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NEW DIMENSIONS IN FDI: FDI IN CIVIL AVIATION

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Abstract: *In recent years, emerging market economies (EMEs) are increasingly becoming a source of foreign investment for rest of the world. It is not only a sign of their increasing participation in the global economy but also of their increasing competence. More importantly, a growing impetus for change today is coming from developing countries and economies in transition, where a number of private as well as state-owned enterprises are increasingly undertaking outward expansion through foreign direct investments (FDI). Companies are expanding their business operations by investing overseas with a view to acquiring a regional and global reach. The study examines the Role of FDI in India and has attempted to estimate possible foreign investment flows if* ***Civil Aviation*** *is opened up for FDI. FDI in services, which accounted for the bulk of the decline in FDI flows due to the crisis, continued on its downward path in 2010. All the main service industries (business services, finance, transport and communications and utilities) fell, although at different speeds. FDI flows in the financial industry experienced one of the sharpest declines. FDI policies interact increasingly with industrial policies, nationally and internationally The challenge is to manage this interaction so that the two policies work together for development. Striking a balance between building stronger domestic productive capacity on the one hand and avoiding investment and trade prot ectionism on the other is key, as is enhancing international coordination and cooperation.*

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EXECUTIVE SUMMARY

The study of FDI in Civil Aviation observed:

- Huge amounts of additional investments required to realize the vision of the Civil Aviation industry as suggested in Working Groups report.
- Airport Infrastructure would require an investment of about Rs.67,500 crore during the 12th Plan of which around Rs 50,000 crore is likely to be contributed by the private sector.
- Airlines in India are expected to add around 370 aircrafts worth Rs.150, 000 crore.
- Decade 2000-2010 witnessed a profitless growth. The Airline Industry in India suffers from huge debt burden – close to US $ 20 billion (Estimated 2011-12) Allowing foreign airlines to pick up stake in three major Indian Airlines (Kingfisher, Jet Airways and Spice Jet) would result in capital infusion to the tunes of
- Promoters off loading 26% of their Equity Stake can raise approximately up to Rs. 1341 crore.
- Figure goes approximately up to Rs.2530 crore in case 49 percent FDI is allowed..
- Equity valuation at 26% of all issued shares (promoter and non promoter) approximately comes out to be Rs.2835 crore.
- Estimates at 49% goes approximately up to Rs.5341 crore.

INDIA'S FDI OVERALL VIEW

The early nineties was a period when the Indian economy faced a severe Balance of Payment crisis. Exports began to experience serious difficulties. The crippling external debts were putting pressure on the economy. In view of all these developments there was a serious threat of the economy defaulting in respect of external payments liability. It was in the light of such adverse situations that the policy makers decided to adopt a more liberal and global approach thereby, opening its door to FDI inflows in order to restore the confidence of foreign investors.FDI provides a situation where in both the host and the home nations derive some benefit. The home countries want to take the advantage of the vast markets opened by industrial growth. Whereas the host countries get to acquire resources ranging from financial, capital, entrepreneurship, technological know-how and managerial skills which assist it in supplementing its domestic savings and foreign exchange.

The contribution or impact of FDI has been well acknowledged in various discussion papers and studies amongst these in one of the recent study done on India's FDI inflows trend and concepts it is mentioned that, "The Economic Survey 2008-09 reiterated that: FDI is considered to be the most attractive type of capital flow for emerging economies as it is expected to bring latest technology and enhance production capabilities of the economy. And the National Manufacturing Competitiveness Council specified that: Foreign investments mean both foreign portfolio investments and foreign direct investments (FDI). FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. This efficiency contribution of FDI is much more important".

The evolution of Indian FDI can broadly be divided into three phases classified on the premises of the initiatives taken to induce foreign investments into the Indian economy:

(a) The first phase, between 1969 and 1991, was marked by the coming into force of the Monopolies and Restrictive Trade Practices Commission (MRTP) in 1969, which imposed restrictions on the size of operations, pricing of products and services of foreign companies. The Foreign Exchange Regulation Act (FERA), enacted in 1973, limited the extent of foreign equity to 40%, though this limit could be raised to 74 for technology-intensive, export-intensive, and core-sector industries. A selective licensing regime was instituted for technology transfer and royalty payments and applicants were subjected to export obligations.

