A Case On Kingfisher - Air Deccan Merger : The Marriage Of Convenience

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The forces of a powerful ally can be useful and good to those who have recourse to them... but are perilous to those who become dependent on them."

Niccolo Machiavelli

INTRODUCTION

Post economic liberalization in 1991, India saw different-sized firms in the same industry surviving together, prima-facie suggesting that economies of scale are relatively unimportant or difficult to realize. This brought in a new wave of Mergers, Acquisitions or Takeovers[1], as a strategic tool used by the Indian Corporates to avoid stiff and unequal competition. Regardless of the nature of a strategic alliance, it is with an intention to lead a larger market share, greater brand power and bring in a lot of synergies. Recent studies indicate that the entire spectrum of the Indian industry is taking recourse to strategic alliances[2]. The reasons could be either to eliminate industrial sickness or to be free from stringent formalities of official procedure. It could also be to restructure itself to meet challenges in the stiff competitive open market economy. However, there is a flip side to strategic alliances. It is observed that rarely do merging companies become stronger than before, however friendly the merger is. KPMG study showed that 83 percent of the mergers failed to produce any benefits and the rest ended up reducing the value of the companies involved. Nonetheless, mergers are becoming the quickest and surest way to growth.

In the Indian Corporate history, one of the seemingly most friendly buyouts of the Indian sky so far has been the *"Kingfisher - Air Deccan"* merger. The alliance was like an arranged marriage, where two individuals are brought together to live a happy life. However, the truism is that one partner ends up becoming more dominating and overpowering over the other. As the story of the merger unfolds in stages, it will illustrate what led to two culturally divergent organizations to merge and what are the managerial challenges in the post-merger phase of the combined entity.

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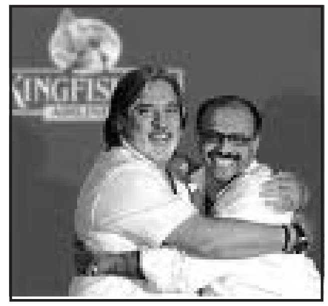
THE PRE-MERGER PHASE

It was on August 30, 2008, a tinge of sadness was felt to see Air Deccan hit by the severest stock market crash down. What might have been and will now never be was a harsh fact for the common man, who thought Air Deccan to be *'their own'* airline and often forgave and forgot all its shortcomings. Looking back, the erstwhile Air Deccan was the first low-cost carrier of India, started by Captain Gopinath in 2003 that demystified air travel by providing reliable air journey at the lowest possible fares. It started on August 23, 2003, with a single flight to four domestic destinations, flying 0.4 million passengers, and in a short span of just four years, it flew 9 million passengers on a fleet of 43 aircrafts to 65 domestic destinations with 350 flights per day[3]. The last good news we heard from the camps of Air Deccan was on January 25, 2006, when Air Deccan's CEO Captain Gopinath said, *"I want the nation to participate. I want to build a company that is larger than any individual or me."* Air Deccan was celebrating its Initial Public Offering (IPO), offloading 25 percent of its stake of 24.5 million equity shares of ₹ 10 each. However, this triumph lasted only for a few months, as its share value sharply dropped down by 50 percent[4]. In the year 2007, Air Deccan was completely cash strapped and was in need of a friend.



Quite in contrast to Air Deccan's position, Kingfisher Airlines was soaring high in the Indian skies. Under the stewardship of Dr. Vijay Mallya, Kingfisher Airlines, a subsidiary of the United Breweries (UB) started its operations on May 9, 2005 with a single business class. And in a short period of six months, it gained a market share of 7.6 percent in domestic air travel, waiting eagerly to spread its wings for international operations. In 2007, Chairman Vijay Mallya of the Kingfisher Airlines, known for his flamboyance, decided to rescue the crashing airline- Air Deccan.

