FINANCE AND INVESTMENT CELL
SHRI RAM COLLEGE OF COMMERCE

VOLUME V

MERGERS & ACQUISITIONS

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"Dil mein India, aasmaan mein Air India"

AIR INDIA

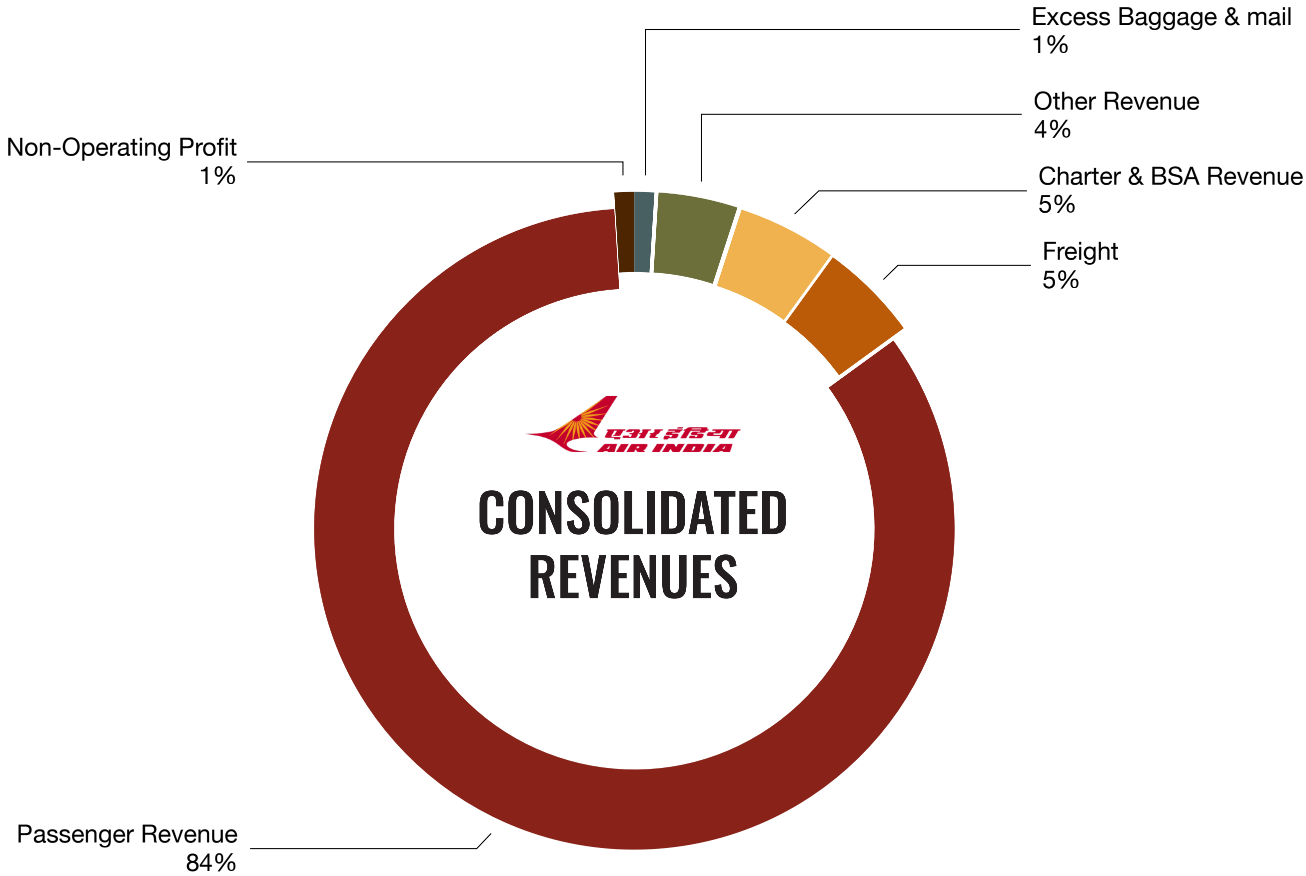
Air India, the premier flight carrier, is one of the most extensive flight service providers in India. Founded in 1932 as Tata Airlines by JRD Tata, the company truly pioneered the Indian aviation sector. The airline company transformed into a public limited company after World War 2 in 1946 and since then it is known as 'Air India'.

