

CREDIT RISK MANAGEMENT IN INDIAN AIRLINES

Supreet Kaur Gaba*

ABSTRACT

Implementation of globalization policy and the abolishment of License Raj has led to the opening up of Indian Markets to the world. This in turn has brought a new wave of industrial growth in the Indian domestic sector. Airline Sector is one such sector which has hugely gained from the new liberal spirit over the past three decades. The figure of annual domestic passenger at an estimated 6 crores in 2000 is a record growth from mere 2.6 crores in the year 2006. This trend augured well. However, with new Airline companies coming into the market and the lack of finances in the execution, created blunder after blunder in the aviation sector. This paper is an attempt to bring out the reasons for the collapse of Kingfisher Airline and highlight the general need and adequacy of Credit Risk Management in Indian Airline Industry.

Keywords: Automated Online Risk (AOR), Credit Policy and Management, Credit Risk Management, Customer Service Platforms (CSP), Debt Recovery Tribunal (DRT), External Commercial Borrowing (ECB), Indian Airline, Kingfisher, Reserve Bank of India (RBI), Debt Recovery Tribunal.

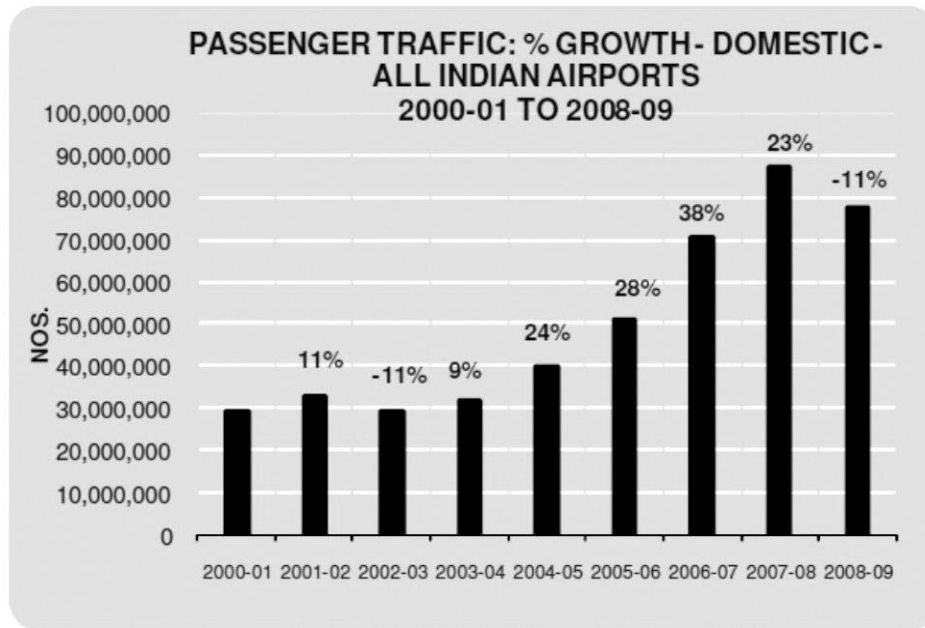
INTRODUCTION

Credit Risk Management is a collective action to recognize, classify, determine, tag and scrutinize various threats that could lead the financial obligation of the business to either underachieve or not achieve the target at all. Lack of fulfillment of these financial obligations has social, economical and political effects on the masses while posing deep psychological blow over individuals.

Financial crisis in an organization emphasizes the need to strengthen the Risk Management with risk-based vision globally, so that the banks can more efficiently deal with the increased complexity at hand. These complexities arise from both financial product novelty and increased inter-connectedness between financial Bodies. Hence, Credit Risk management becomes an important component to maintain the viability of the business. The crisis that has afflicted the Kingfisher Airline has been accumulating through a series of event that led to severe disturbance within the Airlines Management. Economic analysts across the world believe that the mammoth fall of the world economy leading to the subsequent recession of 2008 was contributed largely by the management executives. Indian contribution to such a disaster came from the India's epitome of fashion and luxury Airline, the "Kingfisher". In Indian Airline Industry, despite the surge in the domestic passengers' traffic, there have been larger challenges that the government, the Airlines and the investors had to grapple with.

