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What if we worked for free?

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Nine years after a similar article ran in Flightline, we find ourselves barraged again with repeated allegations that our labor costs are fundamental to the industry problems. It simply isn't so.

In 1993 Bob Crandall was seeking $300 million in savings on our contract in order to make American Airlines competitive with Southwest. Specifically, it was only labor efficiencies he was seeking, as the actual products were vastly different. There was no pretense of competing with Southwest Airlines. In fact, in industry comparisons over the last decade all the "majors" are compared to each other but not to "the other" airline. Southwest with its no-frills service was never viewed as a competitor but when the opportunity arose for cost comparisons, they were the easy benchmark to throw in the face of labor.

So back in 1993, the Allied Pilots Association contracted with airline analyst Bob Mann to do a cost study. There were lots of statistics and education included in the study but we need only to examine a few numbers to understand that efforts on the part of labor aren't going to be the Holy Grail for an ailing industry.

American's premium service and Southwest's leisure market are products that are worlds apart. However, the two labor cost structures are not that far apart. Nine years ago, American Airlines' labor costs were 38% of its costs. Southwest's were a few points lower. Today a look at labor costs during the last two "normal" quarters (Q1 of 2001 and Q2 of 2001), show that labor costs were 37% of total costs for both AA and Southwest. United Airlines was only slightly higher at 38%. Labor costs in the entire mainline industry ranges from 35-38% of total costs.

Airline history shows, then, that 38% of total costs are what management can expect to pay labor to fly airplanes. Presently, however, AMR and UAL management are citing higher proportionate levels of labor costs. Why? They are choosing to man inefficiently. The result of "over-manning" is that pilots receive lower furlough rates and risk having labor costs thrown in their faces or held up to politicians. AMR operates its people and equipment at an underutilized rate to be more responsive as flying returns to pre-September 11 levels. Southwest, which did not reduce its flying, is still at 37% labor costs.

The article speculating on pilots working for free nine years ago made the case statistically that even if pilot wages were reduced to zero and corporate salaries were eliminated, AMR costs still would be out of line with Southwest costs. It was true then and is true now. Why? The comparison is between apples and oranges. AMR's revenue stream is based on business travel and premium revenues. Southwest's is based primarily on leisure market revenues.

During the '80s and the early '90s, these products could successfully coexist in overlapping marketplaces. That changed drastically by late 1990 as the premium market matured. Travelers swore allegiance to single travel plans and travel contracts were firmly etched in the marketplace. During this same time, although the leisure industry was mature, it was not fully saturated.

Economic good times developed untapped markets that offered low fares which lured travelers out of their cars and into airplanes. Emerging new mid-level carriers presented a third travel option, but were undercapitalized and failed to deliver large network carrier service. These carriers also failed to compete with the South-west balance sheet, yet labor costs were never blamed for their demise.

Southwest has never cited labor costs as part of the reason for its success. Instead, it credits a sound business plan and a highly motivated workforce.

So what has changed? Before accepting that labor costs at United and Delta have surged to unprofitable levels, APA members should remind themselves that labor costs were trimmed significantly at United in trade for equity. This equity appreciation model failed miserably. At Delta, overall costs have been balanced on the shoulders of mainline pilots as the airline increases operations of its low-cost regional jets.

Ironically, however, during the phenomenal industry year of 2000, both United and Delta were able to reach contracts that put pilots' pay back on an historic track. At AA, pilots' wages lagged far behind and bolstered a capital windfall for the corporation to seek new growth. With cash and opportunity at hand, AMR embarked on a record level acquisition program that portended great growth for the airline, but not for the labor force that helped subsidize this plan.

Promises of opportunity for better careers were undermined by a transitional industry model and faltering economy.

In 2002, American Airlines' labor force is being told that they should again expect to subsidize survival. But will shrinking the airline or chopping labor costs make the AMR product viable? No.

Would low labor costs have made the Yugo a viable product? Would low labor costs make tube televisions able to compete with high definition TVs? The answer is obviously, no.

American Airlines tickets are generating today only 60-90% of the revenue that they did a year ago. If labor costs were eliminated, the loss would be less, but not significantly so.

If pilot costs were eliminated, the cost per seat mile drops from 11.22 cents per available seat mile (ASM) to 10.07 cents per ASM. This is fully adjusted for pension, benefits, and carrying costs. In the face of unit revenues dropping to 18%, our contribution is seemingly insignificant. The pilot cost per ASM is only .0115 cents (fully adjusted).