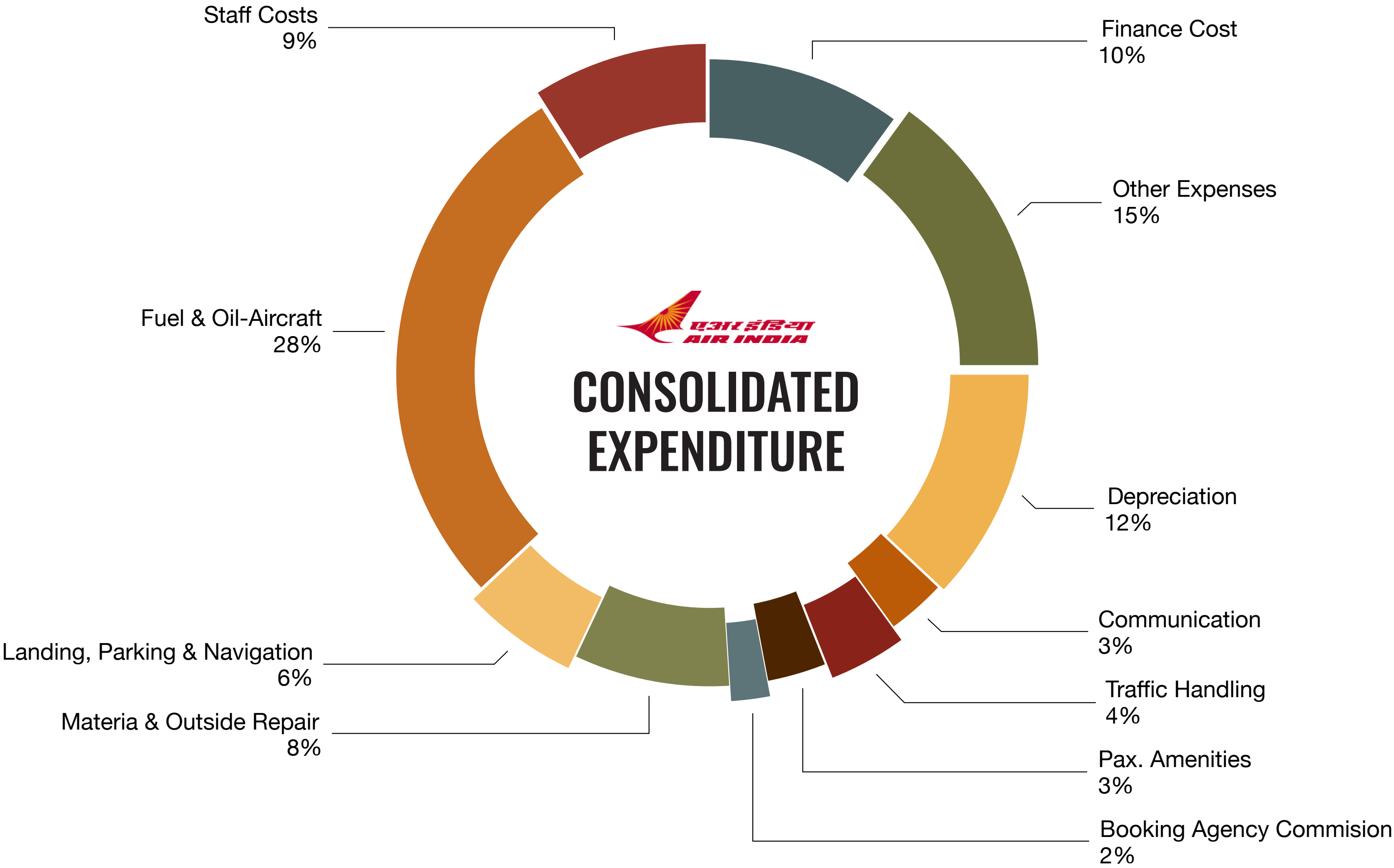
Soon the company expanded its operations and inaugurated internal flights to places like London, Geneva etc. Since then the company has continuously grown to become a mega international airline. Today it connects to over 40 destinations across the US, Europe, South East Asia, Gulf etc. The domestic services of the airline spread over 80 destinations across the country covering even the far-flung areas of the northeast and north such as Ladakh.

