

PRIVATISATION OF PAKISTAN INTERNATIONAL AIRLINES (PIA)

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(Views expressed in the brief are those of the author, and do not represent those of ISSI)



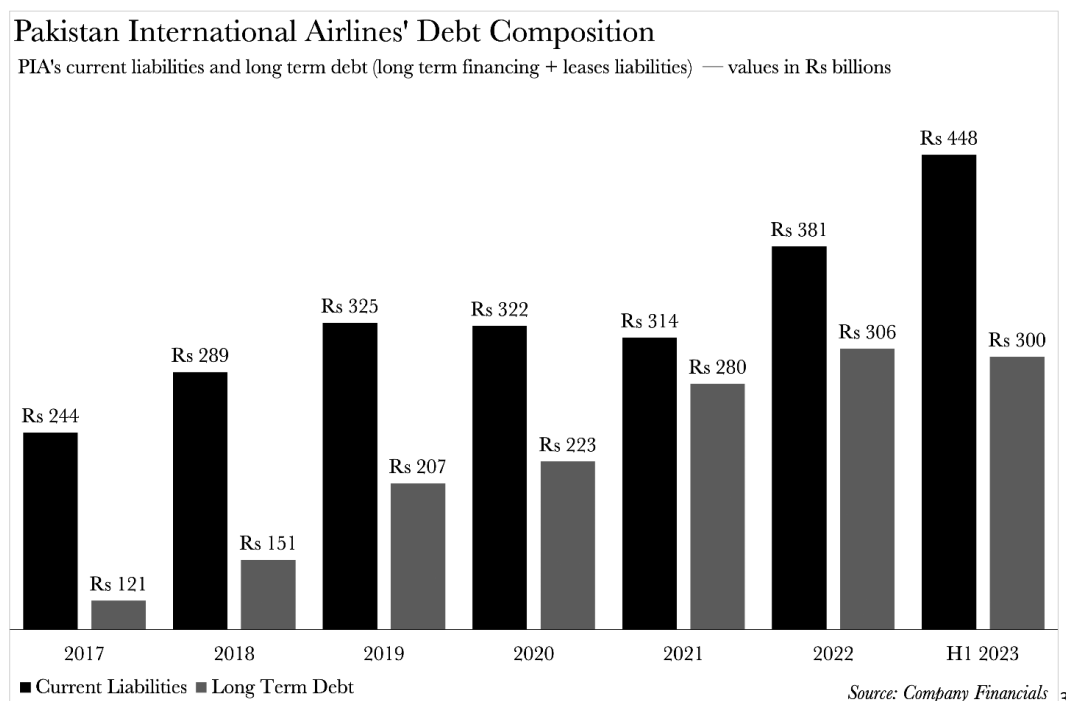
Background:

Established through government's Pakistan International Airlines Corporation (PIAC) Ordinance on January 10, 1955, by merging with Orient Airways (established 1946), the Pakistan International Airlines (PIA) boasted a rich legacy as Pakistan's premier national airline. With an ever-expanding fleet and route network, PIA catered to more than 45 global destinations. Under the stewardship of leaders like Air Commodore Nur Khan, PIA witnessed remarkable periods of growth and prosperity. Nur Khan's forward-thinking leadership during the 1950s and 1960s propelled PIA onto the global stage. However, subsequent shifts in management and market dynamics precipitated a downturn for PIA. The advent of market liberalization in the 1990s ushered in heightened competition, eroding PIA's market share and international footprint. Despite its illustrious past, PIA struggled to grapple with adapting to the rapidly evolving aviation landscape, characterized by the surge of private and foreign carriers.¹

¹ Fatimah Naeem, "Pakistan International Airlines (PIA): From a Glorious Take-Off to a Potential Touchdown?" Paradigm Shift, October 5, 2023, <https://www.paradigmshift.com.pk/pia/>

Current Situation:

