Creating an Effective Configuration for an Airline in the Indian Market

Contemporary Concerns Study

Final Project Report

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Preface

For the economic development of any country, a significant role is played by the industrial activity taking place within the country. In such cases, the knowledge of current market scenario becomes highly essential. Keeping that in view we've been provided an excellent opportunity for industrial interaction in terms of our CCS project.

As a part of our academic requirement of MBA program, we have chosen Indian Aviation Sector as the industry to be analyzed under CCS study. The reason to choose this industry was the dynamic changes that are happening in the aviation market along with the stiff competition in the low-cost airline sector. The report is concerned with the study of market conditions, current competition scenario in Indian Aviation Sector, the different challenges being faced by domestic airlines along with evaluating the feasibility of implementation of point-to-point or hub-and-spoke model in the domestic sector. For the implementation of these models, we will be specifically studying the case of Indigo Airlines as it is the leading low-cost carrier in the country with a highly established domestic network.

We believe that through this kind of industry analysis we will get a better understanding of analyzing, formulating, implementing and executing business strategies in the highly volatile Indian aviation market, along with understanding the current trends of the industry with all its dimensions.

Preface

Executive Summary

India with its vast geography and diverse population is a complex market to understand. To offer fast connectivity to a population with varied income levels, there are currently eight major airlines in India- Air India, Jet Airways, Indigo, Spice Jet, Air Costa, Go Air, Air Asia and Vistara. India is one of the highest growing markets for airlines in the world. According to IATA, by 2034 India is expected to have a total of 367 passengers, adding 266 million annual passengers when compared with today.

Despite the promising outlook, however, there are serious obstacles to the future growth of the airline industry in India. Although the industry as a whole has been growing, most airlines have been suffering from losses and debts, raising the question as to whether the Low-Cost Carrier model is viable and sustainable for India over the long term. Not to forget the severe infrastructure problems with airports that are congested, underdeveloped and somewhere even outdated.

To identify the features and working of an ideal airline in a complex market like India. To understand how can an ideal airline perform on various parameters. Since Indigo is the most profitable and successful airline in India, we then aim to compare Indigo with an ideal airline model. The study would allow us to judge Indigo airlines on various parameters, and will help us understand its scope of improvements in order to become an ideal airline.

Overview of Indian Airline Industry

With an initial capital of INR 32 million, Indian Airline Industry was set up under the Air Corporations Act, 1953 and started its operations on 1st August 1953. The establishment came into picture due to the legislation that forced the nationalization of the airline industry in India. The international routes were managed by Air India while the domestic and regional routes were looked after by Indian Airlines Corporation (IAC). The IAC was formed as a result of the merger of eight pre-independence domestic airlines. These included Airways India, Bharat Airways, Himalayan Aviation, Indian National Airways, Air services of India, Deccan Airways, Kalinga Airlines and Domestic wing of Air India. Air Indian International took over the international operations of Air India Ltd. The private players were allowed to start their operations in 1986 as air taxis. Air Deccan was the first to start operation as low-cost carrier (LLC) in 2003.

Currently, the Indian civil aviation industry stands among the top ten in the world. According to a recent report by KPMG, the industry has a market size of USD 16 billion and contributing 0.5% to the Indian GDP. In the period from January – March 2016, the domestic airlines carried 23.03 million passengers compared to 18.54 million passengers during the corresponding period of previous year showing a growth of 24.03 percent. The domestic passenger traffic grew at a CAGR of 12.03 percent over the period from 2005 – 06 to 2014 – 15. The industry has also attracted Foreign Direct Investment (FDI) of USD 456 million for the April 2000 to July 2013. The industry currently handles 121 million domestic and 41 million international passengers. The Airport Authority of India expects that the aircraft and passenger movement at the airports will increase at the rate of 4.2 and 5.3 percent respectively during the coming years.

Some of the major drivers for the transformation of Indian civil aviation sector include low-cost carriers (LLC), foreign direct investments, increasing tourism and transportation, growing middle-class population, higher disposable incomes, low penetration level and emphasis on regional connectivity.