THE MERGER PHASE

After rounds of deliberation between two Chief executives, on December 19, 2007 [5], Vijay Mallya officially announced the 'Kingfisher-Air Deccan' merger. On the face of it, this seemed to be a philanthropic move to save an airline, but it was settled for absolutely strategic reasons. It was well known that Vijay Mallya wished to fly overseas but was restricted by the Government that mandates a minimum of five years of domestic operations to be eligible for flying on international routes [6]. Yet, he did not give up and smartly manipulated the embargo by buying 46 percent stake in the five year old Air Deccan from Captain Gopinath for approx ₹ 968 crore [7].

Cash Paid = ₹ 550 crore + 418 crore = ₹ 9.68 billion

Present Value of 46% stake = 62316254.28*137.5 = ₹ 8.57billion

Cost for Kingfisher= Cash Paid-Present Value = 968-856.85 = ₹ 111.15Cr

Strangely enough, this alliance came at a time when both Airlines were in deep red, with Air Deccan at a loss of ₹ 418 crore as on June 30, 2007, and the Kingfisher Airlines with a reported loss of ₹ 577 crores as on March 31, 2007 [8]. This, however, made good economic sense for Vijay Mallya to merge with an ailing airline, as there was lot to achieve by overlapping the entities, consolidate the air routes and cutting many overhead costs. Thus, while Captain Gopinath got some money to survive, Vijay Mallya, had a license to fly abroad. Furthermore, he saw the colour of Indian skies changing in favor of Low Cost Carriers (LCC). As predicted by the Centre for Asia Pacific Aviation, there is an expected rise of passenger traffic from 60 million in 2010 to a figure of 280 million by 2020 [9]. To add to the positive market trends, the Government of India (GOI) too became favorably inclined for an easy entry of private operators on domestic routes, and in the 11th Plan, an investment of $30 billion was added. It has also encouraged Public Private Partnership Projects (PPP), by giving 100 percent tax exemption for the next ten years. Due to such emerging opportunities, Dr. Mallya cherished his new acquisition of the first low-cost carrier and said to his people, *"In this rapidly changing and growing economy, a low-cost airline doesn't necessarily have to make a billionaire, a millionaire."*

THE RESTRUCTURING PHASE

One of the necessary outcomes that follows a merger is restructuring, a method of changing organization structure to achieve the new set goals. The two independent organizations move into this phase of becoming a new single entity by way of cosmetic, as well as cultural changes.

Very shortly, the erstwhile brand Air Deccan was rebranded as Deccan, which was later rechristened as Kingfisher Red. It transformed from a single class to a triple class of airline services viz, Kingfisher Red for the price conscious, Kingfisher Class for the comfort seekers and Kingfisher First for the luxury lovers. With the change in the name, Dr. Vijay Mallya gave a new look to the erstwhile Air Deccan, investing an amount of ₹ 150 million (media spend). Very much akin to its flashy mother brand Kingfisher, the logo of two hands was supplanted by the Kingfisher Bird, and the signature color of yellow and blue of Air Deccan was replaced by deep red and white . The Red colour, which symbolizes luxury & energy, was used all over Kingfisher Red. At the outset, the interiors and exteriors of the aircraft, the ticketing counters as well as the on-board crew were spruced up in deep red and white. By April 1, 2008, Kingfisher Red was ready to operate as a single entity with Captain Gopinath as the Vice Chairman and Vijay Mallya as the Chairman and CEO. While both promoters were as different as chalk to cheese, yet they seemed to gel well to co-exist, at least at the start of Kingfisher Red, promising to give flyers reasons to smile .