PIA has encountered countless challenges, including inefficiency, alleged corruption, mismanagement, and safety lapses. Financial audits have unearthed substantial losses stemming from operational inefficiencies and malpractice. PIA has been faced with severe financial distress, with accrued losses standing at Rs724 billion by year-end 2023. The airline's profitability has been inconsistent over the last two decades, with only fleeting periods of success, notably from 2002 to 2004, buoyed by a bailout package. However, factors such as spikes in oil prices and EU-imposed safety bans on PIA flights to Europe in 2007 had severely dented profitability. By 2012, fuel expenses had surged to comprise 54% of total spending due to an aging fleet, exacerbating the airline's mounting losses, which had ballooned to Rs356 billion by 2017.²



In recent years, PIA had been forced to ground aircraft as it struggled to secure operational funds, with only 19 out of 30 aircraft currently operational, while a string of accidents and safety breaches tarnished PIA's reputation, and Senate committees and Supreme Court audits pinpointed governance deficiencies as the primary catalyst for the airline's decline. Furthermore, leadership

² "PIA's losses to go beyond colossal Rs800bn figure," The News, July 6, 2023, <https://www.thenews.com.pk/print/1087569-pia-s-losses-to-go-beyond-colossal-rs800bn-figure>

³ Daniyal Ahmad, "The week everyone thought PIA was no longer a going concern," Profit, <https://profit.pakistantoday.com.pk/2023/09/17/the-week-everyone-thought-pia-was-no-longer-a-going-concern/>

turnover has been rampant, with more than 30 CEOs in recent decades, undermining stability and continuity compared to counterparts at successful airlines like Emirates and Qatar Airways.⁴

Leading factors of PIA's decline:

- Imprudent policies and executive mismanagement, including costly leasing agreements and procurement of expensive aircraft components.
- Allegations of inflated charges by internal stakeholders which exacerbated the airline's financial predicament.
- Political interference and nepotism with politically affiliated private airlines thriving at the expense of PIA's financial viability.
- Governance and safety standards coming under sharp scrutiny, with incidents such as flight diversions and accidents raising concerns about operational efficiency and regulatory adherence.
- Operational disruptions and financial strains, including the looming threat of oil supply disruptions and legal action over unpaid debts.

Ongoing Process of Privatisation:

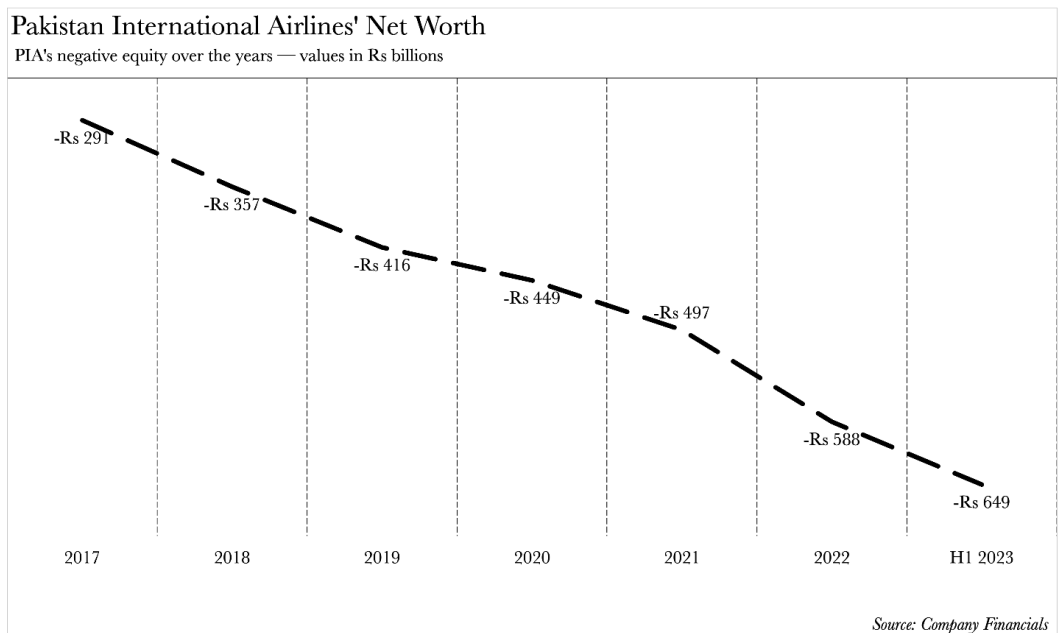
Government of Pakistan is grappling with persistent economic challenges, underlining its inability to sustain subsidies for loss-making entities. This stance aligned with Pakistan's commitment to fiscal discipline, as part of a USD 3 billion IMF bailout package announced in June 2023, the government initiated a privatisation drive, aiming to revamp loss-making State-Owned Enterprises (SOEs), including PIA.⁵