(b) The second phase, between 1991 and 2000, witnessed the liberalization of the FDI policy, as part of the Government's economic reforms program. In 1991 as per the 'Statement on Industrial Policy', FDI was allowed on the automatic route, up to 51% in 35 high priority industries. Foreign technical collaboration was also placed under he automatic route, subject to specified limits. In 1996, the automatic approval route for FDI was expanded, from 35 to 111 industries, under four distinct categories (Part A–up to 50%, Part B–up to 51%, Part C–up to 74%, and Part D-up to 100%). A Foreign Investment Promotion Board (FIPB) was constituted to consider cases under the government route.

(c) The third phase, between 2000 till date, has reflected the increasing globalization of the Indian economy. In the year 2000, a paradigm shift occurred, wherein, except for a negative list, all the remaining activities were placed under the automatic route. Caps were gradually raised in a number of sectors/activities. Some of the initiatives that were taken during this period were that the insurance and defense sectors were opened up to a cap of 26%, the cap for telecom services was increased from 49% to 74% , FDI was allowed up to 51% in single brand retail. The year 2010 saw the continuation of the rationalization process and all existing regulations on FDI were consolidated into a single document for ease of reference.

The evolution of the FDI policy, towards more rationalization and liberalization, has narrowed down the instruments regulating FDI policy broadly to three[2]:

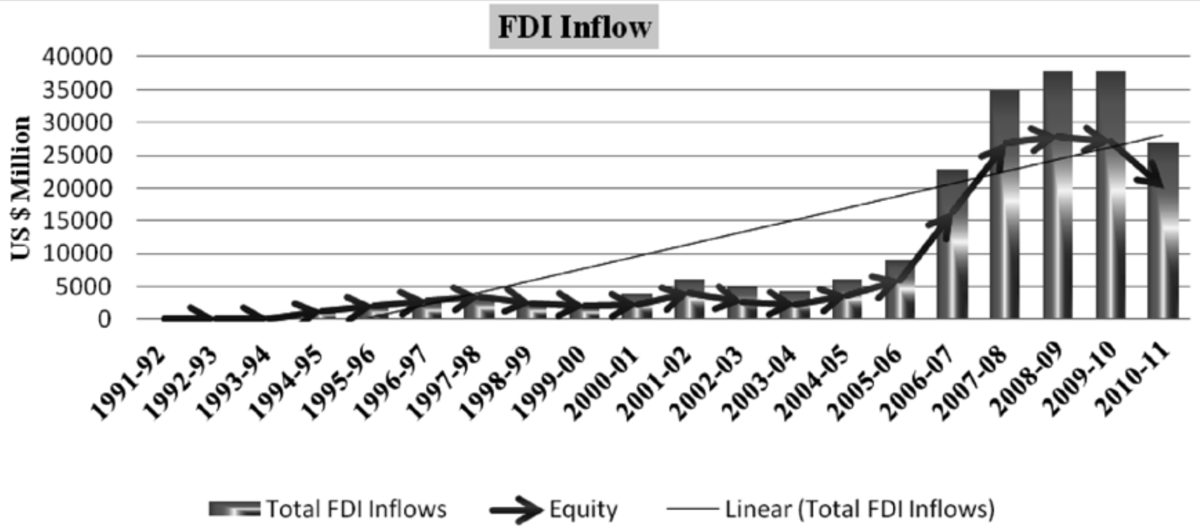
(i) **Equity caps:** restricting foreign ownership of equity capital

(ii) **Entry route:** requiring prior Government oversight, including screening and approval

(iii) **Conditionality's:** comprising of operational restrictions/licensing conditions, such as nationality criteria, minimum-capitalization and lock-in period etc.

