civil Aviation Sector is in for a major overhaul over the next few years. Major policy changes are taking place because of a shift in the mindset of the government from considering air travel as elitist to making it available for the common man. This has led to the liberalization of air travel services. The airport industry is going through an exceptional transformation that has driven the market towards increasing levels of competition. Additionally, major investment programs are required to meet the expected growth in air travel demand (particularly in some emerging regions, such as India). Nevertheless, governments and city airport authorities are becoming more reluctant to support airport projects, since they have major budgetary constraints.

The New Economic policy Reforms 1991 has paved way for almost all Indian industries to undergo a radical change. The traditional and restrictive Aviation industry is no doubt a part of it. In fact, Indian civil aviation had to immediately nod to liberalization due to its poor and pathetic financial numbers. Airline, being a service industry is facing intense competition after

liberalization. As a result, the various airlines are engaged in consolidation, strategic alliance and privatization, with an aim of improving their competitive positions.

KEY PLAYERS IN INDIAN INDUSTRY

Airlines on International Routes

Air India is the national flag carrier airline of India with a network of passenger and cargo services worldwide. It is one of the two state-owned airlines in the country, the other being Indian Airlines. Air India has 44 world-wide destinations. The airline has been profitable in most years since its inception. In the financial year ending March 31, 2006, Air India has made a net profit of Rs.97 million; earned a revenue of Rs.87, 480 million - representing a growth of almost 15 per cent over the previous year.

Air Sahara is a privately owned airline operating scheduled services1 connecting all metropolitan centres in India. The airline was established on 20 September 1991 and began operations on 3 December 1993 with two Boeing 737-200 aircraft as Sahara Airlines. The uncertainty over the airline's fare has caused its share of the domestic Indian air transport market, from approximately 11% in January 2006 to a reported 8.5% in April. Sahara Airlines was rebranded as Air Sahara on 2 October 2000.

Indian is India's state owned primarily domestic airline, under the federal Union Ministry of Civil Aviation The Company was formerly known as Indian Airlines. On December 7, 2005 the company was rebranded as Indian as a part of a program to revamp the company image in preparation for an IPO. Former Indian Civil Aviation Minister, Praful Patel, announced Government of India's plan to merge Air India and Indian into one giant airline consisting of 130-140 aircraft.

Airlines that provide normal scheduled air transport of passengers and freight Jet Airways a “regular” airline which offers normal economy and business class seats. Jet Airways, along with Air Sahara, is the only airline which survived the dismal period of 1990 when many private airlines in India were forced to close down. Jet Airways operates both in domestic and international routes. The airline operates over 300 flights to 43 destinations across the world. It currently controls about 32% of India's aviation market.

Airlines on Domestic Routes

Spice Jet is a low-cost airline. Their marketing theme is "offering low”, “everyday spicy fares” and “great guest services to price conscious travelers". Their aim is to compete with the Indian Railways passengers travelling in AC coaches.

Air Deccan is an airline based in Bangalore, India. It was India's first LCC (low-cost carrier)/no-frill airlines2, and as of May 2006, it connects 55 cities within India. Air Deccan has grown rapidly since it first started air operations in 2003, and despite its almost disastrous maiden inaugural flight (which caught fire), it continued to grow. The growing Indian economy and the increasing number of middle-class people in India have greatly helped its growth.

GoAir or the People's Airline, a low cost carrier promoted by The Wadia Group is a domestic budget airline based in Mumbai, India established in June 2004. It's a relatively small player as compared to other low cost airlines.

Kingfisher Airlines is an airline based in Bangalore, India. Services started on 9 May 2005, following the lease of 4 Airbus A320 aircraft. It initially operates only on domestic routes. The airline promises to suit the needs of air travellers and to provide reasonable air fares. Kingfisher are pushing for an amendment of the present Indian government rule which requires an airline to fly a minimum of five years on domestic routes before it can start flying overseas.