In its 83rd meeting on March 25, 2024, PIA's Board of Directors endorsed the Scheme of Arrangement (SOA) for the restructuring and privatisation of Pakistan International Airlines Corporation Limited (PIACL), along with its associated modalities. The SOA will be submitted to the Securities and Exchange Commission of Pakistan (SECP). Earlier on March 6, Prime Minister Shehbaz Sharif had directed the Privatisation Ministry to present the final schedule for the implementation of the privatisation of PIA. However, the privatisation of PIA is projected to be one of the most intricate

⁴ Imtiaz Ali, "PIA has 'temporarily' grounded some of its planes: spokesperson," Dawn, September 14, 2023, <https://www.dawn.com/news/1775834>

⁵ S Khan, "Pakistan's airline near collapse, heading for privatization," DW, October 10, 2023, <https://www.dw.com/en/pakistan-airline-on-brink-of-collapse-heads-to-privatization/a-67052074>

transactions tackled by the Privatisation Commission, necessitating a detailed 30-step plan for completion. Fulfilling this ambitious agenda could take from six months to a year.⁶



A significant challenge in the process involves obtaining No-Objection Certificates (NOCs) from around 35 lenders, a task with an unpredictable timeline due to PIA's financial struggles. This step is critical for maintaining the airline's operations and is indicative of the complexities involved in the privatisation efforts. Comparing to past privatisations, such as the Heavy Electrical Complex which took two years to transition to new ownership despite concluding the Sale Purchase Agreement in 2022, the PIA privatisation stands out for its complexity.⁸

The privatisation plan, developed by transaction adviser Ernst & Young, hired by the caretaker government outlines the privatisation procedure in which the government would consider selling a majority stake in PIA, possibly through tender or government-to-government agreements. To address PIA's financial woes, the government plans to segregate legacy liabilities into a holding company and privatize core assets and current liabilities. This involves selling PIA's aircraft, routes, landing rights, and essential engineering and air service agreements.⁹

⁶ "PIA's privatisation, restructuring plan approved," Profit, March 26, 2024, <https://profit.pakistantoday.com.pk/2024/03/26/pias-privatisation-restructuring-plan-approved/>

⁷ Daniyal Ahmad, "The week everyone thought PIA was no longer a going concern," Profit, <https://profit.pakistantoday.com.pk/2023/09/17/the-week-everyone-thought-pia-was-no-longer-a-going-concern/>

⁸ Mehtab Haider, "30 steps needed for PIA privatisation," The News, March 11, 2024, <https://www.thenews.com.pk/print/1166854-30-steps-needed-for-pia-privatisation>

⁹ "Pakistan cabinet approves national airlines' privatization plan," Arab News, February 6, 2024, <https://www.arabnews.com/node/2455241/pakistan>

However, cautious approach of overseas investors and forex shortages pose challenges to PIA's privatisation, alongside concerns about maintaining air connectivity to underserved regions. Nevertheless, the government remains steadfast in expediting the privatisation process, despite potential protests and disruptions from PIA unions. Progress on PIA's privatisation is critical, especially as the current IMF bailout program has seen its March 2024 expiration and talks for new IMF Agreement have begun.¹⁰

Potential Outcomes of Privatisation of PIA:

- *Efficiency Improvements and Enhanced Competitiveness:* The privatisation of PIA has the potential to enhance efficiency and productivity, as private companies are typically driven by stronger incentives to innovate, reduce expenses, and optimize operations to stay ahead in the market. Private ownership could stimulate competition within the domestic aviation sector, resulting in higher-quality offerings, more competitive pricing, and enhanced market efficiency. Furthermore, privatisation of PIA could render the enterprise more flexible and adaptable to evolving market dynamics, facilitating quicker responses to technological innovations, shifting consumer demands, and global trends.¹¹
- *Investment Influx and Focus on Core Functions:* Privatizing PIA has the potential to attract private investment into sectors previously under state control, fostering economic growth and modernization by injecting capital and expertise. As per PIA's 2023 annual report, the airline's physical assets, including aircraft and hotels in Paris and New York, are valued at Rs105.6 billion (\$375 million) according to book value, with officials suggesting their market value could surpass \$1 billion. Despite this, they have affirmed that the hotels and other properties will not be sold, irrespective of their market worth. Additionally, privatisation can allow governments to concentrate on core functions such as regulation, oversight, and provision of public goods, while delegating commercial activities to the private sector.¹²
- *Job Losses and Accountability:* A private company taking over PIA could potentially streamline operations, which might result in layoffs or job losses as they aim to optimize efficiency and profitability. In such a scenario, shareholder interests may take precedence

¹⁰ Shahid Kardar, "Privatising PIA as going concern?" Dawn, October 28, 2023, <https://www.dawn.com/news/1784402>

¹¹ Editorial, "PIA's Future," Daily Times, March 27, 2024, <https://dailytimes.com.pk/1180881/pias-future/>

¹² Asif Shahzad, "Ahead of election, Pakistan seals plan to sell national airline," Reuters, February 2, 2024, <https://www.reuters.com/business/aerospace-defense/ahead-election-pakistan-seals-plan-sell-national-airline-2024-02-02/#:~:text=Separately%2C%20PIA's%20physical%20assets%2C%20which,airline's%20annual%20report%20for%202023> .

over public concerns, possibly leading to reduced transparency and accountability in decision-making processes. Additionally, the buyer may expect the government to assume pension liabilities for retired employees and current entitlements. The extent to which the acquiring company would retain the existing workforce is unclear, especially considering that they may negotiate golden handshake packages for laid-off employees, impacting the offer price. Presently, PIA employs approximately 11,000 individuals.¹³ The PIA Board of Governors in its recent meeting has proposed the retirement of employees who are within four years of retirement age in the event of the institution's privatisation, while consultation was also held on the voluntary retirement scheme.¹⁴

- *Long-term Costs:* The privatisation deal for PIA might entail concealed expenses or obligations for the government, potentially imposing a long-term burden on taxpayers. In February 2024, the government and commercial banks agreed on a debt restructuring plan totalling Rs268 billion for PIA. Departing from its prior stance, the Ministry of Finance committed to covering principal and interest payments from the national budget. According to the agreement, the government will allocate proceeds from PIA's sale to cover principal payments, resorting to the budget if necessary. In return, banks consented to a 10-year debt rollover at a 12% annual interest rate, leading to Rs32.2 billion in yearly interest payments. Under this arrangement the banks will accrue Rs322 billion in interest payments over the decade, surpassing their initial Rs268 billion debt. With a 12% interest rate, the total payout to banks is estimated to reach Rs572 billion within the next ten years.¹⁵

Conclusion:

Amidst economic challenges in Pakistan, privatizing PIA could represent a significant step towards rejuvenating the national carrier and strengthening its position in the competitive global aviation industry. Despite obstacles and resistance, the government remains steadfast in its commitment to privatize PIA as part of broader economic restructuring efforts, with the aim of improving efficiency, competitiveness, and service quality while protecting public interests. While facing numerous hurdles, these challenges also offer opportunities for growth and transformation. Experts and stakeholders advocate for fundamental reforms in PIA's governance, stressing the importance of professional leadership and robust oversight mechanisms. However, it's essential for the process to

¹³ S Khan, "Pakistan's airline near collapse, heading for privatization," DW, October 10, 2023, <https://www.dw.com/en/pakistan-airline-on-brink-of-collapse-heads-to-privatization/a-67052074>

¹⁴ Salah Uddin, "PIA privatization: Three Gulf countries show interest in buying national carrier," ARY, March 27, 2024, <https://arynews.tv/pia-privatization-three-gulf-countries-interested-in-national-flag-carrier/>

¹⁵ Shahbaz Rana, "PIA debt burden shifted to taxpayers," Tribune, February 2, 2024, <https://tribune.com.pk/story/2455185/pia-debt-burden-shifted-to-taxpayers>

prioritize transparency, inclusivity, and consideration for financial and human factors to ensure a smooth transition.