Currently, around 450 airports connect major cities in the country, but there are still no airports in tier 2 and tier 3 cities. Out of the 125 airports that Airport Authority of India manages 11 are international airports, eight custom airports, 81 domestic airports and 25 Civil

Enclaves at defense airfields. Only 30 percent of the total air traffic comes from tier 2 and three cities. Under the Greenfield Airport Policy, the Government of India is planning to construct more 15 airports. They plan to do this by identifying the low-cost, viable model for the construction of small airports. The connectivity among tier 2 and tier 3 cities is expected to improve because of this move.

Compared to the air traffic density of 282 in China and 2896 in the USA, the same is just 72 in India. This clearly shows that there is a tremendous untapped potential in the country which presents an opportunity for the industry to enhance the passenger traffic. The Government recently allowed for 100 per cent FDI in airlines with 49 per cent cap for foreign carriers. Figure 1 and 2 shows the domestic market share of various airlines.
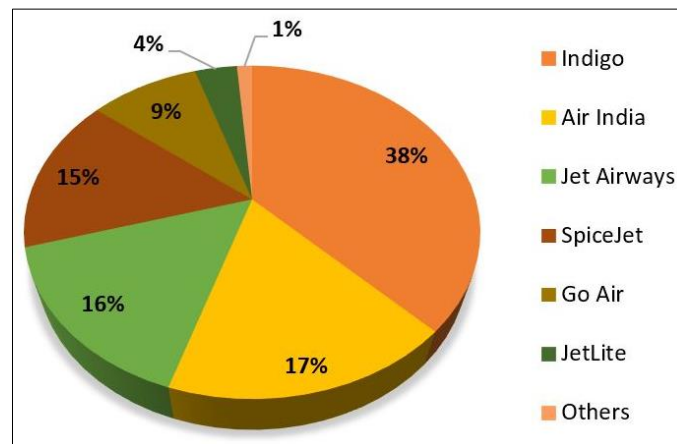

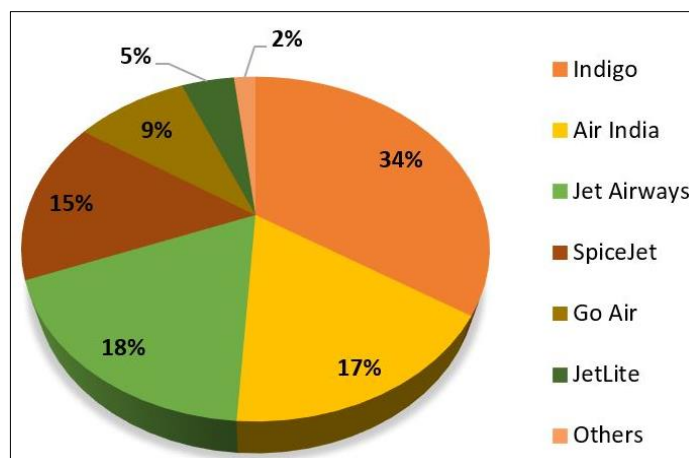FIGURE 1: MARKET SHARE (%) IN TERMS OF DOMESTIC MARKET DEMAND (RPK)

FIGURE 2: MARKET SHARE (%) IN TERMS OF PASSENGERS CARRIED

Understanding Indigo Airlines

Considering Indigo to be currently the best airline in India in terms of efficiency of flight operations, and profitability. Therefore, we tried to understand its success story so far.

In India, when private airlines like Kingfisher have shut shop, and the national carrier is in doldrums, it is astonishing to see an airline like Indigo, that started in 2006 to be the largest airline in India with a market share of 37% with Jet Airways a distant second at 24%.

Indigo operates more than 800 daily flights to 36 destinations. Though Indigo doesn't actually follow a hub and spoke model, but its main hub is Delhi airport.