IndiGo Airlines is a new and a private domestic airline based in India. IndiGo placed an order for 100 Airbus A320 aircraft during the 2005 Paris Air Show. The total order was worth US $6 billion; one of the highest by any domestic carrier during the show. The new low-fare carrier has started operations from August 4, 2006.

LCCs are mostly no-frill airlines i.e. they not provide food, beverages or other amenities to passengers

Growth Potential of Aviation Industry

What drives the aviation dream is the growth potential, estimated to be 25 percent with domestic

players like Indian Airlines, Jet Airways, Kingfisher Airlines, SpiceJet, Air Deccan, GoAir and Air Sahara carrying 25million passengers every year. In spite of the downturn, key players are ramping up to fight the battle.

Growth in aviation industry can also viewed from macro economic perspective. A study by NCAER3 pointed out that one per cent increase in GDP required one per cent increase in air passenger traffic and 1.3 per cent increase in air cargo traffic. In the first three years of the Tenth plan, the air transport has grown at an average rate of 7 per cent per annum as against the planned estimate of 5 per cent. During the year 2004-05, air transport witnessed a very high growth of 22 per cent in passenger traffic and 20 per cent in air cargo.

Growth in India's civil aviation sector, for many years stunted by bureaucracy and political interference, is now booming at an estimated 25 percent per year. The intense competition ushered in by new entrants — and the strategic response by existing players — will drive further market growth. This expansion is being fuelled by annual economic growth of about 8 percent, rising incomes, cash-rich middle class, a reformist government and an ambitious plan to modernize the country's aviation infrastructure.

The Indian aviation industry is growing at a rapid pace, thanks to air transport deregulation, emergence of new operators, lower fares and large untapped demand for air travel.

The New Delhi office of the Center for Asia Pacific Aviation (CAPA), a Sydney-based aviation consultancy, says airlines in India may be selling about 50 million tickets a year by 2010, compared with around 19 million now. Another study conducted by KPMG suggests that the air passenger traffic is likely to reach 100 million in 2009-10.

As per the National Council for Applied Economic Research, the main drivers of air traffic are economic upswing, concentration of population, industries and liberalization leading to higher propensity to travel. The spike in air passenger traffic is largely triggered by the emergence of low-cost carriers in the domestic sector. The penetration of low-cost carriers in small towns, coupled with exceptionally low airfares comparable with railway AC fares has raised the competition to a new level. India is the only country where the number of air travellers a year equals the number of rail passengers in a day. The growth potential in this sector is further leveraged by the first-time flyers queuing up to fly.

The Government has also come up with some initiatives in the right direction which aids the growth of aviation industry such as strong political will and improved policy environment:

Electricity Act, Draft Maritime Policy, Draft Civil Aviation policy, ring fencing of funds earmarked for infrastructure, nomination of implementation authorities, urgency to bring about commercial viability, momentum of private participation, innovative financing concepts like

‘Public Private Partnerships’ and ‘Viability Gap Funding’4 etc.

The aviation industry is almost an under penetrated market with total passenger traffic being only 50 million as on 31st Dec 2005 amounting to only 0.05 trips per annum as compared to developed nations like United States have 2.02 trips per annum. Air Cargo has not yet been fully taped in the Indian markets and is expected that in the coming years large no of players would have dedicated fleets The key challenge for Indian aviation companies is to convert strong traffic and revenue growth to profits for which yields need to stabilize.

<u>Civil Aviation: Before and After Liberalization</u>

Before Liberalization:-

The cost of travel in India was amongst the highest in the world. The two state-owned domestic and international carriers, Indian Airlines (IA) and Air India (AI) dominated the market until recently. Built on huge cost and as full-service providers they justified these high airfares.

Viability Gap Funding' – A scheme which is meant to reduce capital cost of projects by credit enhancement and to make them viable and attractive for private investments through supplementary grant funding.

