Economy & Business

Turbulence in the Skies

Those $99 ticket prices, a boon to travelers, are a bane to the airlines

Delighted air travelers have been crowding ticket counters and tying up telephone reservation lines during the latest round of fare wars. For just $99 a seat one way they have been flying merrily between cities like New York and Los Angeles—a trip that can cost four times as much at full price. But the fares that have been so pleasant for passengers have been torture for the troubled airline industry. Some executives privately refer to the deep discounts as going-out-of-business sales. Says Monte Lazarus, senior vice president of United Airlines, the largest U.S. carrier: "The fares are suicidal, fratricidal and genocidal."

The ruinous price wars are just one sign of the chaos that has overtaken the industry since the Airline Deregulation Act of 1978 gave rise to wider competition. U.S. carriers lost an estimated $550 million in 1982, the third consecutive year of record deficits. Experts now fear that some weaker airlines may follow the route of Braniff International, which declared bankruptcy last May. Among those considered at risk: Pan American, which had $327 million in operating losses last year, the most for any airline; and Air Florida, a onetime highflyer that encountered turbulence after expanding too fast. The test for some carriers could come quickly, since the late winter months are normally slack ones for air travel.

Astonishingly enough, however, such gloom has not prevented a number of airlines from raising cash on Wall Street, which is not notably kind to losers. Although TWA dropped $101.3 million in 1982, for example, it announced plans last week for an offering of 5 million shares of common stock, designed to bring in up to $85 million. Moneymen treated that news with interest rather than as a sign of financial chutzpah. U.A.L., the parent of United, which lost $66.7 million last year, said it would offer 3 million shares.

The biggest shocker came Wednesday when investors snapped up a $135 million issue of Pan Am notes. Those went so fast that the airline was able to sell an extra $15 million of the securities as well. To be sure, the notes have plenty of enticements: they pay 15% interest, are secured by airplanes worth an estimated $215 million, and can be converted into Pan Am common stock at $5.50 a share. That last feature alone could provide a handsome return, since Pan Am stock could take off if the airline became profitable again. Pan Am shares closed at 4⅝ last week.

Investors are willing to risk money on this ailing industry because they suspect that it may be about to return to health. Airline stocks have risen by an average of 66% since August, a run-up that ranks among the best of any industry. Says Robert Joedicke, an airline analyst at Lehman Brothers Kuhn Loeb: "Airline profitability is entering a recovery period that should gain momentum during 1983 and continue for several years." A report from the investment banking firm of Morgan Stanley puts it in plainer English: "Every portfolio should have an airline stock."