Another structural change was the change in the value system along with cosmetic changes. The simple and no frill image of Air Deccan was changed into a flamboyant chilled out image, but along with that, Dr. Mallya also enthused a culture of professionalism and performance in the airline. The on board air hostesses, smartly clad in short red skirts and trendy rolled-up sleeve jackets, were called *'flying models'* [10], and were taken on-board after a rigorous grooming at the Kingfisher Airhostess Academy to develop soft skills and welcome etiquette. And in his zeal to increase efficiencies, Vijay Mallya tried to rework the employee strength of the merged company. He weeded out 300 non-performing employees at a cost of ₹ 25 million, and personally micro-managed all human related concerns - right from job profiling to interviewing and finally vetting an employee to be on-board to serve his guests [11]. Defending these moves, Captain Gopinath, simply said, *"The idea is to make the airline a little sexier. Air Deccan needs to focus on improving its quality of service. The perception about it, too, needs to be changed.* [12] *"* . Thus for Vijay Mallya, his employees became his power engines, and he is said to have magnanimously rewarded high performers to set a precedence that, *'A happy employee makes customers feel happy, who in turn form a positive impression of their interaction with the airline'.*

THE INTEGRATION PHASE

After the initial hiccups on HR issues, Vijay Mallya moved onto synergize and generate profits, which exceeds the sum of their individual profits. For Vijay Mallya, this was not very difficult, because the two airlines were quite similar - both flew similar Airbus fleet, same engines, same brakes, same ATRs, same avionics, same rotables, same maintenance with Lufthansa Technik. It couldn't be better. Alongside, they shared each other's facilities like engineering, resources, aircraft spares, airport infrastructure such as X-ray machines, conveyor belts, and step ladders, resulting in significant cost savings. The scarce manpower too was optimally utilized, and insurance premium and lease rentals were re-negotiated. With a fleet of 71 aircrafts (41 Airbus + 30 ATRs), it was also able to establish seamless connectivity with 69 cities and 537 flights every day [13]. The destinations included the toughest terrains of extreme North and North east zones, Tier-II cities located 500-600 km away from the metros where the air travel options were either none or inadequate, and from a business point of view, flew to the busy destinations like Delhi, Mumbai, Ahmedabad, Srinagar, Goa, Jaipur, Ranchi, Chennai, Port Blair, and many others. As reported in the annual reports, of 2007-08 of Kingfisher Airlines, the above synergistic operations between the two entities led to a saving of around 4-5 percent of the total cost, which was to the tune of ₹ 3 billion, approximately [14].

THE STRATEGIZING PHASE

The merger moved into the final phase, with the CEOs working on the strategy desks to draw out a viable and unique market strategy. Prior to the merger, both individual companies had their own airlines, with an established market position, but after the merger, it became necessary for the combined entity to carve out a distinct segment, with a new service bundle. Vijay Mallya, while joining hands with Air Deccan, knew that he was marrying an ailing brand. However, he was sure to create a new identity for Kingfisher Red by reworking its service mix. He redefined the low cost flying in the following ways:

❁ **Drawing A New Value Proposition**: Taking lessons from the sad demise of Air Deccan, Mallya knew that in India, with a severe lack of infrastructure, high fuel taxes and scarce trained personnel, a true low-cost airline model is difficult to sustain. He positioned Kingfisher Red as a value carrier rather than a true low cost. He reinforced the value for money proposition for the economy traveller by promising, *'consistently safe, value based and enjoyable travel experience to all our guests'* [15]. Vijay Mallya made sure that by associating with Air Deccan, he in no way compromises with the high glamour quotient of all his businesses. Mallya quite intentionally set Kingfisher Red apart from the LCC competitors - Spice Jet, Indigo and Go Air and quite contrary to what the Trio (Spice Jet, Indigo and Go Air) said *'always low price'*, Kingfisher proudly claimed to have *'redefined low fare flying'*.

❁**Targeting A New Audience:** Trying to have a focused group of customers, he targeted the young travellers of 25-45 years of age, hailing from higher socio-economic class of India (Sec A, Sec B+) and politely called them *'guests'*. Psycho-graphically, these guests had extensively travelled and were aware of international standards. They were modern, trendy and upwardly mobile, looking for a great flying experience.

❁**Delivering A New Service Mix :** Addressing this evolved market segment, Mallya tried to create a trustworthy brand with fail proof points, solid actions and actual results. He micro-managed all the tangible and intangible components, and ensured that everything they do, delivers value at multiple touch points to its guests.