With no competition from any front, the state-run airlines enjoyed a monopoly. From their position of strength, they pressurized the state machinery to obstruct foreign airlines from expanding flights to India and also to restrain the growth of private sector players. As a retaliatory measure foreign players hindered the growth of Indian airlines by not accommodating any deals with them. In the early 1990s, steps were taken to liberalise the aviation sector and the rest what we witness today is history.

After Liberalisation

From the consumers perspective; choice of airlines have increased, fares have reduced significantly, and increased routes is another big major advantages. From the airline perspective; Commercial freedom is the biggest advantage along with increased foreign investment. From the airport perspective; increased number of air passengers and aircraft contributing to increased revenue in form of landing charges and consumer spending at airport is the great advantage. All these factors have directly and indirectly contributed to the economy in form of increased tax revenues, increased employment opportunities and increased inflow of FDI, increased tourism etc.

Problems in Indian Civil Aviation

The most restricted industry faces serious setbacks even after liberalization and privatization. Infact such initiatives have caused new problems.

a. Infrastructure bottlenecks: There is hardly an airport with more than one runway.

Also, none of the runways can handle wide bodies like the A380. There is serious shortage of parking bays. Ground facilities are hardly sufficient to process the current passenger volume. While the offer of cheap tickets and the convenience of choosing between different airlines and flight timings are luring domestic flyers, there are other issues that need attention. If one talks to regular flyers today one will come across endless tales of how flights circle above airports, waiting to land, or they are made to wait endlessly in aircraft because of the long queues of planes either waiting to take off or land.

b. Traffic Jam: Airport privatization is facing rough weather. The ground infrastructure of metro-airports is very poor. Delhi and Mumbai together handle around 60 percent of India's passenger traffic. It typically takes 10 to 15 minutes for any flight to land in Delhi or Mumbai airports. Under foggy conditions, it may go up to 40 to 45 minutes. It may be noted that each minute of flying over the airport burns around fuel worth Rs.1000

c. Taxation policy: The taxation policies of the Indian government are also adversely affecting airlines operations. The aviation turbine fuel (ATF) price in India, which is reportedly subject to 8 per cent excise duty, and a high sales tax averaging well above 25 per cent, is on the high side. Airlines in India have to spend 30 per cent of their operating costs on ATF while the international average is 10 to 15 per cent.

d. Productivity: The legacy carriers are replacing their high-cost labour with new blood which would result in lower wages as less senior people means lower wages. At the same time, low cost carriers will be maturing and with older work force comes higher salaries. The most difficult problem facing the legacy carriers will be the transition to higher productivity. Senior workers will be hesitant and it will be difficult tot change the culture. The low-cost carriers will face aircraft that are older. Older aircraft requires more maintenance and more time out of service as the longer maintenance cycles are more intense.

<u>Reasons for Alliances & Joint Venture in Civil Aviation</u>

The salient features that favored the alliances and joint ventures in airlines are as follows:

Capital intensity, service orientation, Limited manufacturers, High level of regulation, low margins and tendency to consolidate and outsource.

- Capital intensity: The modern jet aircraft are products of intensive research and commercial application and are hence very costly. This implies that airlines companies should have the ability to mobilise enormous resources for acquisition and maintenance of their fleets.
- Service Orientation: As the basic aircraft gives little scope for product differentiation, airlines are harping on high level of on-time performance, wide network that offers better connectivity, better in-flight services, attractive frequent flyer's programme, superior lounge facilities etc. to attract passengers. Airlines are, thus, dependent on the skills of the flying crew and pleasant behavior of the cabin crew for attracting and retaining passengers.
- Legacy carrier - An airline revolving around a hub & spoke network and a corporate structure. Legacy Carriers mainly include:: First Class/Business Class , Lounges , Frequent Flyer Programs , Alliances Frills/Perks throughout the cabin (food, beverage, better service)
- Limited manufacturers: Most of the aircraft are manufactured by two manufacturers: Airbus Industries and The Boeing Company. As a result, basic features like carrying capacity, speed, range and facilities offered are likely to be similar for same type of aircraft operated by different airlines.
- High level of regulation: Operations of the air transport industry are governed by the agreements entered into between countries in which the aircraft are registered. These agreements prescribe the names of the carriers that can operate between the countries, the frequency, seating capacity and rights to pick up and discharge passengers. Countries have to enter into bilateral agreements for these rights. Government support is, therefore, essential for the survival of the airline industry.
- High level of concentration: Although there were more than 700 airlines in the world, the top seven (in terms of revenue) accounted for 33% of the total tonne kilometre performed in 1996. Again, approximately 35% of the total volume of scheduled passenger, freight and mail traffic was accounted for by the airlines of the United States. On international services, about 18% of all traffic was carried by the airlines of United States.

