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Price Is Right at AMR

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A year after it reduced ticket prices as part of a fare restructuring that altered decades-old pricing patterns, **American Airlines** says the move has strengthened its appeal to business passengers and improved its financial performance.

"A certain group of our passengers had defected because they saw big price differences between what we were charging and what someone else was charging," said Scott Nason, American's vice president of revenue management, in an interview. "Now they have come back."

One example: Between 2002 and 2004, domestic passenger boardings at Miami International Airport, where American operates a hub, grew 4%. During the same period, boardings at nearby Fort Lauderdale-Hollywood International Airport, a favorite of low-fare carriers, grew 20%.

Since American restructured its fares, Miami boardings have increased 2.5%, despite a 6% decrease in capacity, while Fort Lauderdale boardings merely kept pace with capacity increases, growing 7% with 8% more capacity.

American, a unit of **AMR** (AMR:NYSE) moved to restructure its fare system in January 2005 after losing nearly $6 billion during the previous four years. It followed the lead of **Delta Air Lines** (DALRQ:OTC BB) by reducing the highest business fares, eliminating the Saturday-night stay requirement for budget fares and cutting the number of available fares on each flight.

The moves by two of the three biggest airlines reflected the reality that low-cost carriers were setting prices in the airline industry. In particular, American and Delta were under attack, with American facing intense low-fare competition from **JetBlue** (JBLU:Nasdaq) and others on its transcontinental and Florida-Northeast markets, while **AirTran** (AAI:NYSE) was eating away at Delta's traffic in Atlanta. Other majors followed in select markets.

The price change's effect on business travel was profound. In many markets, the cost of high-end tickets typically purchased by business travelers fell dramatically. For instance, the cost of a round-trip Dallas-La Guardia ticket, purchased on the day of departure, fell to $1,198 from $2,190.

Additionally, the requirement that a passenger stay over Saturday night to get a low fare, long lamented by business travelers, largely disappeared.

American says that the percentage of its passengers who stay over Saturday night has decreased to 47% from 49%, representing about 2 million people a year.

"These are changes that business travelers had been clamoring for," said Bob Harrell, president of consulting firm Harrell Associates. He said the airlines revised a pricing system that had essentially been in place since the mid-1970s, when improvements in global distribution systems enabled carriers to expand the number of "inventory buckets," or ticket-price classes, to about 10 from three previously.

The average one-way fare on the top 40 routes for seven major hub carriers (including America West Airlines) fell to $411 in mid-January 2005 from $576 in the first week of December 2004, Harrell said. The fare climbed back to $448 by late January 2006.

While it was Delta that moved first to restructure, it was American that benefited.

Like other carriers, American reported high load factors last year. In fact, American reported record load factors for every month of 2005. But what is unique, Nason said, is that in American's case, the trends were more pronounced.

"We moved from an airline with below-average load factors, and above-average yields, to one with load factors that were average or above average and yields that are still near the top of the industry, but not as much above the average," he said.

American said its 2004 load factor was 3.7% below the industry average. But in 2005, its domestic load factor increased 4.7 points to 79.8%, even as domestic capacity shrank 2.3%. The industry's average load factor through August was 77.5%, the airline said.

Remaining Seated
Change in domestic revenue per available seat mile for first three quarters of 2005

United	8.7%
American	8.5%
Continental	6.2%
Average	4.1%
Northwest	-1.1%
Delta	-0.1 %
US Airways	-5.1%

Source: Eclat Consulting

Similarly, rising ticket prices, which compensated for fuel-price increases, meant that most airlines reported improvements in revenue per available seat mile, as well as in yield in 2005. Again, American saw more pronounced improvements than other carriers did.

According to Eclat Consulting of Reston, Va., American's revenue per available seat mile improved by 8.5% in the first three quarters of 2004, while the average improvement for the six largest carriers was 4.1%. "American is managing its assets very effectively," said Gary Harig, Eclat's senior vice president. "Both load factor and unit revenue are going up faster than the industry average."

While (UAUA:Nasdaq) led American with an 8.7% RASM increase, its improvement seems to have resulted primarily from an 11% reduction in domestic capacity.

As for Delta, which showed a 0.1% RASM decline, its course has differed from American's since it introduced simplified fares. For one thing, Delta sought bankruptcy court protection in September. Also, its new fares included one-way caps, initially $499 for coach and $599 for first class, but both increased by $100 during the summer. American didn't cap its fares.

Delta spokeswoman Chris Kelly said fare simplification enabled Delta to "re-establish trust with the customer," adding that the airline "has had very positive results from customers." Financially, Kelly said, the fare simplification represented "a wash" for Delta, in which additional ticket sales compensated for the effect of lost revenue.