❁**The Tangibles :** The travel was frilled with comfortable waiting lounges at the airport and in-flight entertainment in the form of reading materials for both adults and children along with some goody bags. Moving away from the other LCCs, he offered the gastronomic pleasure on-board- serving hot *idly sambhar, dahi vada or a kathi roll*. He introduced innovative customized services like the *'King Mobile'*, *'Personalized Valet Service'* or *'Little Wings'*.

❁**The Intangibles :** Enhancing the customer experience, he suffixed the word *'King'* to its exclusive customer services to make his on-board guests feel like a *'king'* - introducing customized check-ins, lounges at the airports, and warm air hostesses on-board. The check-ins which were earlier outsourced, were now manned by airline employees to increase accountability and service delivery. A King's Club frequent flyer program was provided to all Kingfisher Red passengers. This allowed the customer to earn King Miles, which could be redeemed for a travel on any Kingfisher Airlines or partner airlines. Further, to brand the airlines as the *King Of Good Times*, he used both conventional and modern media like print ads, hoardings and websites. To enhance the royal effect, he gained publicity by sponsoring all happening events like fashion shows, IPL cricket matches, and golf tournaments. Adding to this, Vijay Mallya consciously passed on his flashy and poster boy image to Kingfisher Red airlines as the brand ambassador, carving out a young, trendy and fun-loving position for his airlines.

Putting together all tangibles and intangibles, Kingfisher Red promised to give a memorable experience to all its guests. It went on to become the first airline from India to receive the five-star airline status by the world leading independent travel forum Skytrax [16]. The evolution of Kingfisher Red described above definitely has led to the transition of Low Cost Carrier (LCC) towards a luxury carrier. It is quite evident that Vijay Mallya candidly exploited the low-hanging fruits of the airline industry - by harnessing opportunities that existed and by saving costs, wherever he could. Nonetheless, this inorganic growth of Kingfisher Airlines brought in numerous problems, which started posing a challenge in the current phase.

THE POST MERGER PHASE

Evaluation of the events that followed Kingfisher - Air Deccan merger is narrative of the fact that in a merger, the strong becomes stronger, and the weak becomes weaker. Therefore, while Mallya was in an upbeat mood , Captain Gopinath had a tale of woes to tell.

❁**The Losers :** Air Deccan's decline started with loss of equity, then brand identity and finally, its men. For two years after the merger, Captain Gopinath was optimistically wishing that Vijay Mallya will bring back life to his simple, no-frills, low fare Air Deccan service alongside his elaborate, Bollywood-esque, five-star service. However, unfortunately, it did not happen. Instead, the low-cost business model was completely abandoned and Air Deccan was grounded for ever. Captain Gopinath was heartbroken by the way Vijay Mallya treated his airlines and made no secret about being wooed by him, to which he fell[17]. His differences with Vijay Mallya became public with his resignation from the post of Vice Chairman of Kingfisher Airlines in March 2010. However, Captain moved on in his life with what he did best - the hub and spoke model. He once again created history, launching a new Express long haul freight service called *'Deccan 360'* across multiple industry verticals - in partnership with Mukesh Ambani. He started his operations on May 28, 2009, amidst all fanfare, trying to forget the past, but one could see in his media talks that somewhere, he still deeply mourned the sad demise of his first low cost carrier.