- Low Margins: Almost all the airlines are running under losses. If at all any airlines showed profits, it is only marginal. Generally any capital intensive industry would book low or negligible profits.
- Tendency to consolidate: Faced with intense competition and falling yields, the major players in the industry are moving towards consolidation through block space arrangements, code sharing alliances and joint ventures. In 1996, six major alliances controlled 59% of the revenue, 56% of the fleet, 55% of employees and 60% of total tonne kilometer for the top 100 airlines in the world. Through alliances, the partners attempt to edge out marginal players on different routes.
- Adding to the salient features, the following reasons contributed for consolidation in Indian airline industry: Weak financials, high cost of operation, poor brand image, lower fleet capacity and inability for differentiation.
- Block space arrangement - reservation of certain number of seats in oneairlines' flight is reserved for sale of another airline
- Code sharing - seats can be sold by two airlines bearing codes allotted to more than one airlines
- Weak Financials: The Laws of supply and demand in economics were not working for civil aviation business. "In the law of economics, lower prices lead to increase in demand and in turn lead to higher revenues. In the airline business, there has been a reduction in fares resulting in an increase in demand for seats. But the industry does not experience a corresponding increase in revenues; in fact, the reverse is happening." Cumulatively, the losses reported by various airlines exceeded Rs.2000 crores in 2006.
- Declining Yield: Intense competition is leading to falling yields. This issue got compounded by the very high prices of aviation turbine fuel (ATF). Airlines are not able make up for the frequent and steep increase in prices of ATF through price adjustments. It is noteworthy to mention that ATF prices account for around 30 - 45% of an airline's operating cost. Hefty taxes imposed by Central and State government is another reason for low margins. The additional service tax imposed on business class and first class passengers also affected custom from a sector that have been paying handsome prices.
- High cost of Operation: The steep decline in fleet strength and the ageing fleet make

cost of operations still costlier for Indian Airlines. Today, the average age of the Indian Airlines fleets over 17 years; these include fuel guzzlers like A 300 and B 737. With the new order by IA for 43 aircraft, the average age would fall to less than 8 years.

- Poor Infrastructure: Air transport follows road transport case in India. Development of road infrastructure was not matching the production of cars. Similarly Airport infrastructure is far behind the acquisition of aircraft. Presently, there is increase in demand for air travel and this has stimulated the investments in airport infrastructure. Upgradations with huge investment are carried out at Delhi, Mumbai, Bangalore, Hyderabad, Cochin airport. Due consideration is given to smaller airports.
- Poor brand image: Customer service and network are the main aspects of the product offered by airlines. Since it is a service industry, only the quality of service will ensure success in business. AI's product has suffered on these counts in the recent past due to which it has lost its business to other airlines.
- Lower fleet capacity: AI's fleet size is only 26, which is significantly less when compared with other international airlines. British Airways has 256 aircraft while Singapore Airlines is having aircraft. Even after the merger between Air India and Indian, there will be only 112 flights in total.
- All other private carriers also don't have commendable fleet size to meet the growing demand. But almost all the airlines have ordered for aircrafts in big numbers. Fleet acquisition will be a successful only if there is access to adequate capital.
- Inability for differentiation: Being a capital intensive industry, it is difficult for the airlines to differentiate in the aircrafts they run. Hence the differentiation has to be in service – with frills or no-frill service.