* Supreet Kaur Gaba is a Ph.D scholar at Mewar Institute, Sector 4-C, Vasundhara, Ghaziabad - 2010 Correspondence email: gabasupreet@gmail.com

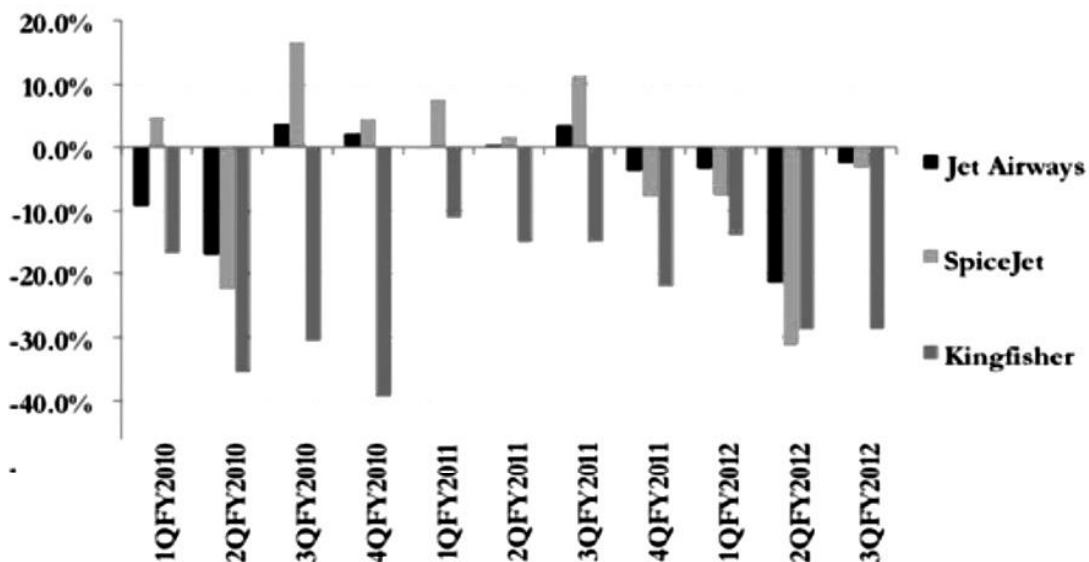
Figure 1: Domestic Passenger Traffic Trend



Source: ACEXC Newsletter vol.(12)

For example, there had been several reasons for the much touted financial downfall of Kingfisher Airline which was foreseen by many experts on the Board of Kingfisher itself. Ever since the Airlines commenced its operation in 2005, it has been continuously reporting losses. After acquiring Air Deccan, Kingfisher underwent a loss of Rs 1000 crores for the next three years. By the start of 2012, the Airlines amassed huge cumulative financial losses of over 6500 crores with more than half of its fleet not flying.

