AIR INDIA PRIVATISATION

Lessons from the past

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IT HAS BEEN REPORTED that Air India is looking for short-term loans for tiding over working capital constraints. Dealing with Air India and securing a sustainable solution is important for the government; it has to get it right this time around, and three elements will be critical.

First, structuring transaction equitably through an acceptable risk-reward trade-off is vital. Strong strategic partners will look at the deal seriously when they are incentivised to do so; a large part of the success of the deal will be written here.

The year 2000 experience of privatising Air India provides a good learning; with a complex structure of operating companies across different aviation and non-aviation businesses, valuing the company transparently became difficult. The perceived lack of clarity in ownership structure and potential government interference depriving the strategic partner to run operations independently were also pain points. Carving out a structure that is transparent and easy to understand should be a key focus, this time. Strategic investors may want to look at specific businesses; some only at the airline, and others at, say, ground handling, while some may want to look at both. However, if the proposed deal brings in different strategic partners for different businesses, how such issues could impact the valuation and the perception of bidders would become pertinent questions.

Once the structure is set out, clarity will emerge in terms of valuation. It will help ensure that an arm's-length deal can be carved out, without putting the public assets in private hands for too cheap a price. At the end of the day, it has to be a fine balance between striking an equitable deal, incentivising the strategic partner and not giving way too much within the realms of an acceptable risk-return trade-off. The past experience and outcomes of Air India's divestment of hotel and hospitality related assets had issues in terms of perceived undervaluation; such issues have to be carefully ironed out.

With the government taking major decisions in selling public assets to private firms, how can key decision-makers secure immunities? This is vital; past deals like merging Air India with Indian Airlines and decisions relating to previous aircraft orders are now being probed by CBI.

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Also, clarity is needed in terms of regulations. The government has increased FDI in airlines to 100%, but still restricts a foreign airline to hold a maximum 49% of equity. The government and DGCA stipulate that Indian nationals need to have 'substantial ownership and effective control' of an airline's operations. While we see a push for more foreign investment in airlines is being solicited, we are yet to see clarity in regulations that will provide foreign airlines and investors an equitable level of management control. Such issues arose when Etihad invested in Jet Airways and during the formation of AirAsia and Vistara.

It should be considered whether the government should completely exit or influence partial control—from the perspective of how bilateral rights and landing slots will be dealt with? Countries need national carriers to ensure the larger economic interest in terms of connectivity and route network, which may not be the primary agenda of private investors.

Second, the choice of partner is crucial—domestic airline, foreign airline, foreign investor, or an Indian corporate having a tie up with an international airline? Ideally, the partner should be able to synergise its own operations with that of Air India's, such that Air India assets are put to the best productive use.

The third issue would be dealing with the assets and employees of the company. The accumulated losses and the large debt Air India is carrying is perceived as the biggest stumbling block, but that's not a major issue; there are a number of ways to deal with debt. Also, its valuable real estate assets will need to be appropriately leveraged. Of course, the government will need to write-off a part of it while passing on the sustainable component of debt to the strategic partner.

The biggest asset of Air India is its licensed employees, including pilots, aircraft maintenance engineers and other crew. The challenge for the strategic partner (and eventually for the government to make this deal sustainable) is the integration of such employees into a 'private' culture.

If properly structured, this deal can generate huge interests. With less than 5% of Indians travelling by air and per-capita trips low, there is a huge potential for air traffic growth. With the new UDAN regional connectivity scheme in place, the government's intention to maximise the currently underutilised regional airports and airstrips adds to potential for high growth. Overall, it's a favourable signal to potential strategic investors.