Three main focus of Indigo are:

a) **Hassle Free** – Indigo keeps it simple and exploits the advantages of being a low-cost carrier. They do not provide free meals like Jet Airways and Air India. And, they charge extra for all additional services

b) **On Time** – One of the key reasons for success for Indigo. Though its aircrafts do not have a business class, yet many business travelers prefer Indigo due to its high on-time performance

c) **Low Cost** – Being a low-cost carrier does not act as a barrier to success and does not portray Indigo as an inferior brand when compared with airlines like Jet Airways. Rather, it is the opposite. Indigo exploits full benefits of being a low-cost carrier – no business class, no free meals. But, it still appeals to customers for whom time factor is more important that too at a low price

Differentiating Factors for Indigo

1. Best Turnaround time of 20 minutes. Indigo takes pride in the efficiency of their ground operations. The reasons are as below:

a) Defining work for **every single minute**. Between the time of flight arrival and flight departure, every minute has some work assigned. This enables the team members to understand their exact role, and leads to greater team efficiency. This is the key reason for their on-time performance that has also helped it garner many awards and accolades not only from the industry but also from customers.

What makes it all the more unique is that for even a one-minute delay, the staff needs to come to back office, and give the reason for the delay on an online system. The President himself directly keeps a track of these for every week. This is followed by a post discussion. This emphasizes the level of perfection Indigo strives to achieve.

b) Team Briefing 'before flight arrival', and most importantly also 'after flight departure'. While many competitor airlines do have a pre-flight arrival briefing, but rarely have another briefing after flight departure. Indigo keeps post-flight departure briefings to discuss what went right, what went wrong, and then how can they improve the operations further. It is this continuous search for perfection and improvement that makes Indigo stand out amongst its competitors.

2. Enhanced Customer Handling

a) For each flight operation, Indigo has three sets of staff – cabin crew, cockpit crew and ground support (customer service)

b) There are only four cabin crew with women only staff. They are trained at their Learning Academy called Ifly. Even for them, work is assigned in detail. For example, there are four food carts with the responsibility of each cart with one cabin crew respectively.

c) For Indigo, one flight operation requires a team of 25 personnel, whereas, other airlines need around 40. They save man power in many things. For example, one can notice at the check in counter that there is only one person standing between two check-in counters helping with the loading of luggage. Most airlines have only one person per check-in counter. Though one can question that it can mean lesser quality service to passengers, but as mentioned earlier, Indigo makes full use of being a low-cost carrier with the focus on its major objective and saving costs from other ends.

3. Using a single fleet of aircrafts (Airbus A320)

   a) Using a single fleet gives various advantages like reduced operational costs, same set of ground and crew throughout helps provide flexibility, and same training for all staff.

   b) Also, Airbus A320 is one of the most successful and efficient aircrafts of Airbus

4. Advantages of being a comparatively newer airline

   a) The aircrafts are new and efficient with an average fleet age of 4.9 years

   b) As Indigo has a fleet of Airbus A320s (one of the most efficient aircrafts), but they entered at a time when it was the last step in the A320 Enhanced modernisation programme, that was started in 2006 (the same year Indigo was founded). They have 5 A320 neo in their current fleet with more orders in the process (Total order placed of 430 such aircrafts in 2015). The A320neo has the latest generation engine and large sharklet wing-tip devices which leads to 15 percent fuel savings

5. High focus on internal scrutiny- Indigo pays a lot of attention in maintaining all its paperwork and accounting efficiently. There are many types of auditors like security, finance, etc. that analyze and help bring out minute improvements. Other airlines mostly do not delve into such depths.