Strategic Alliance – The modern airline trend

Strategic alliances have been one of the most visible responses of airlines to the intense competition of recent years. The main objective of these alliances is to create competitive advantage for the partners by enabling them to complement each other's services and achieve substantial economies of scale, particularly in marketing and maintenance costs and largely retailing and corporate independence. Inter-airline alliances lead to many competitive advantages:

- Merging of commercial activities in terms of sale and passenger service

- Pooling of intercontinental routes and linking domestic routes
- Providing high quality services
- Giving preferential access to a long haul hub8 for feeder airline partners
- Joint ground handling and maintenance at airports
- Capturing market share
- Joint investments and operating expenditure agreements
- Merging of reservation systems
- Joint fare policy
- Code sharing
- Advantage of global status and transcontinental distribution on partners
- Generate economies and new opportunities
- Risk sharing

Hub –An airport or city in which an airline has a major presence and many flights to other destinations. Many carriers use the hub and spoke system to maximize profits by keeping the aircraft in the air as much as possible. Flights to the hub are many, and from there flights to many other destinations are scheduled.

Such alliances enable the airlines to break regional barriers and explore vast and hitherto untapped business opportunities. In the international front, the first major alliance was established in 1989 between KLM and North West Airlines. The 'Star' alliance was initiated in 1993 between Lufthansa and United Airlines. In 1996, British airlines and American airlines formed the 'One World' alliance. Airline merger permits airline that may be constrained by bilateral regulations to offer a global coverage (Agusdinata and de klein 2002).

In the domestic front, such alliances are going to shape the outlook of entire aviation industry. Jet airways and Air Sahara has set the prelude for alliance and mergers. In years to come there would be one or two alliances formed by merging or amalgamating small airlines like Air Deccan, Go Air, Indigo etc. and one national airline (merged entity between Air India and Indian). Kingfisher airlines is looking forward eagerly for such opportunities.

Strategic Initiatives in Civil Aviation

The Ministry of Civil Aviation has taken some serious steps after privatization which was actually pending for a long duration.

Revenue from Real Estate: All most all the airports, be it be Bangalore International Airport

(BIAl), Cochin international airport (CIAL) or Hyderabad International airport (HIAL) – all of them have unanimous decision to earn diversified revenue from their huge real estate land with them. The promoters of BIAL are planning to lease out a 300-acre corridor along the access road. CIAL expects to attract Rs.3, 500 crore of investment in real estate. It will lease some of its land, enter into joint ventures, and may even pick up equity in some projects. It is the same story for HIAL. All this flows from civil aviation ministry policies on airport infrastructure of 1997 and 2002.

Joint venture for support services: IA's joint venture on maintenance, repairs and overhaul is also being extended to take of the maintenance of air frame and other engineering services. IA has been offering a lot of ground handling operations for other airlines. In all 23 foreign airlines, including British Airways and Lufthansa, are provided ground handling services by IA in 1 stations. Some 25,000 third party flights are covered by these stations.

Alliance with low-cost carrier: Jet airways have acquired Air Sahara for $500 million. It is also trying for an alliance with Air Deccan - the largest low-cost carrier in the country. The alliance would be on various fronts – sharing of engineering infrastructure, exchange of passengers when flights are cancelled, and combination offers and so on.

Merger by authoritative bodies: The Airports Authority of India (AAI) was formed after the merger of the International Airports Authority of India and the National Airports Authority by way of the Airports Authority Act (No.55 of 1994). It came into existence on April 1, 1995. The AAI is keen on establishing world-class airports in the country.

Consolidation approach: Despite competition, there seems to be camaraderie between the private airlines. Air Deccan has given one of its Airbuses to Kingfisher so that its pilots can train.