FDI INFLOWS TRENDS 1991-2011

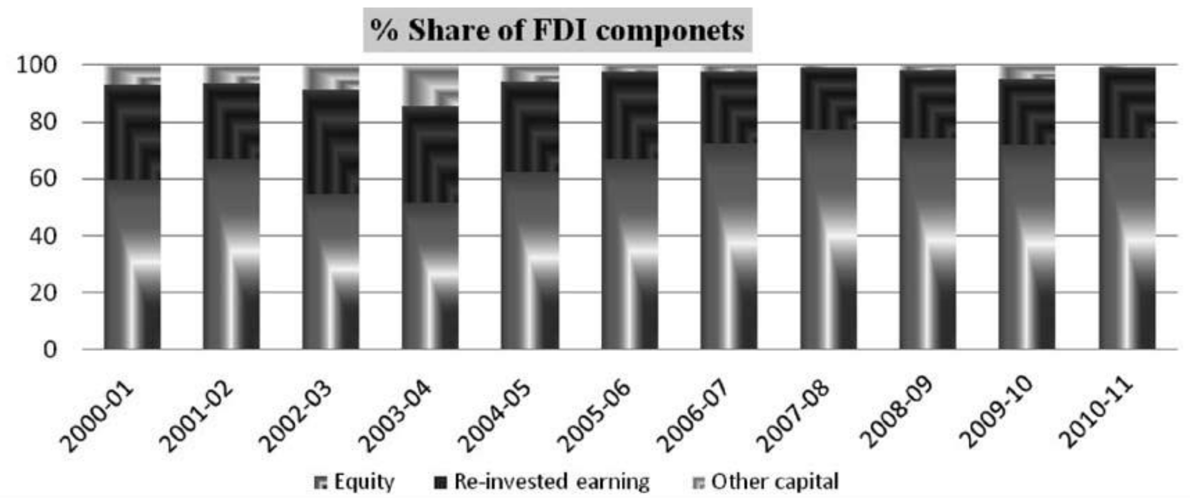
The data on FDI inflows into the country shows that foreign investors have shown a keen interest in the Indian economy ever since it has been liberalized. An increasing trend of flows can be observed since 1991 with the peak of FDI flows being reached in 2008-09. (Chart 1) Therefore the trend gives support to the fact that as and when the government various reasons which work in favour of India and increase the level of interest shown in by foreign organization's some of them being its demographics' with a young population there is a huge consumer base that is to be tapped, the growing middle class, increased urbanization and awareness, rising disposable income.



Source: DIPP

FDI INFLOW BY COMPONENTS:

There has been a change in the method of estimation of FDI inflows since 2000-01, prior to this only equity inflows was taken as the FDI inflow figure however post 2000-01 the RBI has started following the international practice and taken into account other components of FDI inflows namely re-invested earnings and other capital. A look at the contribution of various components of FDI reveals that the share of re-invested earnings was rising from 2000 onwards uptil 2005-06 after which it has constantly been declining. The share of equity inflows has risen sharply since 2000-01 when it stood at 59.6 per cent to 74.3 percent in 2010-11.



RELEVANCE OF FDI IN INDIA

The 12th Plan's draft approach paper of the Planning Commission mentions that"Thus the average investment rate needed during the Twelfth Plan period is estimated to be 38.5 per cent of GDP for the 9.0 per cent growth scenario with 4.5–5.0 average inflation. It would have to rise as much as 41.4 per cent of GDP for the 9.5 per cent growth scenario with 5.0–5.5 rate of inflation" and in terms of investment in infrastructure the same document suggests that "The total investment in infrastructure would have to be over Rs.45 lakh crore or $ 1 trillion during the 12th Plan period. Financing this level of investment will require larger outlays from the public sector, but this has to be coupled with a more than proportional rise in private investment*".*

It is seen that every nation world over is the race of attracting more FDI inflows to accelerate the pace of economic progress India's case is no different as in order to achieve and sustain a healthy rate of growth India would require huge investments which cannot be financed locally therefore the government needs to look at alternate avenues of building up investments, FDI in this context is a very useful mechanism. Recent reports have also suggested that greater FDI inflows must be encouraged to meet capital requirements.6 Aside from using FDIs as investment channel and a method to reduce operating costs, many companies and organizations are now looking at FDI as a way to internationalize.

FDI should be looked upon as a means of industrialization and development.