6. Way of Marketing

   a) Indigo's **brand personality** suggests it to be cool & trendy (busted the outlook that air hostesses should have long hair or hair bun and came up with its own hairstyle), modern (cabin under complete control of women proudly wearing 'girl power' literally on their sleeves), punctual (74% on time arrival), compassionate (step-less ladder specially for differently-abled guests, 'Get Well Soon' written on sickness bags where Air India just mentions 'Air Sickness Bag'). This image is in tune with the customers of modern day India specially youth. Though it is a lost cost carrier

but its *innovative behaviour* in terms of on-time plus hassle free service has had a good connect with even *innovative* business travelers occupying 60% seats as compared with other travelers. Reaching on time is also in line with their *ideal self-image* in the corporate world where the business travelers would want to be perceived as punctual professionals.

b) Even when we look at their print ads, it mostly showcases catchy one liners like 'R.I.P Business class' and are mostly descriptive in nature showcasing greater connectivity through new routes/more flights on the same route. Therefore, it appeals well to customers high in **need for cognition**. Its simplicity in aptly satisfying functional needs of air travel without delays at an affordable cost is apt for most Indians seeking **low levels of optimum satisfaction**. For the same reason of quality and affordability on its International routes, it also connects well with **highly ethnocentric customers** willing to travel on only an Indian airline.

c) Even the brand name Indigo justifies the working style of the airline as **Indigo colour** signifies you are honest, compassionate and understanding with Integrity being utmost important. Being just nine years old, Indigo has made many loyal customers that seeking exploratory purchase behaviour. Indigo has showcased innovation through launching TV ads (not done by other airlines), and has a good online image on social media.

7. Cost savings from all possible ends. Examples are:

a) Indigo was the first airline to do away with manual books inside the cockpit and use an iPad instead. These books were heavy (around 7-8 kg). Therefore, to reduce the weight of the aircraft to achieve even a minute extra efficiency was undertaken

b) The seats are lighter as compared to other airlines. The idea being the same – to reduce weight of aircraft for more cost savings

c) Regarding maintenance, Indigo always tries to repair technical parts rather than replace

8. High focus on cargo. Indigo does carry cargo for companies like Flipkart. With a focus on greater frequency of flights, it does connect well with e-commerce companies. For example, in these companies, there are many cases of return of products. In such a case, a high frequency of flights between destinations allow them to move the goods faster with greater flexibility - that too on the same day

9. Buying, selling and lease structure of Indigo – The way Indigo handles its aircrafts also leads to profits. Firstly, at the time of buying as Indigo places huge orders, it gets a steep discount and cheaper than the market price. After payment and buying of aircrafts, it immediately sells out to lease company and then they lease it back. Lease period is generally 6-7 years. They run the aircraft for around seven years till fuel efficiency is the highest. They return aircraft after seven years. As it reflects it its average fleet age, Indigo prefers new aircrafts. Therefore, this cycle enables them to make new purchases, and contributes a big part of their profitability. Airlines like Ryanair do not buy aircrafts in bulk

10. Other factors of success:

    a) Indigo tries to keep every aircraft in air for 12 hours every day owing to its efficient turnaround time

    b) With regard to serving food, unlike other airlines, they do not keep trays at all. This also helps them save time on every turnaround

    c) Use of ramp instead of staircase – on a ramp, more people can be accommodated at once as compared with a staircase. Also, it is more convenient for travelers requiring wheelchairs. A simple step such as this helps in faster boarding and de-boarding of flight. It leads to a saving of around 5 minutes that is very valuable specially in the case of Indigo. It also leads to fastening of the turnaround process in terms of aircraft cleaning

    d) The buses on the ground are also very efficient. Mostly, they bring the customers to the aircraft even before the aircraft is ready for boarding. Though the customers have to wait near the aircraft but this ensures faster boarding once the aircraft is ready, thereby, saving time. Also, the ramps as well as the oil tanker are both ready

at the time of aircraft arrival. Though oil companies are separate companies not directly under the control of Indigo, but still the on-time image of Indigo has evoked trust in them, and they support the operations team for fast turnaround

e) Payment process for Indigo pilots – The difference in payment process to pilots also creates a difference between Indigo and other airlines. In airlines like Air India, the payment structure is more contract based on time between pushback and parking. Therefore, sometimes pilot tend to move slowly on the runway while taxiing in order to increase their time. On the other hand, Indigo's payment structure is based on per flight basis, and pilots can also be questioned incase the movement of aircrafts is found to be slow

