Sustainability of Low Cost and Simplicity in Airline Industry:A Case of Indigo

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Abstract

This case study demonstrates the significance of low cost and simplicity as a strategy for startup firm to gain leadership position in the market. After using leasing model for many years Indigo is planning to change from single aircraft model to multiple aircraft model, leasing model to owning aircraft model. How did Indigo achieve consistent profits in the airline industry struggling for profits? What were the unique strategies used by Indigo for operational excellence? How did the company use cost and simplicity not only as a strategy but also as a culture to achieve excellence? Why Indigo is changing its successful leasing model and what would be the consequences? Can Indigo manage growth in diverse market segments at the same time?

Keywords: IndiGo, Sale-and-Leaseback, Low Cost Carriers, Startup, Simplicity

1. Indigo

Indigo was launched by Mr. Rahul Bhatia (Rahul) and Mr. Rakesh Gangwal (Rakesh) in 2006. Rahul had worked for IBM and later launched InterGlobe Enterprises catering to air transport management, and later expanded into hotels, technology, airlines and fast cars[1.] Rakesh had a rich experience of working in the United Airlines (US), Air France, and US Airways. Both of them launched the Airline which started with big orders of 100 planes, all Airbus A320. It is the largest airline in domestic market with 40.1% share of market in FY17. Their PAT margin stands at Rs. 16,592 million[2]

2. Simplicity in Culture:

Indigo relies on three pillars, *low-cost fares, on-time performance, and hassle-free experience.* IndiGo has proven its quality of being on time. It currently operates flights for 48 destinations. Indigo operates on 41 domestic and 7 international destinations[2]

IndiGo is the market leader in domestic airline industry and also competing in international market. IndiGo leverages technology in its operations and provides counter tickets to online ticket booking and call center. IndiGo mobile app provides convenience to passengers. Today IndiGo is the most preferred flight in India with lowest fares and great quality.

IndiGo is a preferred place to work. With highly motivated and efficient workforce, it gives the best customer service. IndiGo's state-of-the-art 'ifly' training facility which is one of the best facilities in India provides real-time training to its new recruits. For ten years in a row, IndiGo has been consistently ranked as one the best places to work for and has been named as AON's Best Employer, 2017[3].

IndiGo's CSR initiative focuses on education, empowerment of women and environment. CSR programs work with the objective of upliftment of communities in both rural and urban parts[2]

The simplicity of IndiGo's management is the best thing which led them to this height within a short period of their listing they are almost at the top of Aviation sector in India.

Difference in approach, low cost and simplicity in though and action has made Indigo one of the stars in the sky of domestic airline business. For an instance we can take the case when the MD of IndiGo went to the conference called by Dr. Manmohan Singh (former Prime Minister of India) with his WagonR car where as all other MD's and CEO's visited there in Luxury cars after the conference there was a press briefing in which someone asked the MD of IndiGo about why he does travel in such an economy car when he can travel in luxurious cars. IndiGo had three options; Winger, Swift DZire and Wagon R. Since other cars were used for transportation of people within the airport, only car available was Wagon R. Mr. Aditya Ghosh, the President of the company prefers to stay in budget hotels along with crew members and prefers returning home to avoid hotel expenses[4].

3. Low Cost Model

An extra effort to focus on costs defines the IndiGo's success story. The airline has been profitable for ninth year in a row[2]. Commenting on the results, President Aditya Ghosh stated that the exponential profit growth was achieved due to sincere efforts to consistently bring down costs.

Indigo had a Profit before tax of Rs. 1,847 crore for FY15. Available Seat Kilometers (ASK) increased from 29.9 million to 35.3 million. Revenue per Available Seat Kilometer (RASK) declined from Rs. 3.78 in FY2016 to Rs. 3.44 in FY 2017. RASK decline was driven by lowering of yield by 10.5% though it was offset partially by 0.8 point improvement in load factor.