☸**The Gainers :** Quite contrary to the tragic end, Kingfisher Airlines Annual report 2009-10 spoke volumes of its unabated rise. In the words of the Chairman, *" During the year under review, your company had a domestic market share of 22.9% and carried more than 11 million passengers across both domestic and international sectors, with a year ending overall fleet of 68 aircrafts, having an average schedule of 366 domestic and 12 international flights daily and a route network (as on March 2010) covering 63 domestic and 7 international destinations .* [18] *"* . Growing strong on the international network, he claimed to have introduced new wide body routes to Hong Kong, Singapore and narrow body routes to Dubai and Dhaka. Achieving the highest share in Mumbai, Singapore and Mumbai- Hong Kong sector in less than one year of launch of these sectors, the airlines was set to join Oneworld, the world's leading quality airline alliance, bringing together 11 of the world's biggest and best names in the airline industry such as American Airlines, British Airways, Cathay Pacific, Finnair, Qantas and Royal Jordanian [19]. However, one could see that all is not well in the Kingfisher camp. Despite all possible rationalization and optimization of operations and resources, it did not get translated into profits as expected by Vijay Mallya. As per the annual report 2009-10, the financial statements revealed that Kingfisher Airlines continues to grapple with an accumulated loss of ₹ 2000 crore ending March 2010 . The implication of this is that Vijay Mallya needs more fund infusion to carry on with his ambitious plans. He would need greater support from his parent company and mother brand in the form of goodwill, which has become a matter of concern. On 15 November 2011, the airline released poor financial results, indicating that it was *"drowning in high-interest debt and losing money"*. Mallya indicated that his solution was for the government to reduce fuel and other taxes. The government was engaged in assessing whether to bail out the company and other airlines, or let market forces determine which ones survive. Thus, looking back, one wonders that why did a seemingly well arranged marriage fell apart when the industry is favourably moving towards consolidation. In fact, rationale to stay together was stronger with both Vijay Mallya and Captain Gopinath, as it would have led to economies of scale, enhanced efficiencies, accelerated growth and expanded business opportunities. Regrettably, such prospective advantages were stymied with challenges that included corporate culture clashes, competing executive egos, training gaps, brand/identity dilution and loss of autonomy. Many of these were softer issues that due diligence may not reveal; yet, they were critical factors that companies, considering an alliance, should weigh carefully.

CONCLUSION

Therefore, in any merger, while consolidation is seemingly easier, it is the post - merger phase which brings with it integration hurdles , organizational retro-fits or cultural issues, and that decides the success or failure of any merger. It will be relevant here to quote Lee Iacocca, the American management expert, who brought out the dramatic turnaround of Chrysler. He said, *"I don't mind when a company with a bad performance record gets taken over, somebody ought to take it out of its misery to carve it up. But that's not how these raiders operate. You see the typical takeover target isn't a company in trouble. It's a company with a solid asset base, low debt, consistent profits and a few bucks in the bank to help it get through the next business down turn. Choosing to modernize your factory instead of increasing dividends might make shrewd business sense, but it also is like putting fresh blood in the waters, a sure - fire way to draw the sharks."*

This souring of relationship between the Chiefs definitely led to some pertinent concerns. Firstly, can a young inexperienced carrier like Kingfisher survive the winds of change blowing with the bigger players getting ready for consolidation? Secondly, and more importantly, can Vijay Mallya maintain the transition of a Low Cost Carrier (LCC) towards a luxury carrier? It would be a big challenge for the Kingfisher Red to attract the customers/ passengers, particularly on the routes where the competing LCCs like Spice Jet, GoAir and Indigo provide adequate passenger capacity. Why would a customer choose Kingfisher Red, if he has the option to travel by the LCCs at a far cheaper fare?[20] The facility of on-board catering or check ins may not be a major driver, particularly on the journey involving up to 2 hours. One would like to believe that the Kingfisher Red would possibly pick up either uncovered/non-conventional routes or preferred timings on a given LCC covered sector, to ensure adequate passenger traffic to keep its business viable. Perhaps, the deeper financial analysis would yield certain important conclusions, which may be extremely useful to the existing LCCs, lest the Civil Aviation sector witnesses yet another merger or restructuring, resulting in the LCCs being a non-reality in the times to come.