The company strongly exudes the spirit of India by extending warm hospitality to all its guests which is an inherent characteristic of Indian culture. Apart from the airline services, Air India even provides ground handling, engineering and maintenance services, as well as low-cost travel options and domestic regional connectivity through its subsidiaries i.e. Air India Charters Limited (Air India Express) and Airline Allied Service Limited (Alliance Air).

However due to tough competition by other airlines, including private ones, the company struggled to maintain its share in the market. Despite the struggle and accumulation of losses, the company continued to remain bloated with a large labour size which further aggravated the problem and drove the company to become debt-laden. As a result in 2017, the government decided to privatise the company.

Now, finally, the Government of India has approved its sale to Talace Private Limited, a Special Purpose Vehicle (SPV) of Tata Sons who emerged as the highest bidder at Rs 18,000 crores.





TATA SONS

With more than 150 years of existence, Tata Group was founded by Jamshedji Tata in 1868. A global enterprise which is headquartered in India operates in over 100 countries across 6 continents with the mission of improving the quality of life among various communities through stakeholder value creation based on leadership with trust. The group comprises 30 companies across 10 verticals namely IT, steel, automotive, retail, infrastructure, financial services, trading and investment, tourism and travel, defence and aerospace and telecom and media.

Established in 1868 as a trading enterprise Tata Sons has now become the key component of Tata Group. Initially, it was engaged in opium and tea trading but ultimately it moved towards becoming the principal investment holding and promoter of Tata companies. Each and every company that uses 'Tata' is signatory to 'Tata Sons Brand Equity & Business Promotion (BEBP) Agreement'. This agreement gives companies the right to use 'Tata' in return for their commitment to run and operate ethically within the prescribed code of conduct.

The group strongly believes in benefiting communities across the globe, thereby 66% of the equity share capital of Tata Sons is held by philanthropic trusts (Sir Dorabji Tata Trust and Sir Ratan Tata Trust form the two biggest shareholders) with the purpose of supporting education, health, art, culture, generating livelihood etc.

Following Tata's governance policy of ensuring transparency, fairness and ethical management Tata Sons make sure to follow the laws of land. However, Tata Sons has a history of being in the news due to internal conflicts and battles. One of the longest battles among these is the battle between Tata Sons and Cyrus Mistry, former executive chairman of Tata Sons. It began in 2016 when Cyrus Mistry was removed as the executive chairman and director of Tata Sons and the company was converted from public to a private company. Following this in 2019, the NCLAT declared this conversion illegal and asked Tata Sons to reinstate Mistry at his original position. However, Tata Sons challenged this judgement in the supreme court and finally, after 5 years, on 26 March 2021 Tata Sons won this court race when the Supreme Court set aside NCLAT orders and allowed all the petitions by Tata Sons.

HISTORICAL TIMELINE

1932
JRD Tata founded Tata Airlines as a division of Tata Sons Ltd (now Tata Group)

1947
After India's independence, the government took a 49% stake in the carrier, which had been renamed Air India.

1962
With the introduction of the first Boeing 707-420 aircraft in 1960, Air India started using jets, and two years later, in June 1962, it became the world's first all-jet airline.

1986
Airline takes delivery of the Airbus A310-300, and becomes the largest operator of this type of aircraft in passenger service.

1990
Air India helps evacuate 170,000 people from Kuwait before the First Gulf War. Airline entered the Guinness Book of World Records for the most people evacuated by a civil airliner.

2001
Air India launches its Frequent Flyer program ('Flying Returns')

2003
Air India dedicates several special flights to Kuwait, with the purpose of evacuating Indian citizens from Iraq.

2005
Launch of Air India Express-Air India's low-cost airline.

2007
Air India initiated its cargo service. By the end of July, the airline started carrying non-stop flights to the USA.

2012
The airline posts significant losses and slips to fourth place in the Indian market, behind Jet Airways, IndiGo and SpiceJet.

