INSTITUTE FOR POLICY REFORMS

IPR FACT SHEET

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Facts about PIA

About IPR

Institute for Policy Reforms is an independent and non-partisan think tank established under Section 42 of the Companies Ordinance. IPR places premium on practical solutions. Its mission is to work for stability and prosperity of Pakistan and for global peace and security. IPR operations are supported by guarantees from the corporate sector.

Facts were on the back seat during the passionate exchanges that recently took place on PIA's future. There is no gainsaying that PIA is in financial distress. The corporation, however, needs a fact-based discussion on how to find an exit from its woes. To limit the discussion to the simple binary of 'to sell or not' is not helpful. Let us first look at its finances.

PIA's Balance Sheet shows a financially vulnerable airline that borrows to repay past loans. The company has negative equity of about Rs. 167 Billion (September 2015). Long-term debt is more than Rs. 109 Billion (including advance against equity from government) with short-term debt of Rs. 70 Billion. Total current liabilities, payable within twelve months, are Rs. 197 Billion. Against this, PIA has Rs. 24 Billion in current assets, which is a mere 12% of its payables due in twelve months.

For years, the airline has generated negative cash flows. Cash flowfrom operation worsened from minus Rs. 4.3 billion in 2013 to minus 6.2 Billion in 2015 (nine months). If we include debt repayment, the gap increases several folds to about Rs. 26 Billion. Total of finance cost and debt repayment in 2014 was about Rs. 29 Billion.

Payroll cost, including for distribution, engineering, and administration, is high at about 19% of total operational cost (17% if we include finance charges). The relative number for Emirates Airlines is 14.3%. Landing and handling charges too are high at 13% versus 10% for Emirates. The latter runs many more flights and generates far greater sales. Fuel charges as part of total cost is below Emirates cost, perhaps because PIA's load factor is a good deal lower.PIA's operational cost to revenue is 115%. With finance cost, it increases to 130% of sales.Total cost to sales for Emirates is 96% (Emirates report does not easily separate operational and non-operational costs). Comparison with Emirates may seem unfair. The comparison, however, helps set up benchmarks with an airline that is also in the public sector and belongs to the region.

On surface, government's concern about overstaffing in PIA seems well placed. In 2014, PIA had anaverage number of 16,243 employees (Page 34 of Annual Report 2014. There is a different number on Page 83).

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Consequently, each employee contributed Rs. 6.1 Million to revenue. PIA's available capacity per employee was 147,501tons kilometer. The corresponding numbers for Emirates Airlines are Rs. 55 Million revenue per employee and 1.1 Million tons KM. Load factor, which is a critical indicator of performance, is a concern. PIA's passenger seat factor is an acceptable 72%, but capacity utilization overall, is a sub-par 59%. The Annual Report does not give the breakeven point for PIA. For Emirates, these numbers are 80% and 67% with a breakeven point of 64%. This is an area where improvement in PIA is most necessary.

It is a non sequitur to place the performance deficit between the two airlines entirely on the employees' doorstep. The key to PIA's weak performance is that it is not run as a business. That is the doing of governments and management not of the workers. PIA needs a robust business model.

Too many non-commercial considerations, albeit with justification, become PIA's responsibility. PIA must manage evacuation of Pakistanis from trouble spots, run Haj and Umra flights, connect distant cities, and arrange VIP movements. Government appoints the airline's senior management. Often, it intervenes in appointment of operational, and support staff, sometimes beyond the airline's needs. Government also creates the policy framework in which PIA operates. Its most obvious example is the open sky policy. On its part, management is responsible for enhancing employee productivity.

Public or private, or something in between as the government has proposed, is not the right framework for discussion ofPIA's future. The company must have a new business model. What PIA needs to do most is to increase revenue and decrease costs, especially mark-up (12% of total cost).

For one, it must re-start with a clean Balance Sheet. An investor that brings even a limited 26% of equity would expect government to take over PIA'sabout Rs. 190 Billion long-term and short-term debt and convert to equity GoP's advances of Rs. 23.5 Billion.

The 'new' company must also have the ability to increase revenue. For this, it must compete with other airlines that fly to Pakistan. There is yet no indication of the value of the company. So, it is difficult to say if 26% equity injection will be enough to upgrade equipment, which would help PIA compete on quality and safety. PIA particularly cannot compete at present for premium class passengers.

Despite its troubled finances, PIA's landing rights in major world airports add value to the company. It is not clear if these rights are fully used at present. If not, there may be considerable potential for future revenue increase here.

In addition to capital injection to upgrade physical assets, PIA's management must have full say in operational decisions. This is needed especially for service route and personnel decisions. From now on, PIA must base route management entirely on its effect on the bottom line. To meet social objectives, Government must enter into separate contracts with PIA for special operations for Haj, Umra, and evacuation. Government must bear the cost of any subsidy that it wishes to provide such passengers. Similarly, VIP charters must be under contract that takes into account all costs including aircraft revenue foregone.

Personnel management is critical. In order to compete, PIA must have a work force at par with other airlines. As this is a national issue, all political parties must assist management establish a new contract with employees to ensure performance based incentives. They must also revisit some of the employees' benefits. PIA must increase manifolds its investment in employee training and in improved systems. It cannot compete with the present work force and management systems. And it must show respect for its employees who are to bring PIA back on track. Inevitably, all of this is an incremental process and cannot be done quickly.

Government should decide whether the reforms required in PIA will best be achieved by keeping it in the public sector or finding a strategic partner, and if so, at what point in time. It should be an open and considered decision. If PIA remains in the public sector, Government must follow rigorouslya policy of arm's length with the airline and help PIA reform itself. It must set targets for the top management and hold them to account. It must also allow them autonomy in decisions.