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## American and United Ready No-Frills Fares to Take on Discounters

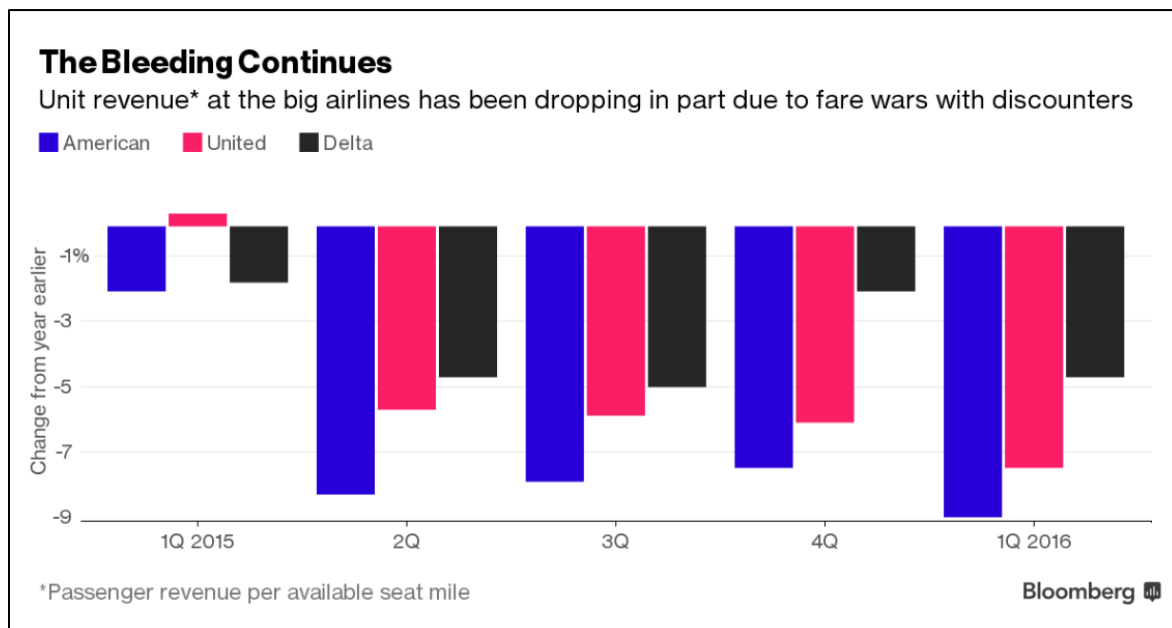
By Mary Schlangenstein

*IdeaWorksCompany contributed information to this article - - see italics.*

Stung by competition from ultra-discount carriers, American Airlines Group Inc. and United Continental Holdings Inc. are striking back with cheap, no-frills tickets of their own.

By year-end, the pair plans to lure budget travelers with basic-economy fares -- inexpensive tickets that don't include typical benefits like an assigned seat before you get to the airport. Taking a cue from Delta Air Lines Inc., the carriers also hope that once the new fares draw attention, the bare-bones features will prompt some customers to "buy up" to a pricier choice, aviation consultants said.

Basic economy is one prong of a broader effort by the largest U.S. carriers to bolster revenue from each seat flown a mile, a standard industry measure that has been battered for about a year, partly because of fare wars with discounters such as Spirit Airlines Inc. and Frontier Airlines Holdings Inc. The declines have helped push down the Bloomberg U.S. Airlines Index 17 percent this year through Thursday.



“Spirit and Frontier, by the choices they’ve made with recent expansion, have managed to give a poke at the dragon,” said Samuel Engel, head of the aviation practice at consultant ICF International. “When you start flying into the major carriers’ hubs instead of skimming a bit at their sides, you tend to evoke a competitive response.”

## **Discount Competition**

Passenger revenue for each seat flown a mile tumbled 8.9 percent at American in the first quarter from a year earlier, and fell 7.4 percent at United. Meanwhile, Spirit plans to boost capacity 65 percent this year in Los Angeles, an American hub, while Frontier will grow 12 percent in Denver, a core market for United, according to Credit Suisse Group AG.

American and United are still working out the details, but the rock-bottom fares could come with restrictions against upgrading the tickets or carry no ability to make changes or get refunds, in addition to allowing seat assignments only at the airport. American declined to comment as it continues to refine its offering. United declined to comment, referring only to previous remarks by executives.

It’s too early to know what effect the new fares will have on the ultra-discounters, according to a Spirit spokesman. A Frontier representative said the airline will watch to see how markets develop.

## **Weighing Risk**

*The strategy carries risks for the legacy airlines. American, United and Delta dominate the U.S. and have alliances with global carriers, advantages that would seem to negate the need to compete for the most price-conscious customer, said Jay Sorensen, a former Midwest Airlines executive who is now president of airline consultant IdeaWorksCompany.*

*“Something just seems very wrong here,” he said. “The analogy is like Kohl’s saying, ‘We’re going to have a section in our store dedicated to dollar deals because we think Dollar Store is a threat.’ You’d look at that and say, ‘Why are you doing that? That’s not your market.’”*

## **‘Wine List Effect’**

The big airlines see basic-economy fares as putting passengers into seats that otherwise would fly empty. A crucial part of the strategy is the “wine list effect” -- a tendency for people to avoid the least-expensive item offered in favor of a slightly higher-priced option, believing they’re getting a better value, Engel said.

The restrictions that come with the low fares may push buyers to higher-priced options, said Peter Belobaba, principal research scientist in the Department of Aeronautics and Astronautics at the Massachusetts Institute of Technology. "As a strategy, it's not a bad one" for the large carriers, he said.

Delta, which also is battling drops in unit revenue and already offers basic-economy fares, has acknowledged the dynamic in how passengers make decisions.

"When presented with the options, when they were informed of what this product was, those customers chose something else," Delta President Glen Hauenstein said on a conference call in April. Basic economy is available on about 2,000 domestic Delta routes, and the carrier plans to keep rolling it out this year.

Delta also has been experimenting by increasing some fares and putting restrictions on certain low-price options in an effort to keep revenue firm. It also has started requiring a round trip for some of its lowest fares, which previously were available for one-way flights.

### **Avoiding 'Buy-Down'**

United expects that many customers "will buy the next higher fare to preserve all of their frills, all of the things they're accustomed to," like priority boarding, Douglas Leo, senior vice president for revenue management, said at a March conference.

"This will help us improve revenue, reduce the risk of buy-down and it also helps us compete in a more surgical manner with ultra-low-cost carriers," Leo said.

"Segmenting products is a good way to compete and to offer those fares when you need to be competitive but not putting them out there and matching the entire economy cabin," said Michael Bentley of consulting firm Revenue Analytics.

American has said that 87 percent of its passengers -- accounting for half the airline's revenue -- flew on the carrier just once last year. For those people, air travel was probably purchased just on the basis of price, meaning 50 percent of the company's revenue was up for grabs, President Scott Kirby said.

"We have to compete for them," he said.