f) Apart from Udaipur, Indigo doesn't offer connections. This helps in avoiding unnecessary delays. For example, many times Jet Airways flight gets delayed as it has to wait for few passengers from connecting flights

g) One of the reasons for such a fast rise of Indigo is its management style. This can be seen in the route planning for Bangalore – Kolkata. Till sometime back, where other airlines operated one flight per day, Indigo provided two-way flights. This worked well with many passengers as it provided them with a lot of convenience. Today, Indigo is the main player in this sector

h) In terms of food choice also, though Indigo does not offer meals but many corporates who are indifferent about money prefer to pre-book a meal on Indigo as they get good variety to choose from unlike a fixed meal offered on other airlines

Configuration of an ideal airline in India

As per our study, we suggest that an ideal airline should follow a hub and spoke model. In many countries, the functioning of the airline industry has been revolutionized by the implementation of the hub and spoke model. Singapore, Frankfurt, Dubai and London have turned into exemplary international hubs. However, the system becomes equally efficient in domestic transport scenario when applied for providing services to a large geographic area

like India. One of the major advantages of using this model is that it serves a larger number of destinations with fewest routes. For example, in a case where five destinations are involved, a hub and spoke model will use only four routes, with a hub and four spoke cities. In the absence of this model a total of ten routes would be required to connect the destinations with one another. This has been one of the major problems with airlines in India where they fail to connect regional destinations (Tier II and Tier III cities). In such a case with this model, the fewest number of aircrafts are required to service any given level of frequency of flights.

A hub and spoke model if applied effectively can greatly increase flexibility and efficiency. For any airport that an airline wishes to make its hub, it can also push for investment and assist for up gradation of infrastructure. It will not only help in the development of the airport, but it will also be beneficial for the flight operations.

Ideally, we suggest an ideal airline to make **Nagpur** as its hub. This is because of the following reasons:

1. Nagpur is **centrally located on India's map**. Operating flights through Nagpur will help improve fuel savings. Even though other major cities will be having more traffic and will seem ideal to make a hub, but there might be other difficulties. For example, if a major city like Kolkata is made a hub that is situated in eastern part of the country, then because of its location, flights to the northern part of India and southern parts will lead to high fuel expense due to long distance. Also, for northern India, in order to fly minimum distance, the airline will have to fly over neighbouring countries like Nepal whose procedure and permits will increase the cost.

2. Nagpur can act as a very efficient airport for connecting flights. This is because it is **lesser congested** than the major cities of India. It will prevent the delays where many times aircrafts have to circle above the airport due to heavy traffic at the airport, also leading to fuel wastage. This will also help in reducing the turnaround time.

3. If Nagpur is made a hub, then a maintenance department can also be put up in Nagpur itself. This will help in saving costs. For example, if an aircraft catches a technical

problem at an airport, sending a maintenance team from Nagpur will save both time and money.

Advantages of using hub and spoke model in India

The advantages result from consolidating the overall demand from Tier II and Tier III cities (spoke cities) to most of the destinations on the domestic network. Economies of scale result in increased economic advantage for the airline as the passenger density increases.

- Both supply and demand are positively affected with passengers preferring to use one airline for the complete journey. This results in a competitive advantage for the airline by giving them the ability to serve many cities of varying sizes.

- Features such as less delay between connecting flights, single check-in, reduced risk of baggage loss and better gate and facility provisions. Also, since the customer will be familiar with the fact that an airline serves a particular destination, it'll help in saving the search and transaction costs. This familiarity will also increase passenger loyalty, and all the more when linked with the loyalty programs.

- With the growth in the number of destinations being served on the network, a sufficient growth can be expected in the number of passengers which will further result in increased flight frequencies. Higher frequency will result in a better matching of flights with the itinerary for the customers (Gillen & Morrison, 2005). Usually, with high frequency, most of the major network carriers operate ten or more connecting flights every day. The increased frequency of flights also helps in giving a larger base over which the company can spread their advertising and promotional expenses. The efficiency and utility of frequent flier programs also increases.