2014
Air India becomes the 27th member of Star Alliance. A Boeing 787 Dreamliner, a Boeing B777-300 and an Airbus A320-200 are painted with special Star Alliance livery.

2018
The Indian government tries to privatise Air India by selling 76 per cent of its stake in the national carrier, but fails because no private-sector buyer expresses interest.

2020
The government approves a new proposal to divest 100 per cent stake in Air India, which is followed by an Expression of Interest document the same month.

2017
Air India takes delivery of its first Airbus A320neo (new engine option) and plans to lease 13 more such re-engined narrowbody planes. The A320neo is configured in two classes: Economy and Business.

2021
Tata Sons takes over the airline once again, after more than 50 years.

MERGER OF AIL AND IAL INTO NACIL

In order to provide an integrated international/ domestic footprint, which would significantly enhance customer proposition and enable optimal utilization of existing resources, the merger of AIL (Air India Limited) and IAL (Indian Airlines Limited) into NACIL (National Aviation Company of India Limited) was initiated. Accenture India Pvt. Ltd. was appointed as the consultant by the Joint Committee of Boards of AIL and IAL on Merger (constituted by GoI), After GoM recommended the proposal to the Cabinet, the merger was approved and National Aviation Company of India Ltd. (NACIL) was incorporated.

The merger was foreseen to be beneficial in the following ways:

- The merger was intended to provide an integrated international and domestic footprint which would ultimately enhance the customer proposition and allow easy entry into one of the three global airline alliances.
- The merger predicted a net synergy benefit of Rs 820 crore, as against the integration cost of Rs 200 crores and recurring synergies were expected to enhance profitability by Rs 600 crore by the end of third year of this merger.
- It would enable optimum utilization of existing resources via improvement in load factors and yields on commonly serviced routes
- It would provide the merged airline a better position to serve and promote air hubs that were coming up in the metro cities and contribute towards airport reconstruction and modernization by providing seamless connectivity.
- The merger gave an edge as it operated a combined fleet strength (approx. 112), which is largest in India.
- It would improve the combined market share and provide maximum flexibility to achieve financial and capital reconstruction through revaluation of assets of both the airlines and improving the combined net worth.

However, the merger didn't go out as planned. Key factors that led to failure of this merger are:

- **Human resource Issues:** At the time of merger, the combined employees stood out at 30,000 i.e., 256 employees per plane which was twice the global standard. As a result, almost one fifth of the revenue was spent on employee pay and salaries whereas other airlines spent almost half of it on their employees. Not only monetary expenditure, the merged companies also witnessed social issues among employees. The work culture, areas of operation, compensation plans etc. of both the companies were quite different and both the companies failed to plan out effectively. This led to frustration and discontent among the employees thereby lowering their morale. As a result, instead of facilitating better synergies the companies and resources remained divided.
- **Financial Issues:** Instead of making profits and gaining high market share the merger pushed both the airlines into non recoverable financial crises. From the very beginning the losses began to escalate from Rs 1,200 crore in the first to Rs 2,600 crore in the second to Rs 5,500 crore in the third. As a result, today the airline has the accumulated losses of around Rs 16000 crores.

- **Operational issues**: Another operational factor contributing to the failure of the merger was restructuring of routes. According to industry officials and reports, about 40 routes had been restructured since 2007. Revenue creating profitable routes on which AI flights operated were cancelled. Lack of planning and mismanaged decisions like buying Boeing 777 made things worse. Furthermore, the Committee on Public Undertakings (CoPU) had reviewed the slot allocations to all airlines including AI in 2011 wherein the public carriers of India like AI were seriously affected because the commercial routes had been largely allocated to private airlines and also to foreign airlines.

On the AI merger failure, the CAG committee commented, “The decision was taken in haste, without required homework and consultations. As a result, the entire process has, in fact, been unduly delayed, if not derailed.” Thereby lack of planning, decision making and coordination led to massive failure of this merger.

