Delta must avoid United's road map--but how?

Why United Airlines will fail again

By Joe Brancatelli

There is a plethora of financial and operational reasons why the United Airlines that exits bankruptcy early next month will soon enough be back in Chapter 11 or desperately seeking a merger to keep itself afloat.

But United Airlines will fail again primarily because it has no organizational heart, no identity and no definable brand. Most of all, it has none of the vision and discipline that separates the winners from the losers in the deregulated skies.

Consider the airlines that have had success of any meaningful duration in the last decade. There is, of course, Southwest Airlines. Whether you like what it sells is beside the point: You know and understand the product that it sells. And you know that Southwest delivers it at every seat on every flight on every route that it operates. Southwest's management and employees are fanatically devoted to its standards of simplicity and its unabashedly mass-transit approach to air travel.

Ditto JetBlue Airways. You know what you buy every time: a leather chair with decent legroom; free in-flight satellite TV and radio; a sense of casual style; and rational prices. AirTran Airways has found success because it offers a definable and recognizable product: no-frills, two-class service at simple prices. It even did the unthinkable˜dump commuter flights because they did not fit the image or the financial model. And before its corporate ego ran amok, Continental Airlines had a profitable run. Why? It crafted a demonstrably higher quality of "traditional" full-service flying and then reworked its management, crews, fleet and operations until the airline was a consistent and marketable whole.

United has done none of those things during its 38 months in Chapter 11. In a market that has proven it will only support consistency, United Airlines is a bizarre amalgam of in-flight products, fleet configurations and service concepts. It cynically tries to be all things to all fliers and careens from idea to idea, cabin to cabin and fare to fare, sometimes on a route-by-route basis.

In fact, United isn't. Not in concept or in execution. It is a disjointed collection of flights run by executives with no overarching vision, no unifying commitment and no marketing or brand discipline. In every conceivable way, United is the opposite of what works in the sky.

United will emerge from the most costly bankruptcy in American history with 26 separate in-flight seat configurations. It dabbles in everything from the upmarket p.s. service to the downmarket Ted. It slaps its name and logo on five types of narrow-body planes, four types of widebody jets and eight flavors of regional aircraft. It befuddles buyers with an ever-shifting combination of one, two, three and even four classes of in-flight service. And like all of the Big Six, its rococo fare structure is repulsive.

It is, simply put, an unholy mess competing in an unforgiving marketplace that only spares carriers with impeccable systemwide coherency.

United's intellectually slovenly approach to air travel guarantees its failure. But it's not just theory: United exits bankruptcy as a textbook example of worst-case practices. Consider:

United's oil-price projections are fantasy. The five-year plan that United submitted to its bankruptcy court predicts annual operating profits through 2010. But its projections are based on oil selling for an average of $50 a barrel. The market price of oil is currently north of $65 a barrel. Given the growing demands of China and India and the upheavals in Iran and Nigeria, oil could be closer to $100 a barrel than $50 in the next five years. In fact, last week at the World Economic Forum in Switzerland, experts contemplated the mechanics of a global economy with $120-a-barrel oil.

United is swimming in debt. United will exit bankruptcy saddled with about $17 billion in debt. It expects to issue about 125 million new shares under the ticker symbol UAUA. While some observers predict the stock will quickly trade higher, the opening price is likely to be about $15 a share. That gives United an equity value just shy of $2 billion and a debt-to-equity ratio of about 8.5-to-1. By comparison, American Airlines' debt ratio is deemed much too high at about 6-to-1.

United is mortgaged to the hilt. United made public relations hay this week with its announcement that it quickly secured $3 billion in exit financing. What it didn't mention was that the loan was secured with just about every asset that United owns: fleet; spare parts; Atlantic and Pacific routes; corporate headquarters building; flight simulators; accounts receivable; and even the Mileage Plus frequent-flier program.

United's route network is no longer admirable. The talking-head experts routinely prattle on about the peerless United Airlines route network. But, frankly, they aren't paying attention. United's Chicago hub is under constant pressure from American at O'Hare and Southwest is growing rapidly at Midway. Southwest has also returned to harass United in Denver, where Frontier Airlines is also an established competitor. Independence Air has disappeared at Washington/Dulles, but that isn't good news for United because two much stronger players, AirTran and JetBlue, are now able to make inroads there. Its Pacific routes are under pressure from some of the world's best airlines. It faces brutal competition in Latin America and Europe, too.

United is less competitive than ever. United constantly promotes p.s., its three-class service in the New York-Los Angeles-San Francisco transcontinental triangle, as proof of its commitment to serve higher-fare, higher-profit business travelers. But United has little to offer those customers elsewhere. The p.s. concept, after 15 months, hasn't been added to any other route. Instead, United has turned huge chunks of its domestic route network over to Ted, which has no first-class service. And almost 40% of United's network fleet is now comprised of regional jets. United has equipped some of those smaller craft with first-class cabins, but those planes have generally replaced the larger jets that travelers prefer. Internationally, United has aging premium-class products that are notably inferior to the perks offered by it major competitors.

United is stretched to the limit. United has improved its once-atrocious on-time ratings during its 38 months in bankruptcy. But those gains are constantly at risk because United has stretched its workforce to the limit. After shedding about 25,000 workers, it no longer has the capacity to cope when a few days of bad weather in Chicago or wonky computers upset daily operations.

Operations nearly collapsed under the strain of both occurrences in December and United will probably be back at the bottom of the on-time ratings when December's numbers are published.

United has no capacity to grow. Having dumped more than 100 planes in bankruptcy and deferred delivery of most of the rest of the mainline jets it ordered, United is stalled at its present size. In fact, its five-year business plan predicts no substantive capacity growth between now and 2010.

United has a looming frequent-flier crisis. The no-growth scenario and high load factors˜United currently fills almost 82%of its seats also means that the airline will be hard-pressed to make good on all of the frequent-flier miles it uses to keep travelers loyal. Worse, it seems clear that there will be a torrent of new miles pouring into Mileage Plus. Earlier this month, United moved its credit card transaction processing to Chase, the bank that also issues the Mileage Plus credit cards. Why the switch? Chase agreed to make an advance purchase of miles equal to the hundreds of million of dollars that United must keep in reserve for credit-card refunds that would result from its grounding. That means Chase will be churning out an endless series of mileage-accrual offers that United's static capacity won't be able to easily absorb.

United's top managers are focused on short-term gains. United's top executives recently rewarded themselves with 8% of the new airline's shares. This bonus plan, which The New York Times called "insanity squared," has another intriguing fillip: They vest with head-spinning rapidity. According to court filings, 20% vest after six months and another 20% vest after one year. Then 20% more of the shares vest in each of the next three years. Bottom line: Chief executive Glenn Tilton and his 399 top lieutenants now have a financial incentive to make the kind of short-term, shore-up-the-share-value decisions that are often incompatible with the long-term vitality of an airline.

United's employees are angry. How would you feel if you lost your stock? United was largely employee-owned before bankruptcy, had your pension plan gutted when management dumped it on the Pension Benefit Guarantee Corp., made two rounds of salary-and-benefit concessions and then learned that the bosses rewarded themselves with a stock-bonus windfall? Now you know the state of mind of most of United's rank-and-file employees. It won't make for a lot of happy flights in the weeks and months to come.

Sadly, for all these reasons and many more, from whatever day that United officially exits bankruptcy next month, the clock will begin ticking on the next, and inevitable, crisis.

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