The liberalization by government led to fast growth from 2003. The CAGR of 8.3% was achieved in ASK from FY2012 to FY 2017 revenue passenger kilometers (RPK) for domestic sector grew at a CAGR of 10.8%. The government's initiative of establishing Greenfield airports, growing middle class, passengers substituting train travel by air travel, growth in economy have been triggers for the growth of domestic airline industry. Structural advantage of IndiGo makes it a strong player to withstand adverse environment and business cycles[5]. The company adhered to its low cost business model like a Bible.

Indigo doesn't buy multiple types of aircraft, doesn't offer airport lounges and Business class tickets. Great commitment and leadership of founders have had a significant impact on creating a successful and profitable airline. Many firms focus on improving yields, however IndiGo focused only on reducing costs by sticking to just the basics. In mature, affluent markets like the USA and Europe, firms like Ryan Air, Easy Jet have followed low cost model and have been profitable for years. Replying to a question on sustainability of extraordinary financial results, Mr. Ghosh commented that it is difficult to make predictions about future of airline business. It was commented that Indigo will follow a low cost strategy as long as demand is growing.

Indigo does not use receptionists, as security guards have been trained to play dual role of security and as receptionists. Ghosh commented that first 100 planes order was instrumental to build certainty into the system and get the benefits of economies of scale. First order was followed by next orders of 180 A320 Neo aircraft and next order of 250 planes.

The company has managed to achieve the lowest turnaround time by taking care of little details like time taken to board and de-plane. To save time IndiGo uses low slopping ramps instead of stairs for fast and convenient movement of passengers. IndiGo is the only airline to use ramp for entry and exit of passengers.

Cost cutting is a culture in company. To save the fuel pilots switch off one engine when taxing the runway. Indigo runs one of the lowest cost operations but still charges nearly same fares as charged by full service airlines, thus providing leading to a big difference in the operating profits between Indigo and other airlines[6]

Indigo is different from other airlines in its leasing approach. Indigo uses six years lease and uses the planes only for six years whereas other airlines uses planes for a longer duration. Indigo saves maintenance cost by running a young fleet of planes [7]

4. Peer Comparison

In the mentioned figure, the CAGR of IndiGo is setting an example for rest of the industry as it has already proved its potential by increasing its rate by 24.2% in previous 5 years, whereas the rest have just managed a hike of 1.8% during the same duration.

Also, the RPK graph showed a drastic jump by 25% of CAGR whereas the rest are still suffering and increased by only 4.6%.

Capacity Growth: 27.5%

Passenger Growth: 31.5%

5. Emerging As Successful Airline:

It was the worst recent years to 2013 when fuel cost was increasing and rupee became weak. In the difficult operating environment, witnessed shut down of kingfisher airlines. In such a difficult environment, Indigo evolved as the only firm which proved that it is possible to make profits in the struggling industry.

The IndiGo airlines continuously raised the interest of air travelers. Their success mainly lied upon two basic parameters i.e. on time boarding and efficient service. Interestingly analyst highlighted that besides operational profits, large part of profits come from leasing transactions. Indigo sells planes to leasing companies at a higher price than the price paid to makers of aircraft (Airbus).

Interglobe aviation, the company which operates Indigo revealed that indigo had profit of Rs 993.2 crores due to its reputation of operational excellence, punctuality and leasing was not the only reason for profits. Aviation expert Hormuz P. Mama commented that higher aircraft utilization provides higher revenues to IndiGo.