Also there are strategic alliances especially in sharing infrastructure at airports and inventory. There are also reports about joint bidding for aircraft manufacturers so as to get a good deal.

Indian Airlines and Air India have decided to jointly tender for ground handling at the GMR Hyderabad International Airport (GHIAL). Singapore air terminal service (SATS) was selected by GMR as the JV partner with 49% share holding, while Air India and Indian Airlines both jointly hold the remaining 51%.

Perhaps one of the most published deals is stopping poaching of pilots from one other's airlines. As airlines in India find their niches (at home and abroad) the advantages of code-sharing and other joint market approaches will become clearer.

Opportunities in 2007

Indian aviation industry is optimistic to take up pleasant journey in 2007. Though almost airlines have exhibited losses in the past few years, still the industry seems lucrative both for the players and for the changing Indian consumers.

Reduction in Fuel bill: ATF accounts for 35-40% of the cost of an aviation company. Any drop in prices will spare losses. Oil prices have declined from the peak of US$ 78 per barrel. Now it is around US$ 76 per barrel.

More disposable income with the Indian population: IT revolution and earning youth in India are left with high disposable income. Also the LCC have targeted at the first class train travelers who don't mind paying a little extra thereby reducing journey time.

Funds pouring into the sector: Aviation is a capital-intensive business with long gestation. Both domestic and international carriers are in the full swing of expansion to meet the growing demand.

Unlike earlier days, investors are willing to pour in their funds in to this loss making but still but still optimistic sector. The players are adopting different funding strategies. For instance, SpiceJet announced it would raise about US$118.5 million by offering stake to potential investors which include Tata group companies, Texas pacific group ventures, Istithmar PJSC and Goldman Sachs. In August 2006, Spice jet and Babcock & Brown Aircraft management (BBAM), along with a long term strategic partner Nomura Babcock & Brown Co (NBB), signed a sale-and –lease back agreement covering 16 brand-new Boeing 737-800/-900 ER aircraft valued at over US$ 1.1 bn based on the manufacturer's list prices.

Similarly Air Deccan had announced that it had entered into financial structure with a consortium of European banks for US$ 100 mn to be received in four tranches against the assignment of aircraft purchase contract through a special purpose company funded by consortium of European banks. Air Deccan has also issued equity shares to Investec bank (UK) on a preferential basis. Jet airways has successfully launched its IPO and several other airlines are to follow this route.

Own MRO units: Global players like Boeing and Airbus are collaborating to set up MRO units and aeronautical flight training centre in Nagpur with estimated investment of $ 185 mn. Not only airline carriers are pitching in this space. Even infrastructure developers like GMR group have business plans to set up MRO units. There is strong trend of outsourcing in this space. For instance two decades ago, about 85 percent of global engine maintenance was

done in-house.
Now, this is reduced to 30 per cent. Locating MRO units in India saves time and resources.
Globally 25 percent of flight delays are maintenance related. A research by Hamco reveals that in India these are as high as 60 per cent.

Case of Air-India Limited

Air-India (AI) was set up on October 15, 1932, as Tata Airlines, the first scheduled airmail service in India. In July 1946, the company was converted into a public limited company and renamed as Air-India. By the end of 1947, Air-India International was launched for international services, with the participation of the Government of India. In 1952, the Planning Commission recommended nationalization of the air transport industry. Nationalization was effected on August 1, 1953 with the creation of two corporations, viz. Air-India for international services (as the nation's flag carrier) and Indian Airlines for domestic services.
The paid up share capital of AI as on 31st March, 1997 was Rs. 153.8crores and is wholly owned by Government of India.