The Benefits of FDI Inflows can be broadly identified as:

- Bridging the financial gap between the quantum of funds needed to sustain a level of growth and the domestic availability of funds
- Technology transfer coupled with knowledge diffusion that leads to improvement in productivity. It can, thus, fasten the rate of technological progress through a 'contagion' effect that permeates domestic firms.
- The transfer of better organizational and management practices through the linkages between the industries.

FDI IN CIVIL AVIATION

Importance

The aviation industry is critical for any nation to gain from participation in the global economy. Civil Aviation in its role of a key infrastructure sector facilitates:

- Growth of other industries
- Trade - by offering a reliable and faster mode of transport services to move products and personnel across long distances
- Tourism
- Generates both direct and indirect employment opportunities

The vision for the Indian civil aviation industry for the 12th Plan period is: "To propel India among the top five civil aviation markets in the world by providing access to safe, secure and affordable air services to everyone through an appropriate regulatory framework and by developing world class infrastructure facilities.

Potential

A growing middle class supplemented with rise in disposable incomes, change in lifestyles, a globalized economy all act as drivers that project a huge potential for the industry. Another way of looking at the potential of the sector is by comparing the domestic tariff of another emerging economy China.

Domestic traffic in China is believed to be five times the size of India's despite having a population just 10% larger. Forecast of air traffic carried out for 12th plan13 period suggests:

- Domestic passenger throughout would grow at an average annual rate of around 12%.
- Domestic passenger throughout is expected to touch around 209 million by FY-17 from 106 million in FY-11.
- International passenger throughout is estimated to grow at an average annual rate of 8% during the 12th Plan period

Investment Required

Huge amounts of additional investments will have to be made into the sector to develop more airports, increase the existing capacities as well as improve and create additional support infrastructure if India intends to harness the existing potential efficiently.

Broad Investment requirements:

Expense on	Amount (Rs. Crores)
Airport	67500
Fleet Expansion	147600
Total	215100

Estimates given in the Report of Working Group on Civil Aviation suggest the investments requirement would be:

a) Airport Infrastructure

Estimates received from AAI and the industry indicate that the Indian airports would require an **investment of about Rs 67,500 crores during the 12th Plan** of which around Rs 50,000 crores is likely to be contributed by the private sector. Please refer to the Table below:

Table: Expected investments in airports during 12th Plan

Investor	Investment Category	INR (Crores)
AAI	Airport Projects	17,500
Private	By Airport Operator	40,000
Investments	By Others	10,000
	Subtotal	50,000
	Total	67,500

Source: Report of Working Group on Civil Aviation for formulation of Twelfth Five Year Plan (2012-17)

b) Airlines

Airlines in India are expected to add around 370 aircrafts worth Rs 150,000 crores to their fleet by FY-17. Fleet expansion at this scale would require airlines to explore multiple funding options including capital markets, long-term borrowings and leasing etc. Please refer to table below:

Table: Expected fleet expansion by Indian carriers

Airline	Number of aircrafts expected to be added by 2012	Estimated Value of aircrafts to added (crores)
Air India	40	18,000
Go Air	22	8,100
Jet Airways	79	32,000
JetLite	20	7,600
Kingfisher	78	29,700
Space Jet	68	26,100
Indigo	69	26,100
Total	376	1,47,000

Source: Report of Working Group on Civil Aviation for formulation of Twelfth Five Year Plan (2012-17)

Realization of the civil aviation industry's vision would require huge amounts of funds to be invested.

However, looking at the existing financial status of the industry the achievement of set objective seems to be ambitious14.

- The decade 2000-2010 witnessed a profitless growth phase of the air lines industry.
- During the three year period between 1 Apr 2007 and 31 Mar 2010, Indian carriers incurred an accumulated operational loss in excess of Rs 26,000 crores.
- As per certain estimates the Airline Industry in India suffers from huge debt burden – close to US $ 20 billion (estimated for 2011-12).
- Half of this debt is aircraft related and the rest for working capital loans, payments to airport operators and fuel companies.
- High costs of operation and competitive pricing mechanism followed has adversely dented the financials of the airline sector

Foreign Airlines Equity Participation

Raising huge amounts of investments would require the government to adopt more progressive and positive fiscal regime as well as develop a collaborative approach with the industry.