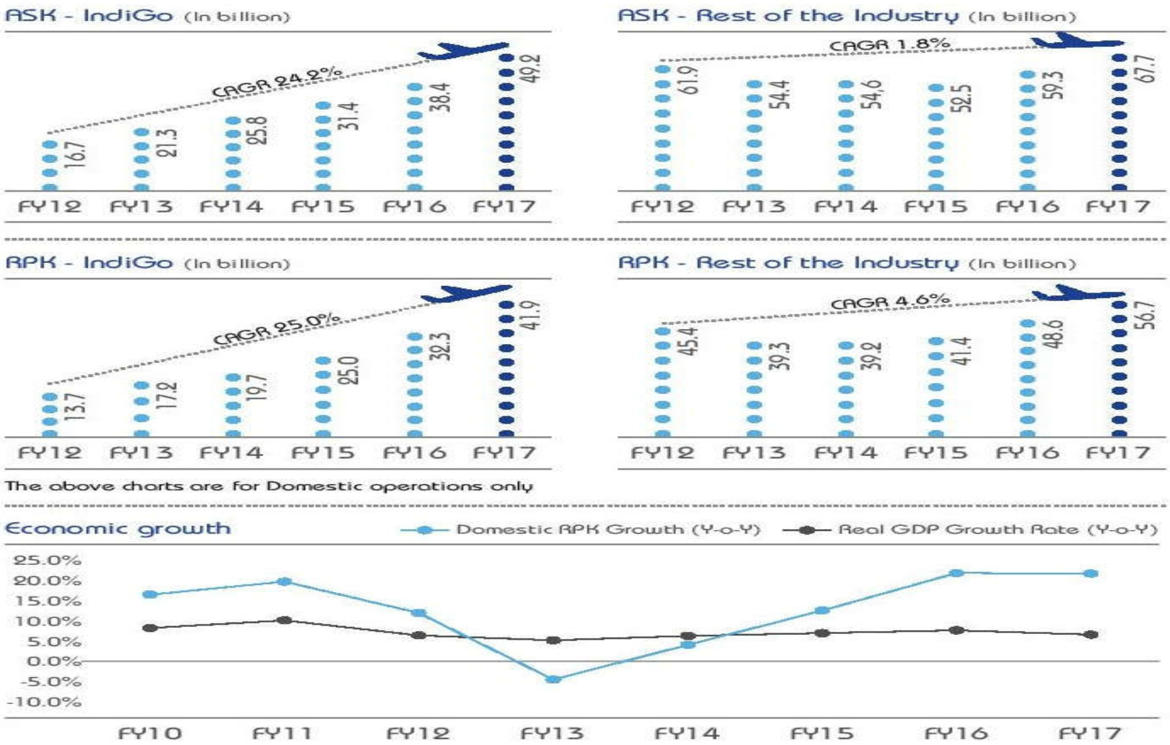

Figure I: Operational Performance of IndiGo

Source: Annual Report (Interglobe Aviation)

Table 1: Comparison of Financial Performance

RATIOS	INDIGO					SPICEJET				
	Mar,17	Mar,16	Mar,15	Mar,14	Mar,13	Mar,17	Mar,16	Mar,15	Mar,14	Mar,13
Dividend/Share (Rs.)	34	15	35169	12299	17870.90	---------	-----	-----	-----	-----
Net Profit/ Share (Rs.)	45.90	55.22	42201.40	15454.10	25516.50	103.28	84.88	86.77	117.77	115.63
PBIT (Rs. Crores)	68.47	82.25	63559.50	19418.80	34042.90	5.46	6.02	-14.58	-15.61	-4.85
Net profit margin (%)	8.92	12.32	9.30	4.26	10.72	6.95	8.00	-13.20	-15.91	-3.41
Total debt equity ratio (%)	0.63	1.61	8.49	7.37	4.41	---------	---------	---------	--------	---------
Asset turnover Ratio (times)	122.16	123.97	129.25	122.11	157.25	15.17	18.47	15.99	6.46	5.18
Current ratio (times)	1.97	1.41	1.07	1.02	1.64	0.40	0.45	0.32	0.39	0.68
Quick ratio (times)	1.94	1.37	1.03	1.00	1.61	0.44	0.44	0.35	0.42	0.76
Inventory	113.89	127.37	106.66	165.21	176.05	71.17	76.46	115.29	139.62	122.76

turnover ratio (times)										