REASONS FOR AIR INDIA LOSSES

Less income in passenger revenue: Passenger revenue earned by the company has consistently been lower than forecasted. The company failed to meet the targets despite meeting load factor targets which implied that the airline lost revenue due to its inefficiencies like lack of aircraft availability, faulty deployment, low utilization of human resources and lack of ancillary revenue.

Low monetization of assets: Lack or faulty initiatives to monetize its assets is one of the primary prerequisites of meeting the revenue deficiency that led to a dip in the company’s fortunes.

Mismatched international operation: Air India can be on an expansion drive to new international destinations but most of such routes burn a hole in the airline’s pocket as it fails to recover the cost of flying. Complete lack of ownership and responsibility for the results and failures of the airline. Deeply ingrained corruption at all levels. The combined effect of all these reasons shoved Air India deep into the clutches of losses.

Increase in competition: The increase in the number of players in the market led to a substantial increase in competition thus affecting the balance sheets of the company.

Non-availability of the proper fleet: Numerous strategic limitations were faced by the company due to mismatch between demand and supply. For instance, there was over-provisioning of wide-body aircraft whereas it did not have the required number of narrow-body aircraft.

Piecemeal recapitalization weakens turn around efforts: Although, the government had committed to funding the carriers turnaround plan, the uncertain schedule of infusing capital acted as a major drawback in this plan. The payments which were received were significantly smaller and were often absorbed by overdue vendors or utilised for salary payments. Thus, the recapitalization efforts are not providing the strategic stability required.

Huge interest burden due to debts: The total amount of its aircraft- related and bank loans is approximately $ 9 billion in addition to the vendor-related liabilities like airport operators, fuel suppliers, etc. Together they will add up to be double the amount of debt than of all the other airlines in India.

Sub-optimal aircraft utilization: Even though Air India has a total registered fleet of 127 aircrafts, it could manage to use only around 100 operational aircrafts leading to poor fleet utilization. And the daily utilization rate of those in service is below the industry average. Air India: ‘There are some routes in which Air India and AI Express are competing’.

The productivity of the bloated workforce: According to the requirement, the company had 11,433 employees compared to the envisaged requirement of 7,245. Besides, there was underutilization of pilots and cabin crews which led to a loss for the airline. It has the highest employee per aircraft in the world i.e. 200:1 whereas desirable is 130-170: 1. The airline carries a legacy of unsolved issues in regard to the integration of employees during the merger of Air India and the former Indian Airlines in 2007.

Review of business model: Air India’s business model needs a comprehensive review since each of its key domains is suffering from fundamental weaknesses. For example, it is devoid of the commercial strength to drive the necessary yields and premium traffic volumes on its long-haul routes. While on the domestic front it faces a significant capacity crunch due to a limited fleet, which itself is dominated by an aircraft type that is not competitive on most of the routes that it operates. The absence of a domestic low-cost operation or a clear regional strategy means that it is not participating in the fastest-growing segments of the market.

Government intervention: Air India's management had to struggle with excessive intervention by the Ministry of Civil Aviation and others.

BREAKUP OF THE FINANCIALS OF THE DEAL

The Tata Group emerged as the successful bidders of the disinvestment process of the national airline – Air India. The group acquired 100% stake in the subsidiary company – Air India Express and a 50% stake in the Air India SATS, for a whopping Rs. 18000 crores. Air India Express is a low-cost carrier airline focusing mainly on short-distance travel in the Middle East, while Air India SATS refers to the airline services on ground as well as cargo handling.

As a result of the acquisition, the Tata Group will also fully own Air India, the full-service airline which operates in both domestic and international markets. Currently, the total contractual and permanent employee strength of the airline is 13500 people.

Through the deal, the Tatas now own the brands – Air India, Indian Airlines and the Maharajah. Air India comes with 117 wide and narrow body aircrafts while Air India Express has 24 narrow-body aircrafts, most of which are owned by Air India.

In the fiscal year 2020, Air India held almost 10% of the domestic market share and approximately 12% of the international airlines market, giving the Tatas a good holding to work with post the acquisition. More than two-thirds of the airline's consolidated revenues comes from its international market; it has a strong presence in various parts of the world including North America, Europe, and the Middle East. It has more than 3 million active members.