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Increasing pilot costs by 20% increases overall costs per ASM to .0018 cents per ASM.

Should AMR continue to focus on pilot wages as a way to shore up revenue swings of 15-18%? APA doesn't think so. Instead, the company should view a wage increase as a small investment in one of their most precious assets.

In an industry that markets a perishable commodity, high fixed costs compel AMR to get more planes flying just to generate revenue that will cover costs. In today's economy, industry revenue is dictated by two things: product differentiation and competitive capacity. Over time, American's revenue — based on the sale of premium tickets — has fallen prey to a number of factors:

- Internet sales portals (including AMR's own spin-off, Sabre) where business is based on driving users to the cheapest fares
- More efficient tracking of business travel expenses
- Over-capacity
- Development of new RJ markets
- Hub by-passing (which will continue until the RJ market matures)

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Another factor to consider is that the mainline hub-and-spoke system does not offer enough product differentiation to prevent customers from flying point-to-point. Individual markets will continue to define themselves. Financially viable service will not be an initial threshold, as market share will drive carriers to examine feasibility. In addition, low-cost carriers are now in a position to attack the lucrative point-to-point flying dominated by premium carriers. New equipment and route structures are enabling carriers like Southwest and jetBlue to overlay American's routes. Business will be pressured to gravitate to the lowest cost service and will gladly do so as some of the newer carriers begin offering satellite TV and airborne internet capability.

So how low do labor costs have to go to make AA's product viable? Too low. The premium customer market is now level at 9%, down from the stratospheric levels of 14% or more that AMR enjoyed in 2000. That means revenue will remain below the breakeven point for the AMR business model. This problem surfaced in March of 2001 and was becoming a problem even before 9/11. The AMR revenue-pricing model is damaged. Stripping out labor costs will not make this model profitable until capacity is stripped out and revenue per seat mile rates increase significantly.

Cost per ASM at Southwest is approximately .076 cents per ASM. As demonstrated, dropping the pilots out of the AA formula will not make it competitive. It only reduces AA's cost per ASM to .1007 cents per ASM. The company's premium product, international service, and carrying costs for an infrastructure to support the product, drive costs well beyond Southwest's costs.

Are the labor force expenses, as a part of cost structures, in line between the two carriers? Yes. At Southwest labor has traditionally equalled 37% of costs. Pilot labor at Southwest equals .75 cents per ASM. Southwest's overall costs are 7.6 cents per ASM. For the past decade, pilot labor costs have remained at approximately 10% of the cost per ASM.
At AA, pilot costs equal 1.15 cents per ASM and costs are 11.22 cents per ASM. AA has done a fine job of managing these costs, but it still has to overcome the cost burden inherent with multiple fleets, extra training, and a higher percentage of reserves. Even if adjusted stage length costs are considered, the argument only gets stronger that AA labor reductions would still not make the airline competitive with Southwest. It's a product and revenue problem, not a pilot problem.

Management would like compare its pilot costs to other's pilot costs, but fairness dictates that it look outside the industry to see that, over the last decade, salaries have increased between 60 and 80%. Salaries for teachers and pilots continue to lag. For example:

- Delivering newspapers in NYC tops $100,000 a year.
- Sanitation engineers for Browning Ferris Waste Management can make between $80,000 and $90,000 a year.
- Nursing contracts in California are pegged to increase 38% on a base of over $100,000 a year.

Airlines know that they must address revenue issues. As the only controllable cost, labor is an easy target. But even Wall Street gets it, pointing out that revenues are lagging and business models are aging. Washington, DC is another matter. There the sell makes headlines such as: "labor intensive industry," or "Scope issues stifling service," or "broken RLA provisions threaten to disrupt service to your constituents." There is little admission that the industry is out of control or that customer choices have eroded the marketability of the premium revenue product. AA and other ATA carriers are utilizing congressional pressure to beat down your career in hopes of salvaging a profit depleted product. Airlines are selling Congress on the dream that 45% of future domestic travel should be in RJs.

While labor has always been ready to listen to the needs of the industry, we know that flying for free couldn't fix the ills that plague this battered industry. Here are the facts:

- If you and I fly for free, service to Brookings, SD will still need to be subsidized.
- If you and I fly for free, premium carriers will still need to fix their revenue problems.
- If you and I fly for free, we only give the company more time to delay making difficult decisions.

It's time for AMR to recognize that its pilots and entire workforce deserve respectful wages and safe work rules. As your union representatives, APA will demand it.