Source: Compiled from Company Annual Reports

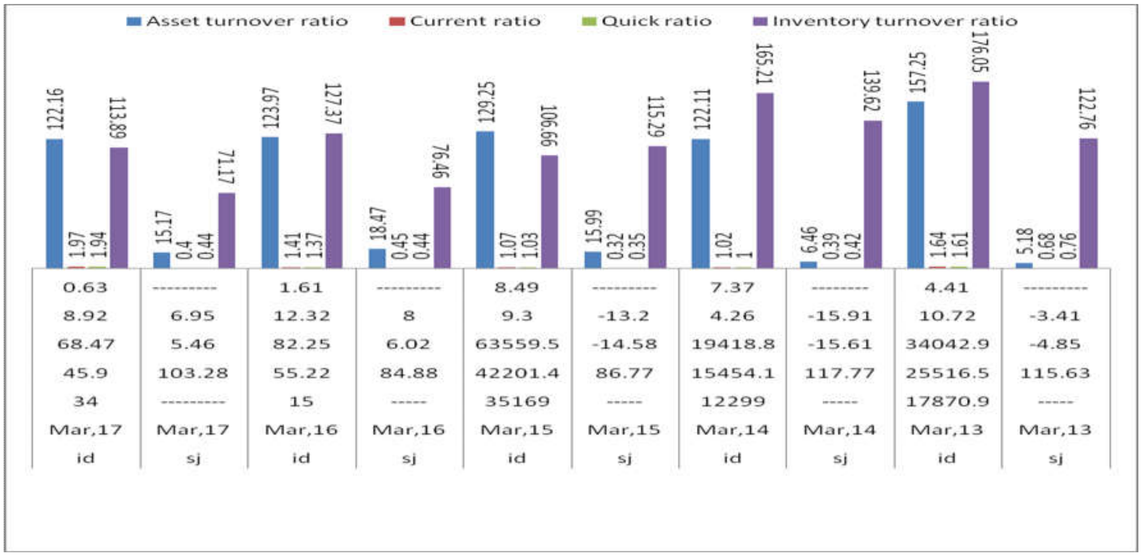

Figure 2: Comparison of Performance of IndiGo (id) and Spicejet (sj)

Source: Compiled from Company Annual Reports

6. Credibility of Promoter:

Mr. Rakesh Gangwal with rich experience in airline industry was a credible face for the company. He had more than 35 years of experience in the industry. The credibility of Rakesh had such a positive impact that Airbus had accepted for his terms. The company not only had to pay a down payment of just 4%, but also received a 40% discount on list price for placing 100 aircraft order.

7. Operational Style:

The operations were simple crafted to fulfill the core needs of customer while keeping the cost at lowest levels.

7.1. Single Type of Aircraft: Single type of aircraft (Airbus A 320) allowed IndiGo to use same crew and standardize operation, training, ground force, maintenance cost.

7.2 No Frills Service: IndiGo has been able to keep fares low by avoiding expenses on complimentary meals and does not provide in flight entertainment.

7.3 Low Maintenance Cost: Using leasing model has kept operational cost low for IndiGo. New planes do not require regular checks and does not require major repairs. Major checks are usually required for above eight years old fleets, however, as IndiGo maintains six-year-fleet, it saves cost on cost and time involved in maintenance of planes.

7.4 Focus Approach on Operations:

Focus on better operational performance has been a key strength of IndiGo. Low cost economy class seats save time money and effort on maintaining costly lounges at airports. Focus on more frequency on less number of destinations as compared to its competitors has supported better operational performance for IndiGo. Destinations of IndiGo are connected to at least two cities and majority of them are connected to three destinations. IndiGo flights are able to fly for longer durations. While it saves airport charges and provides better per plane per hour aircraft utilization of above 11.5

IndiGo uses Information Technology tools for optimization of flight planning and operation to ensure less consumption of fuel. Airbus A320neo is used to gain with 15% less fuel usage and saves 8% operational expenses. Using aircraft tax to terminal and using only one engine saves fuel. Indigo also uses fuel hedging.

IndiGo also has the aircraft taxi to the terminal with one engine, shutting down the second engine to save fuel. This moderates the aeroplane's speed in the air and saves fuel [8]

7.5 Turnaround Time:

IndiGo has the demonstrated quick turnaround time. The staff has been trained to ensure passengers deplane quickly and in shortest possible time, the plane is ready to take off for next flight.