Breaking down the intricacies of the deal that took place:

The Aviation Ministry fixed the reserve price at Rs 12096 crores for the airline and the condition that the winning bidder would also have to take over Rs 15300 crores of the company's debt. Furthermore, the bidder would have to retain all Air India employees for one year, post which they can offer a voluntary retirement scheme in the second year. As on 31st August 2021, Air India had a combined debt of Rs 61562 crores. With respect to the disinvestment scheme, the Aviation Ministry would take over Rs 46262 crores of the debt while the Tatas would take over only Rs 15300 crores. The remaining amount of the Rs 18000 crores (Rs 2700 crores) would go to the Government.

Initially, five bidders were disqualified as they did not meet the necessary conditions. Later, however, the two companies that placed a bid were the Tata Group and the SpiceJet chairman Ajay Singh in his personal capacity, with the Tatas ultimately winning the bid.

FLIP SIDES OF NATIONALISATION AND DENATIONALISATION

Natinalisation tends to follow from implementation of communist and socialist theories of policy, economics and social ideologies. The transfer of industrial, banking and insurance enterprises to the Russian state after 1918, the nationalisation of the oil industry in Mexico (1938) , Iran(1951) and Venezuela (1976) are few instances in history of nationalisation following socialist and communist ideologies. Generally, industries which are considered the commanding heights of the economy such as mining, energy, healthcare, education, military and police as well as insurance and banking are nationalised.

On the other hand, denationalisation is the process when the national government sells assets or operations of a state owned firm to private players and investors. There are generally many reasons why governments carry out the process of denationalisation/privatisation. These reasons depend largely on the type of firm and the country's economic philosophy, however common underlying themes remain the same.

It has been observed that private sector run enterprises tend to be more efficient. Furthermore, it is an excellent way for the government to save huge tax money especially in the case of state owned enterprises which have been running in loss, as was the case with Air India.

The major goal of state owned firms which often comes in the way of ensuring a competitive market structure is provision of service to the general public rather than producing profits at its expense, these firms are often uncompetitive. The management of state owned enterprises is also sometimes heavily influenced by politicians and politics. Unlike the private sector, the management of these enterprises might not have enough or adequate business experience.

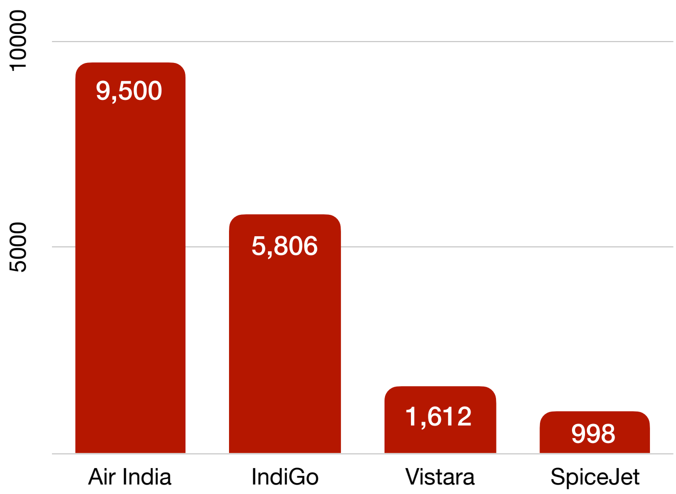
Furthermore, since the state-owned firm working on the directives of the government might hire large numbers of unnecessary staff as a form of political patronage, for example.

The term dirigisme or dirigism which originates from the French work diriger meaning to direct, is an economic doctrine in which the state plays a strong directive role instead of a regulatory role over a capitalist market economy. This doctrine is in stark contrast with the laissez-faire style. In India, one can see traces of dirigisme during the pre-liberalisation period after the end of British rule. It is represented by features such as domestic policy aimed towards protectionism, emphasis on import substitution, economic interventionism, large and wide government run public enterprises, strong business regulation as well as central planning.