- Considering the supply side, economies of increase in traffic density will result in seat mile costs benefit. With the increase in the number of passengers per route, larger aircraft can be utilized. This is because in comparison to increase in operating and capital cost, seating capacity increases. This results in provisions for reducing the fares or increasing the margins. Another important point to be noted it that with the addition of a new destination on the network, only one additional route is required. This comes from the fact that the existing hub facilities can be utilized with the additional route, and still easily provide service to every city on the network.

- With the options of adding more destinations in a hub and spoke model, it's considerably easier to add lower demand cities that can't be added to a network supporting fewer destinations. Considering that the demand patterns of a pair of city within the network are not highly correlated, it's possible to smooth out the total demand by allowing better capacity utilization.

Complexities in hub and spoke model

Although hub and spoke networks offer a very effective method to provide air service to varied and dispersed markets, they come with their own complexities, not to mention that they are costly to operate. Network carriers have often ended up offering a complete array of services in order to maximize their revenue and increase profits.

- To accommodate the increasing number of connecting passengers, a substantial number of personnel are needed. Although, if the flights operate non-stop between the stops, facilities like the passenger service agents, gates, lounges, baggage facilities, ramp and maintenance personnel dedicated to passenger connections are not necessary (Donoghue, 2002). However, since there is an intervening stop at the hub, it results in an additional take-off and landing consequently incurring landing fees and facility charges.
- The higher costs also result from the geography system of the network route. Even with a large number of destinations being connected on the route, the hub can be directly in alignment with only a few origin destination cities. All other spoke cities require continuous routing to the hub increasing the total flight time with increase in cost. Per mile, short flight segments are more expensive to operate (Swan, 2002). This is because additional taxi times and manoeuvring for take-off and landing results in lower block speeds for the aircrafts.
- Another important but less highlighted fact is the effect on utilization when the spoke cities are at varying distances from the hub. To maintain the timing with the next inbound bank, aircrafts that operate to the closer spoke cities must wait for the aircrafts to from the most distant spoke cities. These delays imposed due to scheduling procedures result in a reduction of proper utilization of aircraft and flight crew.
- Since hub and spoke model is used to serve cities of varying size and demand in the first place, the need arises to use different aircraft models to match capacity with

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traffic. Generally, the fleet of a large airline carrier consists of aircrafts with 50 – 350 seating capacity. However, in this model, as commonality of fleet decreases, costs increase proportionately. This is due to increase in costs incurred to train pilots and mechanics, maintain higher inventory including maintaining fleet-specific support equipment. With the increase in fleet complexity aircraft and crew scheduling becomes more difficult and constrained.

- The hub and spoke models are also highly susceptible to delays. The spill-over effect can occur easily with the delay on one or a few inbound flights spreading to the outbound flight. Then, there are disruptions which can affect the entire hub. Some of these include weather, radar or computer outages. An opportunity to mitigate this can be through having multiple hubs.

Reason why hub and spoke model will be effective

For any airline, the competition arises from other modes of transportation – railways, train, road.

India being a vast country, major competition arises from the train due to their vast connectivity and cheaper fares.

The switchover to an airline depends upon two main factors – distance and time. Nowadays, as we observe from previous times, airfares have reduced greatly and at the same time air traffic increased. As a result, air travel has become more common.

However, compared with metropolitan cities, though one can find connectivity between tier II cities, but often the tickets are quite expensive. This is one reason for people preferring trains over airlines. That is where an effective hub and spoke model using Nagpur can be useful. The benefits being:

- Cheaper tickets – avoiding landing and take-off at a major city can help avoid high ground handling and airport charges. This, in turn, should help the airline to offer cheaper tickets
- Decreased travel time – Heavy congestion at major cities often lead to delays. In this case, choosing Nagpur means there will be lesser congestion. Also, as it is a hub, the expected turnaround time is also less