7.6 Leasing Model:

The combination of operational performance and implementation of sale-and-lease back

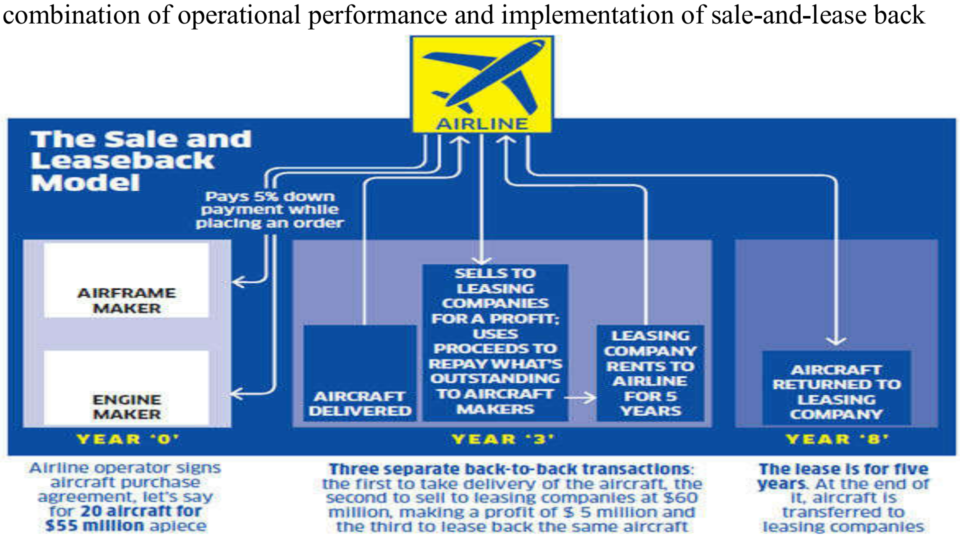

Figure 3: Leasing Model

Source: Economic Times

model has amplified IndiGo's valuation. The plane acquisition model of IndiGo has been a popular sale-and-lease back model. After six years, planes are returned to lesser and new ones are added to its fleet. Such new aircrafts would not only have low operational and maintenance cost but also offer better service.

8. Shifting From Leasing Model

IndiGo is changing gears and moving from leasing aircrafts model to owning aircrafts model. Indigo had a followed a six year lease model. The model helped to manage a young fleet, lower operational expenses and higher profitability. Interestingly in a fleet of 136 planes, only 18 are owned by IndiGo.

The CFO, Rohit clarified that the change from lease model to owned fleet model will be gradual. As per current plans, lease model will co-exist with own fleet model. Initiating owned fleet model is a strategy to fetch long-term benefits. While not disclosing many details about the plan to own aircraft, Rohit said the company will not completely scrap the sale-and-leaseback model but shift to an owned fleet model in a phased manner. The airline will in the meanwhile operate with a mix of both models, he said. The plan to own aircraft, Rohit added, would result in long-term gains for the carrier.

The airline has plans to start low-cost, long-haul operations, deviation from its current model of domestic and short-haul international flights. Indigo is considering public issue of shares to raise funds for acquiring planes and meeting promoter holding requirements[9]

9. Accounting Regulations: Impact On Indigo

As the new AS (Accounting Standard) comes into force, the Aviation industry in India may face debt cloud as the latest set rules may hamper aircraft leasing by increasing loans' liability by an amount higher than Rs 50,000 crore. IndiGo will face the huge impact by these new accounting policies. It is said that from January 2019, lease rentals would be considered as a debt obligation. Thus it will impact profitability by affecting depreciation and interest

10. Aiming Higher-International Flights:

After proving its excellence as a start up airline by giving consistent profits for nine years and capturing 40% market share, IndiGo has started aiming higher. IndiGo had expressed its desire to buy stake in Air India. Commenting on the plans to acquire stake in Air India, IndiGo's president Aditya Ghosh, commented that it is the right time for India to capture market share of international traffic and bring back the wealth to India. The market did not react positively to such an ambitious plan of Indigo given that IndiGo's share fell about 3% after the announcement [10]. However the plan could improve the IndiGo's international market share.