FUTURE PLANS FOR AIR INDIA BY THE TATA GROUP

Earlier in September, before they had won the bid, one of the executives had mentioned that Tata Sons had proposed to bring its low- fare airline AirAsia India under the Air India's brand,if they succeed and would also try to bring its full service carrier Vistara under this plan if Singapore Airlines (its 49% owner) agrees to create a combined entity. Eventually, by March 2022, Malaysia's AirAsia Bhd, will exit by selling its total share of 16% in AirAsia worth $18 million. Tata Sons had bid through its new subsidiary Talace Ltd., which is speculated to be the single holding entity of all the Tata owned airlines.It even possible that Tata might merge Air India Express and AirAsia India into a larger low cost carrier.

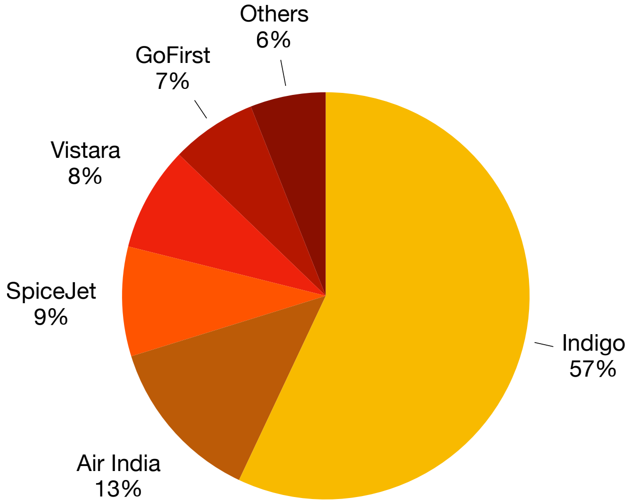
Although,as of now the Tata Group has not yet revealed what they have planned for Air India after the completion of its purchase.



Losses for FY21 (in rupee crore)

According to an expert, Tata should focus more on cost rationalization by reducing its operational costs which is possible by negotiating with fuelers,aircraft lessors,etc. They also need to negotiate with OEMs like Boeing and Airbus for aircraft replacements in order to renovate Air India to meet the standard of Vistara and do optimal utilisation of international routes and slots to increase revenue.

According to AT-TV's data, this acquisition will result in Tata Group having a total market share, much ahead of its competitors, of about 27%-35% which also includes AirAsia India and Vistara (a joint venture between Tata Sons and Singapore Airlines). However, Indigo will remain the largest domestic airline with 52%-58% share of the aviation market.



Market share of airlines in the domestic aviation space as of August 2021

NATIONALISATION OF AIR INDIA 1953

For a country which in its initial years was a paragon of socialism, the nationalisation of 9 air lines into 2 individual units was understandable but yet the purpose behind it remains a mystery to many. As part of the Air Corporation Act of 1953 that came into force on 28th May, 1953, the government nationalised nine airlines —Air India Ltd, Air Services of India Ltd, Airways (India) Ltd, Bharat Airways Ltd, Deccan Airways Ltd, Himalayan Aviation Ltd, Indian National Airways Ltd, Kalinga Airlines, and the Air India International Ltd—and merged them into 2 single entities; the Indian Airlines and Air India International.

The function of the thus formed corporations became provision of safe, efficient, adequate, economical and properly coordinated air transport services, whether internal or international or both. Overnight, the business of running airlines by private citizens was made illegal, with punishments ranging from a minimum fine of Rs.1,000 to a maximum imprisonment for three months, or both for each flight. The political success of this single Act captured and consolidated the government's attitude towards the private sector and set the pace for the nationalisation of several other sectors, notably banking, life insurance, general insurance and mining.

The critics of denationalization often argue that private sectors often pursue profit at the expense of the society's overall wellbeing. This might be specially harmful if the firm provides essential goods or services such as energy, transportation, or telephone service. Privatization naysayers therefore hold the view that these necessities shouldn't be vulnerable to market forces or driven by profit. Oftentimes, states and municipalities run liquor stores and other nonessential businesses as revenue-generating operations. Nationalization can produce adverse effects, such as reducing competition in the marketplace, which in turn reduces incentives to innovation and maintains high prices. Thus, although in the short run, nationalization can provide a larger revenue stream for the government, it can cause the industry to falter in the longer run especially if the firm or sector ends up becoming a loss generating item on the balance sheets of the government.

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