Air India and Lufthansa Sign Strategic Alliance

Lufthansa and Air India have significantly improved their market leadership positions on India-Europe-USA routes with the Strategic Alliance agreement signed between Lufthansa & Air
India. From 1st October 2004, Air India has been a partner of Lufthansa. Within the scope of an extensive agreement covering a far-reaching bilateral cooperation, Wolfgang Mayrhuber, Chairman of the Executive Board of Deutsche Lufthansa AG, and V. Thulasidas, Chairman & Managing Director of Air India, signed a Strategic Alliance agreement in Mumbai. The objective of the partnership is expansion of the offer of flights between Germany and India. All flights between the two countries are operated by the two airlines in code-sharing. New routes are added. Through the cooperation in the area of frequent flyer programs, customers on flights of both airlines can collect and redeem miles for the respective programmes - Miles & More and Flying Returns.
Air India has been accorded the IOSA Audit Certificate by IATA which puts it in the league of a dozen Airlines conforming to quality standards required for joining Global Alliances.
India - Germany/ Europe and India-USA are very important markets for Air India which it plans to serve over Frankfurt in 10. IOSA (International Civil Aviation Organisation) – A

specialized agency of the United Nations whose objective is to develop the principles and techniques of international air navigation.

IATA (International Air Transport Association) –

A trade association serving airlines, passengers, shippers, travel agents alliance with Lufthansa. In addition to the code-sharing between Germany and India, the code of Air India will also be bookable on Lufthansa connecting flights from Frankfurt to Berlin, Munich, Stuttgart and Düsseldorf to Amsterdam, Geneva, Zurich and Lyon as well as to Washington, Denver, Detroit, Chicago and Los Angeles.

This cooperation agreement results from a memorandum of understanding which the two carriers signed on 26th August 2003. In it, cooperation in the area of sales and marketing is also foreseen as well as cooperation in the medium term in other areas, for example, in the area of IT.

Lufthansa which was flying from Frankfurt to Delhi (once daily), Mumbai (once daily), Chennai (once daily) and Bangalore (five times a week) as well as from Munich to Delhi (three times a week.) would fly further six weekly flights between Frankfurt and Mumbai as well as three weekly flights between Frankfurt and Delhi which are operated by Air India and can be booked with a Lufthansa code.

Air India served up to 33 destinations from Mumbai and Delhi, including, among others, Frankfurt, Chicago and New York. The fleet of Air India consists of 33 wide bodied aircraft and it had planned to add more to make its Los Angeles & Chicago flights daily. It has also planned to operate daily services between London and Mumbai & London and Delhi and link Bangalore with Frankfurt four times a week from March 2005.

The Lufthansa - Air India pact paves the way for joint development of air services on India-Europe-USA route.

Air India – Indian Airlines Merger

The Indian government has cleared the merger of two state-run carriers Air-India and Indian (Indian Airlines Ltd).Government will continue to be the sole owner of the merger entity and has made it clear that the public sector character of the merged airline would be maintained.

But the Government may look for IPO after getting approval of a committee consisting of Finance Ministry.

The merger of the two airlines would enable them to leverage their combined assets and capital better and build a strong and sustainable business. The potential synergies are expected to enhance the new combined airline's profitability by over US$133 million per annum, or about four per cent, of their current combined assets. By 2010-11, when all the new aircraft ordered by the two carriers are inducted into the fleet, the merged entity's employee-aircraft ratio would come be about 200:1, comparable with any major global airline. While Air-India has ordered Boeing planes, Indian has finalized the acquisition of 43 Airbus aircraft.

According to the report submitted by Accenture, there will be no manpower rationalization as the consultancy has suggested 'careful integration' of manpower at various levels. It has also suggested a top-to bottom integration of the employees. It is proposed that the pay-scales be revised to bring parity in promotion procedures.

The merged entity of state-owned international and domestic carriers Air India and Indian - National Aviation Company Ltd - is now in the process of drafting the Scheme of Amalgamation under Section 391-94 of the Companies Act. This would pave the way for the integration of the two national airlines and their subsidiaries — Air India Express (Air India) and Alliance Air (Indian).