Table 2: Market Share of IndiGo and Air India

2016	Air India	Indigo
Domestic passengers	13737814	39263954
International passengers	8901292	1797360
Market share domestic (pax)	13.80%	39.50%
Market share international (pax)	44.20%	8.90%

Source: Bangalore Aviation, 2017

Air India has a debt of Rs. 50,000 crore and the valuation of its aircrafts is between Rs. 20,000 crore and Rs. 25,000 crore[11].

The company is planning to increase capacity from domestic destinations to international destinations such as Dubai, Abu Dhabi London, Singapore, Frankfurt, Paris, Doha and Bangkok[12]

11. Bullish On Regional Connectivity:

The initiative of NDA government to improve air connectivity of smaller towns under its UDAN scheme by reducing fare and promoting more towns for air connectivity, 33 unserved airports are planned. 128 routes are awarded to five operators. UDAN scheme provides half of the seats at Rs. 2500 for each hour [13]. Under UDAN 2, 92 more routes will be offered[14]

To capitalize the opportunities in regional traffic growth, Indigo announced the plans to buy 50 aircrafts of ATR 42-600 make worth $1.3 billion to operate flights on regional destinations [15]

Indigo is planning to launch 'focus division' to manage the turbo-prop operating functions, so that it will not overlap with its narrow-body working. The strategy will add to the cost of trained manpower, especially pilots to operate the ATR 42-600 aircraft. Expat pilots will cost monthly salary package of $10,000 (Rs. 645,000) per commander. The rules stipulate that there should be a minimum of 3 different sets of crew for each aircraft, which means that the Indigo will require at least six pilots per aircraft [16]

Complex processes and practices lead to a tendency to ignore simple but effective means to provide better service and higher profits. Simplicity of the model and work culture was observed from the beginning. The low cost plan of the Bruce Ashby, the first CEO has been followed by the firm, later led by Aditya Ghosh. Simplicity in dealing with employees was observed as Ghosh replied to all messages of all level of employees.

There is no airline other than Indigo that uses single type of Aircrafts. Ghosh came from a law background but consistently following simplicity led to efficiency gains for IndiGo.

Participants can discuss whether simplicity can be used as an organizational culture to improve customer service or is it just a personality attribute of founders/senior executives of a business, which will not add any value to organization?

IndiGo has used sale and lease back transactions extensively. 90.07% of its aircrafts are on operating lease. While it keeps the fleet young, it also contributes in a profit of $4-5 million per aircraft. For last quarter of FY2017, twenty four percent of profits were attributed to leasing operations. Participants can discuss on the ways in which leasing can contribute to financial performance of a firm. Why other airlines could not use leasing in same manner as IndiGo? If leasing was a winning formula for IndiGo, What are the triggers for IndiGo to shift from leasing planes to owning planes model? Is it done to align with the new accounting standards from January 2019, which will consider rental obligations as debt?

According to Center for Asia Pacific Aviation (CAPA), IndiGo has an order book of 458 aircrafts, largest by any airline in the world. The order book of Indian operators collectively is 1123 aircrafts. IndiGo plan to expand the low cost model is aimed at extending the low cost model for long haul flights and increasing the market share in international flights.

Indigo is trying to switch from a simple, single aircraft, low cost strategy to a global airline by focusing on owning larger planes for international expansion and smaller planes for regional operations. The model is going to change at multiple levels, scale of operations, complexity of handling diverse routes, higher operating cost due to more than one type of planes and higher human resource expenses. Is Indigo ready to take off from the simple domestic low cost airline to a global carrier?

14. Assignment Questions:

I. Examine the low cost strategy used by IndiGo.

II. Evaluate the contribution of simplicity in IndiGo's success.

III. Comment on significance of leasing in the success of IndiGo.

IV. Comment on the change in strategy from leasing the planes model to owning the planes model.

V. Comment on the strategy to moving from single aircraft model to multiple aircraft model to meet the needs of smaller towns domestically in India as well as to manage international operations simultaneously

Conclusion:

Indigo has demonstrated the significance of simplicity and down to earth approach in business. Visionary leadership, strong performance on core needs of customers, smart flow of funds using simple tools like leasing and optimum utilization of resources and time can become a competitive edge in a tough industry such as aviation.

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