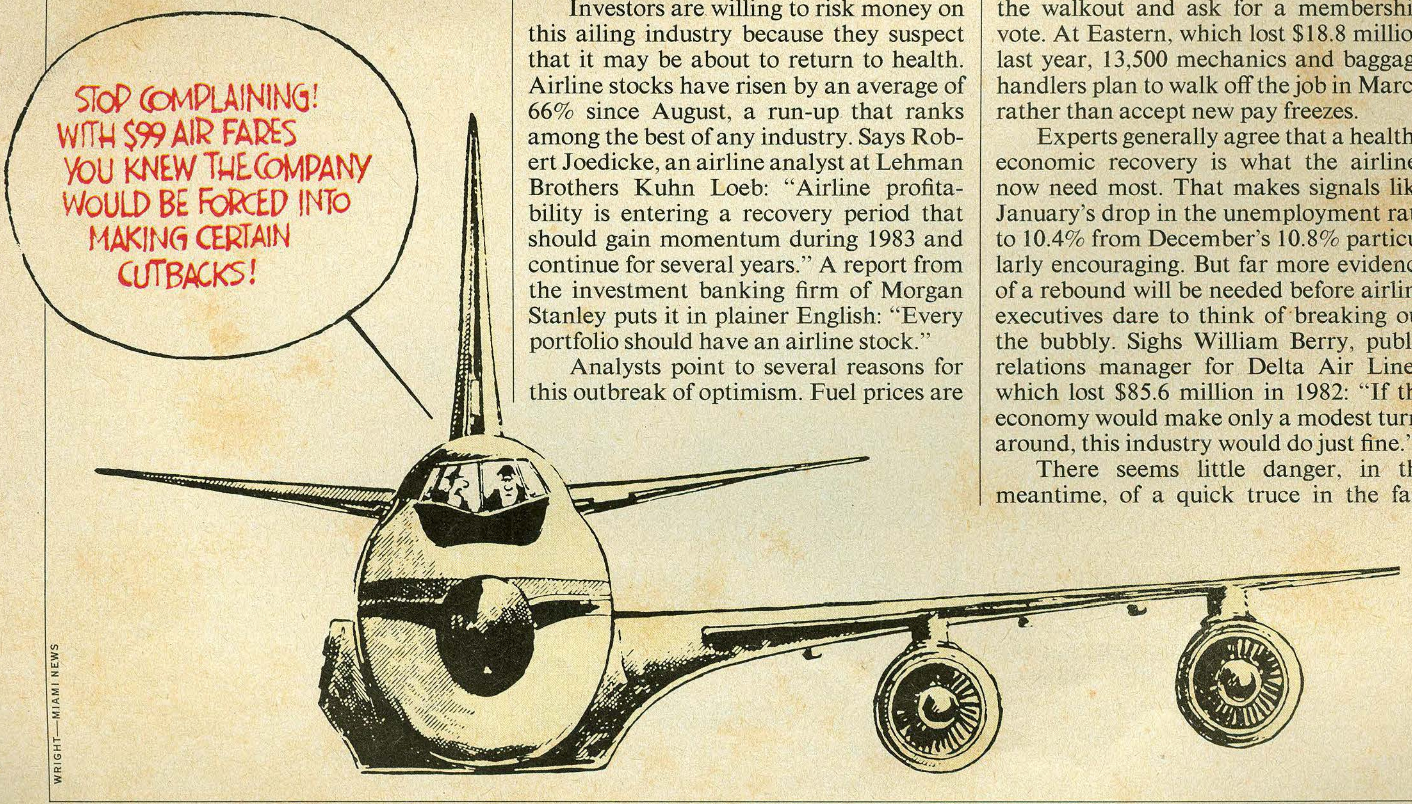
Analysts point to several reasons for this outbreak of optimism. Fuel prices are one. The airlines now spend an average of 95¢ per gal. for fuel, down about 7¢ from a year ago; that figure could drop a nickel more in 1983. Experts estimate that each 1¢-per-gal. decline saves airlines about $90 million a year. Fuel, in fact, accounts for fully 30% of airlines' total operating expenses. Notes Donald McGuire, a vice president of Piedmont Airlines, a healthy carrier that earned $23.8 million in 1982: "Any time you can fix one-third of your problems at once, you gotta be happy."

The carriers have also been bringing their labor costs, which represent 35% of spending, under tighter control. They laid off more than 15,000 of their workers last year, bringing total employment to 250,000. The cutbacks, expected to save the industry up to $500 million this year, hit workers in hangars, on flight decks and in the executive suite. Most carriers also negotiated pay freezes or wage cuts, along with changes in work rules.

Labor relations, however, have begun to turn sour for some companies. American Airlines, which lost $18.2 million in 1982, won about $20 million worth of concessions from its pilots last August. But American narrowly avoided a strike last week when negotiators for 10,000 of the airline's ground workers decided to delay the walkout and ask for a membership vote. At Eastern, which lost $18.8 million last year, 13,500 mechanics and baggage handlers plan to walk off the job in March rather than accept new pay freezes.

Experts generally agree that a healthy economic recovery is what the airlines now need most. That makes signals like January's drop in the unemployment rate to 10.4% from December's 10.8% particularly encouraging. But far more evidence of a rebound will be needed before airline executives dare to think of breaking out the bubbly. Sighs William Berry, public relations manager for Delta Air Lines, which lost $85.6 million in 1982: "If the economy would make only a modest turnaround, this industry would do just fine."

There seems little danger, in the meantime, of a quick truce in the fare



WRIGHT—MIAMI NEWS

wars that have been such a boon to travelers and a bane to carriers. An estimated 80% of all passengers flew at discounts last year, at an average saving of 50%. Such bargains are likely to continue as long as the weakest airlines are tempted to cut prices to fill seats and competitors feel compelled to follow. Says Arthur Jackson, an American Airlines spokesman: "The leaders in discounts are airlines with severe cash problems. Discounting is a way of raising money in order to pay the bills."

Pan Am showed last week just how hard it can be to kick the discount habit. The airline, which set off the recent round of $99 fares by offering them on more than 40 of its U.S. flights in January, had planned to halt them Friday. But Pan Am executives changed their minds at the last minute, and decided to keep the $99 rate on most of the flights through March. The airline apparently did so because virtually every other major U.S. carrier is offering some form of $99 ticketing until the beginning of April.