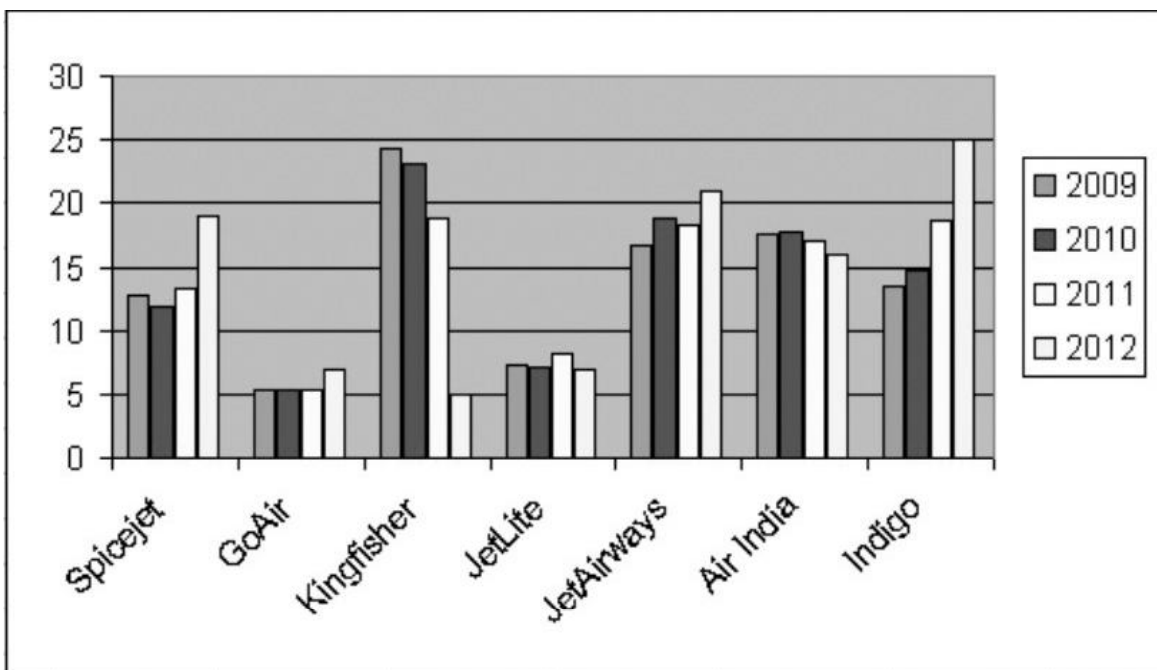
Figure 2: Revenue Share of 3 major Private Indian Airline from 2010-2012 (%)



Source: CAPA – Centre for Aviation & Company Reports

BK Ramadhayani & Co, the auditor for the Kingfisher Airline raised concern over “its ability to remain a “going concern”, stating it would need to inject more funds to remain in such a position.” The report further added that the financial statements being prepared on a going concern basis, notwithstanding the fact that the company’s net worth is eroded. The appropriateness of the said basis is inter-alia dependent on the company’s ability to infuse the requisite funds for meeting its obligations.

Figure 3:Market Share trend (%) of few major Indian Airlines from 2009-2012

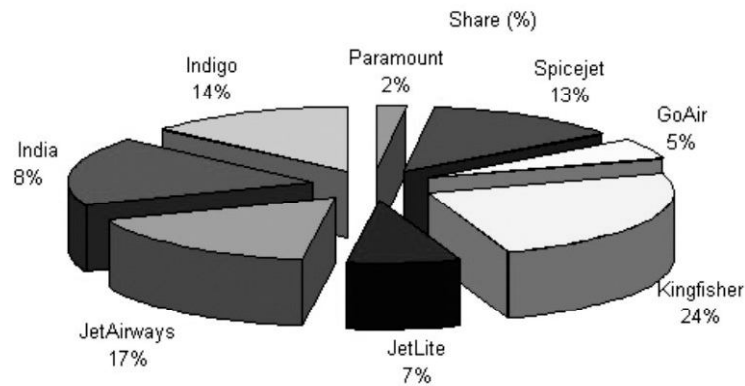


Flight Name	2009	2010	2011	2012
Spicejet	12.8	11.9	13.4	19
GoAir	5.4	5.3	5.3	7
Kingfisher	24.4	23	18.8	5
JetLite	7.3	7.1	8.1	7
JetAirways	16.6	18.9	18.2	21
Air India	17.5	17.8	17	16
Indigo	13.5	14.7	18.7	25

Source: Centre for Asia Pacific Aviation

The auditor’s remarks clearly reflect how badly the market value of the company had plunged. Kingfisher which ranked among top Indian Airline by virtue of sheer market valuation suddenly slipped to the last position because of the financial crisis.