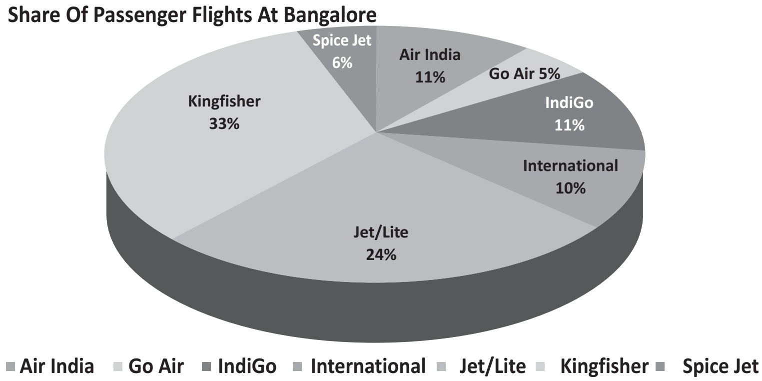
ANNEXURES

Table 1 : Cash Flow (₹ Crores)					
	Mar ' 10	Mar ' 09	Mar ' 08	Jun ' 07	Jun ' 06
Profit before tax	-2,417.92	-2,155.21	-682.59	-416.18	-336.80
Net cash flow-operating activity	-1,665.09	-645.78	-541.52	-552.58	-179.81
Net cash used in investing activity	235.13	206.63	13.82	119.48	-345.72
Net cash used in fin. Activity	1,464.55	290.11	-9.23	993.68	699.08
Net inc/dec in cash and equivalent	34.60	-149.04	-536.93	560.57	173.55
Cash and equivalent -begin. of year	171.87	320.91	817.05	256.47	82.93
Cash and equivalent- end of year	206.47	171.87	280.12	817.05	256.47

Annexure 2 : Annual Results Of Kingfisher Airlines (₹ Crores)					
	Mar ' 10	Mar ' 09	Mar ' 08	Jun ' 07	Jun ' 06
Sales	5,067.92	5,269.17	1,441.39	1,774.55	1,236.39
Operating profit	-899.37	-1,396.54	-742.44	-677.61	-387.98
Interest	1,096.51	696.23	50.38	62.40	31.95
Gross profit	-1,792.75	-1,784.47	-688.77	-372.25	-304.52
EPS (₹)	-61.95	-60.50	-13.85	-30.97	-34.69

Annexure 3 : Annual Results In Details (₹ crores)					
	Mar ' 10	Mar ' 09	Mar ' 08	Jun ' 07	Jun ' 06
Other income	203.12	308.30	104.05	367.76	115.41
Stock adjustment	-	-	-	-	-
Raw material	-	-	-	-	-
Power and fuel	1,802.99	2,602.62	889.30	979.50	625.45
Employee expenses	688.75	823.85	254.69	251.79	170.62
Excise	-	-	-	-	-
Admin. and selling expenses	-	-	-	131.27	109.12
Research and development expenses	-	-	-	-	-
Expenses capitalized	-	-	-	-	-
Other expenses	3,475.55	3,239.24	1,039.84	1,089.60	719.18
Provisions made	-	-	-	-	-
Depreciation	217.29	133.20	18.28	43.92	32.28
Taxation	-770.69	-546.38	-494.45	3.41	3.75
Net profit / loss	-1,647.22	-1,608.83	-188.14	-419.58	-340.55
Extraordinary item	-407.88	-237.54	24.46	-	-
Prior year adjustments	-	-	-	-	-
Equity capital	265.91	265.91	135.80	135.47	98.18
Equity dividend rate	-	-	-	-	-
Agg .of non-prom. shares (Lacs)	896.91	1048.08	448.84	1133.08	760.20
Agg.of non promoter Holding (%)	33.73	33.73	33.05	83.64	77.43
OPM (%)	-17.75	-26.50	-51.51	-38.18	-31.38
GPM (%)	-34.01	-31.99	-44.57	-17.38	-22.53
NPM (%)	-31.25	-28.85	-12.17	-19.59	-25.19

Annexure 4 : Share of Low Cost Carriers In 2010



Source: BangaloreAviation.com

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