- Increased loyalty from customers – In a market like India where there is cut-throat competition in pricing, a differentiating factor based on saving both time as well as money can help build brand loyalty, and also a well-perceived image

Proposed steps of setting up an ideal airline in India

The aim for the first five years should be to establish the airline and prepare a base for future expansion. Apart from the licensing and formalities, route planning will play an important role. The initial first 4-5 years will be required for establishing the base. They routes can be classified into three broad types:

1. Most profitable and major sectors like:

a. Delhi - Mumbai (10th busiest route in the world based on total no. of seats flown and 11th based on aircraft movement)

b. Kolkata - Delhi

c. Mumbai - Kolkata

d. Mumbai - Bangalore

e. Bangalore - Kolkata

f. Delhi - Hyderabad

g. Mumbai - Chennai

h. Kolkata - Chennai

2. Sectors connecting upcoming cities like Jaipur, Lucknow, Chandigarh, Ahmedabad, Bhopal, Nagpur, Vizag, Surat, Bhubaneswar, Pune and Kochi. The hub and spoke model will be quite effective in connecting these cities

3. Tourist places (scheduling can be done based on season, major events/festivals, etc.) like Leh, Srinagar, Kullu, Shimla, Udaipur, Jodhpur, Varanasi, Patna, Gaya, Guwahati (strategically located for tourists visiting north-east)

Depending on the budget, a perfect mix of the above three broad types will be a good option.

Next point will be the type of aircraft. Like Indigo, selecting A 320s will be good - as they are efficient, maintenance required is low, chances for technical snags are less, plus modified

engines can be used e.g. Kingfisher Airlines A 320s had a modified engine as compared to A 320s of other airlines. Indigo airline uses mostly A 320s, and the results in their growth are phenomenal.

It will take nearly 4-5 years to establish the airline, ground, and technical support also counting the delivery time between placing and delivery of aircrafts.

Once the airline is established, economies of scale can be exploited for further growth.

Comparing Indigo with an ideal airline

The common points between Indigo and an ideal airline:

- Choice of aircraft: Even for an ideal airline, we suggested using only one type of aircraft – in this case A 320. In a highly competitive market like India, it is essential to save costs wherever possible and using one type of aircraft makes the handling and operations more streamlined and easier
- Management style: In the current scenario, especially in the Indian market, the emphasis of the management of an ideal airline should be on enhanced customer experience and improvements on all ends. Emphasis should be on maximizing the flying time of aircrafts, cost savings from all ends – using a small but efficient team per flight, reducing ground handling & airport expenses, and time – turnaround time, on time arrival and departure. Indigo's management is like an ideal management that is innovative and focused on continuous improvement.

Our suggestions:

- Use of Hub and Spoke model using Nagpur as the hub: Though Indigo uses Delhi as a hub but an effective hub and spoke model can provide it a high competitive advantage. Given it being a low-cost carrier, if it can connect Tier II cities saving time and money, it can also create a new customer base that would have chosen railways over an airline. In the process, it would also help garner brand loyalty and trust. Also, it will bring down the overall costs as well.

  Also, on-time performance of Indigo has dropped due to increase in a number of flights. A hub and spoke model will also be useful to remove the inefficiencies involved with expansion.

- Launching a loyalty program: Indigo offers the cheapest prices and due to its on-time performance does not require a loyalty program as such. It enjoys a loyal customer base from all segments – occasional travelers (cheap fares), regular travelers(on-time), business travelers (on-time and hassle free). However, a loyalty program can attract new customers. At the same time, it can give Indigo an advantage over other low-cost carriers like Spicejet specially in the case of occasional travelers who are more focused on savings.

- Route Planning: Indigo's growth is remarkable, and it shows in its route planning. Every now and then, they keep adding new destinations or keep increasing the frequency of flights between two destinations. Better connectivity between cities using Nagpur as a hub can be one area of improvement. Also, connecting tourist cities based on season/festival can be looked upon. Also, strategically choosing cities like Guwahati-based on its central location in north-east India can be beneficial.

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