Figure 4: Market Share of scheduled carriers in India (Domestic in 2009)



There had been plethora of reasons for such a steep downfall. To begin with, Mallya’s inability to exercise and place his dream Airline on the Airline map of India and the world, along with completely different nature of his other business including that of his liquor business could not save “Kingfisher”.

Due to overindulgence in the management decisions making process, which was partly due to his inability to trust other executives for taking right decision for the business, Mallya took the business off track. Kingfisher’s effective President and CEO, Alex Wilcox quit in 2005. There was a lot of rumor about the tussle between the Executive and the owner, Vijay Mallya. Nigel Harwood, who joined as CEO subsequently, also resigned following disagreement on how to run Airlines.

Secondly, Mallya’s inability to identify the opportunities versus challenges and ignoring the basis rules of business, led to loss of huge prospects to his airline growth. He focused hugely on elite and the business executive.

Figure 5: Profit & Loss of Major Indian Airlines

F/Y	Jet Airways	SpiceJet	Kingfisher Airlines	Jagson Airlines
07-08	-654	-134	-188	-6.2
08-09	-961	-	-1609	-7.1
09-10	-420	61	-1,647	-5.7
10-11	-86	101	-1,027	-7.8

Note:

- Profit / Loss is reported only for airlines listed on BSE
- All figures are in INR Crore

Thirdly, his neglect of the newly acquired Air Deccan’s USPs, led to the collapse of Kingfisher. Had he taken into consideration the core proficiency of Air Deccan and balanced International flight slots, the sick airline could have been saved. The issue therefore underscores insufficient Credit Risk Management covering the complete process from lack of proper Risk Measurement & Assessment.

The review of management practices & techniques for identifying, measuring and monitoring risk would have synchronized and improved the constant changes and would have worked in support of investors, banks and Airlines.

Due to low passenger traffic and Mallya's inefficiency to handle such situation, things were going out of his hands. Increase in the fuel prices left him with no option but to cut employee salaries. There was an outrage among the employee which bursted out in the form of misconduct and maltreatment of passengers finally snapping the hospitable ties between the airline and its loyal customer base.

Figure 6: Airline Revenue Sheet

Carrier Name	Revenue (Difference from last year) (%)	Operating Costs(Fuel) (Million)	Profit/Loss (Million)
Kingfisher	-5%	149.9	-90
Jet Airways	13.6%	349.3	-20.2
SpiceJet	42%	120	-8
Air India	**	**	**

Source: Center for Aviation, Data collected as on Dec -2011; ** not available

Mallya continued to work upon high dream to fly the airlines and he kept pumping more and more money into providing luxuries to his customers rather than providing essentials to his own staff. By mindlessly negating the fundamental human need to survive, Mallya created enemies within. Services ranging from lavish food menu, to in-flight entertainment, DTH services, in-seat massagers, USB accessories, and such luxuries offered to the business class added to the extravaganza. With pilots of the airline being offered double of the existing salaries, extravagant calendar model shoots in exotic locations and highly paid crew and expensive airline supplies, the monies involved in the airlines business were decanalized.

His overindulgence in luxuries and wasting huge monies in glamorous activities like "The Calendar Shoot", or investing huge sums in the "Indian Premier League from his core business caused a drain on the finances of the airlines.

Diverting this fund in organizational changes and restructuring could have been a rewarding exercise for the airline. The Government of India analyzed the complete situation and took the decision to not to provide any monetary relief to bail out the Airline as Kingfisher.

