THE AIRLINE INDUSTRY
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The merger of India's state-owned airlines heralds an industry shakeout

IT WAS on a helicopter flight from Mumbai to Goa that Captain G. R. Gopinath had a vision of lifting Indians to the skies. Far below, silver television aerials were glinting from mud huts: signs of an economic boom that India's four main airlines, at that time, had failed to capitalise on. So in 2003 Mr Gopinath launched India's first low-cost carrier, Air Deccan, and started a craze. India now has 13 passenger airlines and a dozen awaiting permission to launch. The number of domestic passengers increased by around 30% last year.

Hence the government's approval, on March 1st, of a long-standing proposal to merge four badly run state-owned carriers, in order to make them more competitive in a crowded market. The four are Air India, which mostly flies internationally, Indian (formerly Indian Airlines), which is mostly domestic, and their respective low-cost and regional subsidiaries, Air India Express and Alliance Air. Both the big firms have had to endure years of political meddling and underinvestment, and have lost out to sleeker competitors as a result. Indian, which until 1994 had a monopoly on domestic passenger services, now has a market share of 17% and falling, despite getting most government business.

Some immediate benefits are promised. The new airline, which is scheduled to emerge after four months, will have 121 aircraft and 30,000 employees, making it one of the world's 25 biggest. That should interest investors: the government means to float 10-20% of the new entity on the stockmarket to raise cash and, it dares to dream, standards too. The government is hoping for a tie-up with one of the global airline alliances, membership of which would multiply foreign passengers. Ending competition between the state-owned firms will also benefit their main shareholder. At present, three of them vie for the same passengers to Singapore.

Cleared For Take-Off

There is also huge potential for rationalisation of ground handling, engineering, sales offices and so on. Air India is one of only a handful of large airlines without a big domestic feeder airline. The others--Emirates, Singapore and Virgin Atlantic--have none of its potential advantages as a national carrier of a vast and thickly populated land. According to Praful Patel, the minister for civil aviation, the merger will cost $50m and will reap annualised benefits of $150m. He calls it a "no-brainer".

He may be right. Only around 1% of India's 1.1 billion people fly, so there is a lot of room for growth. The 35m-40m domestic air tickets they are predicted to buy this year compares with 130m in China. But to realise this potential, the newly merged union of Air India and Indian will need overhauling at every level. For one thing, its competitors are fierce. India's biggest domestic carrier, Jet Airways, with 27% of the market, aims to make half of its revenues from international flights by 2009. Given its big domestic base and good service, this would make it a strong candidate for a global alliance.

To increase efficiency, newly merged companies usually cut jobs--and the state-owned airlines, which employ some 400 people per aircraft, roughly twice the international average, have jobs to burn. But to soothe the government's communist allies, Mr Patel has promised that not one job will be lost. Mr Gopinath, one of many sceptics about the merger, says it is "like tying together two legs of an elephant."

Still, the new airline will have two big advantages. The first, after years of under-investment in state firms, is new aircraft worth $10 billion. Air India and its subsidiary will soon start receiving 68 new planes, including Boeing 777s and 787s, which will enable it for the first time to fly non-stop between India and America. Indian has 43 new aircraft on the way. Second, the merger comes at a time of rapid growth. If sustained, reckons Binit Somaia of the Centre for Asia-Pacific Aviation in Sydney, it could mop up the new airline's excess labour within three years.

If the industry's long-term health is assured, the short term is murkier--as ever in India. Under pressure from low-cost carriers, all domestic airlines have slashed prices, and most are losing money. A few years ago the average Jet Airways fare from Delhi to Mumbai was around 8,000 rupees ($180), twice today's average. Since mid-2006 passenger loads have shrunk to some 60-70% of capacity for both low-cost and full-service carriers. That is roughly 10% below profitable levels.

Increased capacity partly explains this, but not completely. Some analysts expect official figures on passenger numbers, which grew by 45% between April and October, to show more moderate growth in the second half of the financial year that ended last month. This might indicate that some of the pent-up demand for affordable air travel, from businessmen and middle-class families, has been satisfied. Even the cheapest carriers are, after all, usually dearer than India's buses and trains, which carry 25m passengers a day.

Another reason for slackening demand could be disenchantment with flying. India's aviation infrastructure is overstretched, causing annoying delays at every stage of a journey. Delhi airport's domestic terminal was built to carry 7.3m passengers a year, but handles twice that number. Aircraft flying from Mumbai to Delhi, a two-hour trip, routinely circle in the air for another hour while a landing slot is found. New airports are due to open in Bangalore and Hyderabad next year. Private investors are developing old ones in Delhi and Mumbai, but these will have little extra capacity until 2010.

Some airlines are finding novel ways to relieve these pressures. At a time of high world demand for new aircraft, Deccan has raised $100m by selling some of its options on new airliners. Others have tried new business models: Paramount, a small regional carrier based in Chennai, offers only business- or first-class service.

Nonetheless, ticket prices are simply too low for most carriers to turn a profit. At some stage they will have to rise, which will turn off more potential flyers. By that time, however, more consolidation within the industry may have further cut the number of airlines left in the air. "Everybody's bleeding, everyone's losing money," says Vijay Mallya, the boss of Kingfisher Airlines, a high-end, full-service carrier. "The question is: Who has the staying power to escape the bloodbath?"