

### Finding feathers: India's regional flight puzzle

The government wants India to fly high. Consider the developments that have taken place in the realm of civil aviation, from the rollout of the 0/20 Rule to the latest divestment plans for Air India.

And then there's UDAN (Ude Desh ka Aam Naagrik), a one-of-a-kind scheme, seeking to provide connectivity to unserved and underserved airports of India through the revival of existing air strips and airports.

As the acronym suggests, UDAN is a regional connectivity scheme (RCS) which aims to give wings to as many Indians as possible, 'uplifting' small towns in the literal sense of the term. It aims to increase ticketing volumes to 300 million from 80 million, a 3.75 times growth by 2022, and specifically develop the regional airline segment, as India makes its way to become the third largest aviation market by 2020.

"India's domestic aviation market grew at over 20.3% during 2015. Drop in ATF prices, increase in arrival of tourists, and visa reforms, have placed India in a unique position, bringing the country closer to achieving its vision of becoming the largest aviation market by 2030," reflects Aerosource India Managing Director Vinod Singel.

The passenger throughput for 2015-16 was 184 million, which is expected to reach 370 million by 2020, with domestic traffic constituting around 80%. It is estimated that around 28% of air traffic today is from the least busy airports, which could be accounted as regional aviation. Today, over 400 regional airports exist, and UDAN has brought in around 31 underserved airports already. "Regional airports comprise a small fraction of this currently, but are likely to

grow. Many Tier-II and Tier-III airports are showing growth of over 30-50%, highlighting the potential there," KPMG Partner and India Head (Aerospace and Defence) Amber Dubey says.

Market turbulence

Through UDAN, it is clear that regional air connectivity is viewed as an important infrastructure and development asset by the Centre, but is it a favourable growth industry? The airline industry is uncertain, volatile, cutthroat-competitive, and extremely price-sensitive, troubled by inflexible break-even opportunities. Over the decades, global airline giants such as Pan Am, Swissair and Sabena went bankrupt, while in India, once popular carriers like Damania Airways and Kingfisher Airlines ceased to exist.

Sustainability is vital from the beginning, and one cannot say when the winds might change for the worst, forcing airlines into a nosedive.

The problem becomes more compounded in terms of regional carriers, which are small, yet risk it to find some ground in a nascent market. In the last few years, many regional players came and went — Paramount Airways, Air Costa, Air Carnival and Air Pegasus, to name a few.

Among the various issues that bothered them were markets with few passengers leading to low load factors, high capex and opex, few aircraft, inability to manage or balance costs, and so on. "In Tier-III cities, people are not used to travelling by air because they don't value time as much as urbanites. It will take a while for people to understand the advantage of flying, safely.

Also, infrastructure and security services at regional airports are poor, but this opens up employment opportunities,” Singel says. Among the said carriers who are out of service, Air Pegasus however, is hopeful of returning to the sky in late-July, having secured fresh funding.

Explaining the perils that regional airlines face in order to grow, Air Pegasus Managing Director Shyson Thomas says, “For regional airlines, capacity is everything. Any regional airline needs at least two aircraft to begin with, and as average load factor grows, and the airline lands in new markets, more aircraft must be periodically added.”

When Air Pegasus stopped operations last year, it had a fleet of three ATR-72 aircraft, which Thomas says is enough to break even for a regional airline. “However, with more than five aircraft only will an airline begin tasting profits,” he says, adding, “The moment you are stagnant, you are falling fast.” Also, capital inadequacy is a major challenge, which is why established carriers are in a better position to raise capital and tap the regional space. Having tasted and tested medium-haul and long-haul routes, established carriers — both full-service and budget — seem to be clearly bullish on UDAN, which if not anything else, will secure them presence in more sectors. Backed by a strong financial support system, operational infrastructure, staff and institutional knowledge, these risk-taking airlines are making the most of the RCS, a pushover against tiny regional players.

While Air India Regional and Jet Airways are traditional contenders in the regional markets, SpiceJet and IndiGo have made their presence felt more in recent times. Recently, SpiceJet launched two daily direct flights on UDAN routes of Mumbai-Porbandar-Mumbai and Mumbai-Kandla-Mumbai. The no-frills carrier was awarded

six proposals and eleven routes under the first phase of the RCS. Out of the six proposals, four will cater to unserved markets of Adampur, Kandla, Puducherry and Jaisalmer, whereas two will be for underserved markets of Porbandar and Kanpur.

At the recent International Paris Air Show, the airline also signed a letter of intent with Canada’s Bombardier Commercial Aircraft, for up to 50 Q400 turboprops, an order potentially valued at up to \$1.7 billion, translating into the single biggest order for the Q400. “SpiceJet operates India’s largest regional fleet and is the only organised operator in this space. This order will help us further increase connectivity to smaller towns and cities, and help realise Prime Minister Narendra Modi’s vision of ensuring that every Indian can fly,” SpiceJet CMD Ajay Singh says. Acknowledging SpiceJet’s UDAN push, Civil Aviation Secretary R N Choubey states, “This latest aircraft order by SpiceJet is testament to the huge demand for air travel in India’s smaller towns and cities.”

India’s largest airline by market share, IndiGo, has also placed an order for 50 ATR-72 planes worth \$1.3 billion. “In support of Prime Minister Narendra Modi’s UDAN vision, we are embarking on a journey to build a nation-wide regional network and connect cities that have not benefited from the growth in Indian aviation,” says IndiGo President and Whole-time Director Aditya Ghosh. Cleared for take off

With established carriers having already grabbed a large piece of the pie, what remains for young regional-only ones? An unperturbed Thomas feels that while there is competition, each has its own market, and suitable offerings to customers must be made in the form of apt flight timings and right pricing. With UDAN, regional players

are assured of some support from the government too, such as certain concessions in terms of lower tax on fuel, zero airport charges, and so on, through which costs will substantially reduce and infrastructure at regional airports will develop.

On flights operated under the RCS, 50% of the seats will have a fare cap of Rs 2,500 per seat per hour. The operators of such flights will be extended viability gap funding (VGF), for which money is partly raised through a levy imposed on flights operating on major routes.

“Only spare capacity can be used for UDAN, and not prime capacity. For an aircraft that can cover 10 sectors a day, eight sectors will be concentrated on the prominently successful routes, while the last two will be left for UDAN,” mentions Thomas, adding that it is important to fill the aircraft to the maximum capacity to break even.

Also, in order to derive effective load factor, the industry is considering the use of smaller 19- and 21-seater planes, from the likes of Cessna, Beechcraft, and Dornier.

New airlines have already begun to reap the benefits of UDAN. Air Odisha and Air Deccan, which were among the five operators awarded 128 routes under the RCS, are likely to start operations by September-end, after they informed the government about having acquired Beechcraft 1900D aircraft. The other airlines that were awarded routes are Alliance Air, SpiceJet and TurboMegha, which have already begun flights. Regional aviation is expected to become a game-changer in the way average Indians travel, but the market must be a level-playing-field. “There’s space for everyone. Every top airline in India and abroad started small. The best survive and the rest fall through,” concludes Dubey.