Figure 7: Revenue Loss per year (in INR Crore)

Total revenues	1,441	5,239	5,068	6,233
Operating expenses	1,810	(5,860)	(4,867)	(5,371)
EBITDA	(724)	(1,806)	(893)	(122)
Interest	(50)	(778)	(1,102)	(1,313)
Depreciation	(18)	(133)	163	(203)
Net debt to equity (ratio)	0.60	12.20	17.10	2.80
Secured/Unsecured loans	934	5,665	7,923	7,057
Shareholder's funds	1,166	451	451	2,397

Source: Kingfisher Airline Annual Report

However, another question begs our attention as to how the banks provided loans to such poorly managed Airline. What was the relation of banks with the airlines that led to this symbiosis between a creditor and extravagant debtor. Similarly, one can compare another scenario of crisis in Indian Airlines which happened due to its merger with Air India. In 1994, India's Air Corporation Act of 1953 was repealed giving private airlines the chance to schedule serviced flights. Following this repeal, a multitude of new airlines came into picture to take advantage of the increasing demand for aviation.

India is considerably under- penetrated in the civil aviation sector. At present , an estimated 0.52 departures per 1,000 people is recorded. Of this, less than 2% of Indians actually travel by air each year. India is having a population of about 1.2 billion people, it is needless to say that the market is big and so is the opportunity.

There had been many reasons behind malfunctioning of Indian air industry. Some of those are as follow:

In case of merger of Air India and Indian Airline

- The Government did not fulfill its' promise of equal pay. There have been different pay organization, training schedule, working hours, career headway and all these leave HR issues remain unsolved for five years even after the merger of two airlines.
- Air India still lives in pre-merger period.
- Ego issues amidst the two airlines remains.
- The pilots were on strike since May 7, 2012. While this was the 6th strike in Air India by employee, it was 4th by its pilots.
- Air India pilots pushed for restricted access and right on the Dream liners Boeing 787 and they also wanted other aircraft which they are flying like the 777s or the 747s be under restricted access.
- They further demanded that they be allotted first class confirmed seats. These seats would cost a price that is comparable to the remuneration of the flight captain.
- Air India pilots want co-pilots to be promoted the rank of captains in 6years, and not in 10 years.
- Air India is in a disarray and the government is continuously pouring in money to save this national carrier.
- The first assistance was given in 2009 by the government to Air India to a tune of Rs.5500 crores to keep the airline flying.
- In February 2010, the government funded approximately 2000 crores
- In August 2011, the government gave an additional 1200 crores to facilitate Air India meet up its cash requirements.
- In 2012, it has approved an additional 30,000 crores of which 6,750 crores will be given without delay.
- Ever since the merger, the airline is incurring losses even after the unremitting aid given by the government at different point of time.

The aviation sector has seen increasing stress with Kingfisher Airlines, and AI is facing streamlining of debt due to various operational issues. Companies including Jet Airways faced problems related to tax payments. Later, banks assured credit to Kingfisher Airlines. AI loans have been recasted following government's involvement to smoothen the process.

In case of the Kingfisher, astonishingly 17 banks and three other lenders who were not the part of the consortium are bearing the brunt of the poor "Credit Risk Management" policy.

Figure 8: Consortium of Banks in case of “Kingfisher Airline bailout”

Bank Name	Amount (Crore)
SBI	1457
IDBI	719
PnB	702
Bank of India	552
Bank of Baroda	532
ICICI	430
UNITED BANK	395
Central Bank of India	360
CORPORATION BANK	305
UCO BANK	287
STATE BANK OF MYSORE	139
IOB	122
FEDRAL BANK	100
OBC	56
PUNJAB & SIND	51
AXIS BANK	46
INDUSIND	6

These banks include SBI, Punjab National Bank, IDBI Bank, Bank of India, Bank of Baroda, United Bank of India, Central Bank of India, UCO Bank, Corporation Bank, State Bank of Mysore, Indian Overseas Bank, Federal Bank Ltd, Punjab and Sind Bank and Axis Bank Ltd. The cumulative capital totalling around 6300 crores has been infused. The propping up of Air India, at the expense of the Indian taxpayer, enables it to continue its voracious pricing initiative. The net result of the government back support was the undermining of the Indian Airline Industry as a whole and the loss of confidence by the prospective investors.