Civil Aviation industry would require not only large but continuous flow of funds if the next phase of growth needs to take place. For this to happen the government must relook at its FDI policy which disallows foreign airlines from purchasing equity of domestic airlines.

Direct investment by foreign airlines would:

- Provide managerial and technical expertise needed to improve productivity.
- Raise much-needed capital for the private-sector players
- Improve operating standards and services

An estimation of the amount of capital that can be raised by three prominent Indian Private Airlines shows: (foreign non- airline investor's equity has not been considered in estimation).

- The promoters by off loading 26 % of their Equity Stake can raise up to Rs. 1341.45 crores.
- This figure goes up to Rs. 2528.3 crores in case 49 per cent FDI is allowed.
- Combined equity valuation (promoter and non-promoter) at 26 % comes out to be Rs. 2834.27crores.
- The valuation at 49 % goes up to Rs. 5341.52 crores.

The capital raised from equity sale can be used to address the working capital requirements of the airlines.

Estimates:

Table: Estimates of capital that can be raised

Condition	FDI raised at 26%	FDI raised at 49%
Promoter off load their stakes	1341.54	2528.29
Total available equity is diluted	2834.27	5341.51

Investment flow through FDI

Promoter's share is diluted

Airline	No. of Shares	Total value(Rs. Crores)	FDI raised at 26%	FDI raised at 49%
Kingfisher	263085543	4268.56	1109.82	2091.59
Jet Airways	10183	0.57	0.15	0.28
Spice jet	156528305	890.65	231.57	436.42
Total			1341.54	2528.29

Overall (promoter and non-promoter's) share is diluted

Airline	No. of Shares	Total Value (Rs. Crores)	FDI raised at 26%	FDI raised at 49%
Kingfisher	469107140	7611.26	1978.92	3729.51
Jet Airlines	17275436	983.17	255.62	481.75
Spice Jet	405378065	2306.6	599.72	1130.23
Total			2834.27	5341.51

Individual Airlines

Kingfisher

Category	No. of shares	Total Value (Rs. Crores)	FDI raised at 26%	FDI raised at 49%
Promoter	263085543	4268.56	1109.82	2091.59
Non-Promoter	206021597	3343.11	869.20	1638.12
		7611.26	1978.92	3729.51

Note: Rs 162.27 that is the average of highest share price and lowest share price in the last four years has been used to calculate the valuation.

Jet Airways

Category	No. of shares	Total Value (Rs.Crores)	FDI raised at 26%	FDI raised at 49%
Promoters	10183	0..57	0.15	0.28
Non-Promoters	17265253	982.60	25547	481.47
Total	1727543	983.17	255.62	481.75

Note: Rs 569.13 that is the average of highest share price and lowest share price in the last four years has been used to calculate the valuation.

Spice Jet

Category	No. of Shares	Total Value(Rs. Crores)	FDI raised at 26%	FDI raised at 49%
Promoters	156528305	89.65	231.57	436.42
Non-Promoters	248849760	1415.96	368.15	693.82
Total	405378065	2306.60	599.72	1130.23

Note: Rs 56.9 that is the average of highest share price and lowest share price in the last four years has been used to calculate valuation.

SUGGESTIONS

Bureaucratic delays and various governmental approvals and clearances involving different ministries need to be fastened so as to increase the absorption rate of FDI into the country.

• Restrictions on sector caps and entry route to sectors other than those of national importance need to be liberalized further and constant reviewing of policies must be done.

• Government must ensure consistency of policy so as to improve the business and investor confidence.

It is in the interest of the industry at large if a mechanism could be developed which facilitates a consultation between Centre and State governments before a policy rollout so that once the decision is taken its implementation does not get affected.

• Government must recognize that good regulations and efficient processes are key catalysts for FDI. Accessible and reliable information and efficient and predictable actions by public institutions help create a business environment conducive to investment.

• Time bound, non-discretionary, simplified and less number of procedures and approvals would also help in uplifting the international investor's confidence and help foster more investment into India

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