Almost none would do so, however, were it not for the other guys. TWA pointed out with stunning clarity last week the damage that cheap rates can cause. In a prospectus for its stock offering, the carrier noted that competition has forced it to set fares throughout most of its system that are less than the cost of providing the seats. Adds Neil Effman, a TWA senior vice president: "If these discounts continue, there will have to be fewer carriers in the U.S. air transport industry by the end of the year." In a sense, that is an unspoken purpose of the discounting game: to force the weakest airlines to go bankrupt, leaving fewer seats and more customers for the survivors to share.

The discounting has become so frenzied and complex that even mainframe computers have trouble keeping the fares straight. Delta has more than 56,000 separate fares on the 2,700 routes it serves, and is working to untangle that price thicket. Western Air Lines, meanwhile, has simply given up. Chairman Neil Bergt has told ticket agents to match whatever fare a customer claims to be able to get elsewhere, once a computer confirms that such a rate exists.

The fare wars have ultimately been caused by the twin impact of deregulation, which brought price competition to the airlines and allowed nonunion upstarts to flourish, and the recession, which caused traffic to shrink. Result: too many seats chasing too few passengers. No-frills carriers like People Express *(see box)* and Southwest Airlines are thriving on the competition by holding down costs, but some other small airlines are being squeezed. Air Florida, which had helped spark an earlier round of discounting, lost $64 million in the first nine months of 1982 after Delta and Eastern began matching the fares on its expanding routes. Says Arthur Bass, chairman of Midway Airlines, a Chicago-based discounter that earned $4.5 million last year: "With excess capacity, the big airlines are out there to kill someone."

Discounts may shrink as the airlines recover, but bargain fares are likely to remain. "The American consumer is doing to the airlines what he has already done to the auto industry," says Julius Maldutis, an industry analyst at Salomon Brothers. "He buys only at discount." Concedes Delta's Berry: "Discount rates are here to stay, but they must also be realistic." Indeed, with a lot more realism and a little more luck, U.S. airlines may finally pull out of their financial nosedive and regain their cruising altitude. —***By John Greenwald. Reported by B.J. Phillips/Atlanta and Frederick Ungeheuer/New York***

How People Does It

One feisty little carrier with rock-bottom prices has more business than its reservations clerks can handle. At People Express, callers sometimes find themselves talking to President Donald Burr. No wonder Burr is glad to pitch in wherever he can: last month, People flew 357,000 paying customers, a whopping 146% increase over traffic a year ago.

In the 22 months since People Express started up, its home base—a former freight terminal—has become the busiest gateway at Newark International Airport, some 13 miles southwest of New York City. Flying passengers between cities from Boston to Palm Beach and as far west as Columbus, the pint-size airline earned a profit of $2.7 million in the first nine months of 1982, while the likes of Pan Am, Eastern and TWA were all showing losses. People's progress is mainly due to the lowest operating costs in the business, an average of 5.3¢ per seat per mile flown *vs.* up to 11¢ for other airlines. Says Burr: "We don't have any secret weapons. Our competitors can do it, and many of them are working day and night to get their costs down."

Burr, 41, formerly president of Texas International Airlines, gives much of the credit to his dedicated staff of 1,200 "race-horse types" who hire on for less and work hard. They have reason to: on the average, People Express workers own $20,000 worth of stock in the company. The onetime schoolteachers, anthropologists and art historians recruited by Burr seem to thrive in a company that has no secretaries or plush offices, and whose chief financial officer, Robert McAdoo, helps serve coffee on some flights. Says McAdoo: "We're all in this together."

KIM STEELE

President Donald Burr

Passengers seem to feel the same way. They do not mind paying 50¢ for a soft drink, or $3 for every bag checked. After all, there is plenty of room for carry-on luggage, and People's buy-while-you-fly on-board ticket sellers eliminate those long waits at airport counters. But it is the fares that clinch customers' loyalty. Eastern Air Lines, once the king of the New York–Florida routes, is scrambling now to hold on to the business. Reason: People's $69 one-way fare ($49 at night). Eastern, whose standard coach fares are more than $200 for those flights, has retaliated with a $72 fare, but only for a few seats on night flights out of Newark. Moreover, Florida-bound Eastern customers boarding at nearby La Guardia Airport pay more, mainly because People flights are not available there.

Thanks to People's competitive punch, the airline's stock has more than doubled, from 11 to 24⅜ per share, over the past year. Donald Burr may still be working seven days a week, but his 9% share of the company stock is now worth $17 million. And the customers keep coming out of the woodwork. Says Burr: "We're getting people who wouldn't have traveled to New York to see a show, or buy clothes. If they did, they would have driven or taken a train." These days, at least on People Express, it is cheaper to fly.