Jet Airways, India’s another premier airline, is the first airline in India to execute an Automated Online Risk (AOR) (fraud) Management Solution. Cyber Source Ltd., a completely owned auxiliary of Cyber Source Corporation (NASDAQ: CYBS), is providing its Decision Manager Solution to Jet Airways to help streamline online risk management processes and trim down fraud. Historically, Jet Air has relied upon in-house software solution and review mechanism for managing online payments. In keeping with its philosophy of inventive solutions, Jet Airways was quick to recognize the need to upgrade its operational procedure along with automated mechanisms for Risk Management Solution that is modified as per the Indian market.

Decision Manager automatically evaluates communication in real-time, and based on a grouping of rules determined by Jet Airways, the airline is able to calculate the approximation of whether the online ticket buying should be accepted, rejected or reviewed. All this happens within few seconds. The rules can be updated at any time through an easy-to-use business interface. This greatly helps companies to continually customize Fraud Screening approach while meeting the market demand.

Let us look at the larger picture. The Reserve Bank of India introduced specific guidelines for airlines. RBI has issued the details allowing Airline companies to tap External Commercial Borrowing (ECB) for working capital needs. The then Finance Minister Pranab Mukherjee’s budget speech clearly narrated how Indian carriers would be allowed to borrow for working capital from foreign banks. Airlines welcomed the progress, as it could get loans available at lesser rate of interest. RBI has mandated that a company should raise this foreign debt within 12 months. The minimum standard maturity can be three years. Also, ECB has permitted the Airline companies based on cash flow, foreign exchange earnings and its potential to service the debt. Companies may refinance its lending from domestic banks. As a matter of fact, Air India has floated an

invite of offer for receiving funds through ECB. It is in quest to raise this fund for at least a year at either a fixed or floating rate, in accordance to the offer document.

In the case of Kingfisher Airlines, the lending process was based more on the face value of the business man, rather than on the business model. While banks looked into the past performance at some level and the political closeness of an individual for accessing the repayment capability, seldom was there any effort to understand the metrics of complete business execution plan and the ratio of Service Level Orientation verses Service Quality Adequacy.

If banks and regulators have had their say in the decision process, disaster like this would have been absorbed. Loans at arm length could have been the policy in lending, however the closeness with the big and the powerful led to unrestricted extraction of credits at a very high risk.

Debt Recovery Tribunal (DRT) has a vital role to play in such cases. However, the process is lengthy and reactive in nature. Specialized Mediation process should be designed to deal such cases on fast track basis. This in turn will ensure that re- lending is regulated and optimized, taking into consideration the complete picture of the microeconomics involved. In case of the Kingfisher, there is absolutely no clear suggestion as to why lending was happening and what formed the basis for recognizing any such collateral for the purpose.

Many of the private carriers show off better performance metrics, and have expanded speedily at the expense of Air India. In order to play hard, companies including the Air India would lower the ticket prices even below the break even rates. However, Air India has hugely relied upon the Government for reorganization on the fact that it is an offshoot of the Indian Government, to restructure its obligations on more encouraging terms.

Credit Risk Management(CRM) has proved itself as the epitome in the process of lending. Not only at the highest level of corporate ladder, but even at the lowest level of decision making process, the reference to Risk Management Process is very crucial. At the same time, an absence of CRM actually has led to the wide scale misappropriation of funds, making banks and the investors taking a direct hit of financial burden and eventually leading to the suffering of employees and the customers. Had the Process of lending taken into account the factors of Credit Risk Management in true sense, Airlines like Kingfisher could have been saved, while thousands would have been rescued from the financial crisis .

However, the commonality shared between the banks and the Airline, is their embrace in extravaganza. Such crony-alliances do not happen just by chance. Public interest is what really suffers the blow.

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