Legend Airlines: American Airlines' Worst Nightmare?

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ABSTRACT

This case reviews the air battles American Airlines (AA) and Legend Airlines (LA) engaged in over the right to fly out of Love Field in Dallas, Texas, the home of American Airlines based at Dallas-Fort Worth International Airport. Legend Airlines was attacking the industry with a value proposition of quality flights and superior customer service with a laser focus on passengers who traveled frequently and paid top fares. The case is designed for classroom discussion and application to understand the economic consequences American Airlines faced with the up-scale entry of Legend Airlines into the heart of American Airlines market.

Keywords: Airline Industry; Customer Service; Value Proposition

INTRODUCTION

Between 1978 - the year of deregulation - and 1990, there were 58 new airline ventures with only one - America West - surviving. However, America West flirted with failure for years and it had become clear that an airline based solely on lower fares does not work. In the late 1990's customer service was the only strategic marketing tool a carrier could use to pull customers away from an established airline. Years later, JetBlue had success with low fares coupled with high service quality.

Legend Airlines was attacking the industry from the other side with quality flights and superior customer service with a laser focus on passengers who traveled frequently and paid top fares. Legend's value proposition provided superior customer service with comparable prices in the Dallas market. However, the opportunity to test this proposition in the marketplace eluded Legend Airlines as it spent the majority of its existence locked in a legal battle with American Airlines.

THE LEGAL BATTLE

Legend Air was the worst nightmare that American Airlines could imagine. American Airlines' management waged a legal battle against Legend Airlines because business travelers are the lifeblood of the airline industry and American Airlines had no answer to compete in the marketplace. Though these full-fare passengers – "road warriors" in air-lingo – make up just 10% of the typical carrier's customers, but they account for nearly half its revenue. So adding or losing a few business types per flight can mean the difference between a profit and a loss.

The legal battle centered on Legend's right to use Love Field, conveniently located near downtown Dallas. Legend Airlines offered first class travel from the most convenient terminal in Dallas, but at coach prices. Although the Wright Amendment did not allow planes that seat more than 56 passengers to fly to states outside those contiguous to the state of Texas, Legend got around the restrictions by refitting the DC9 aircraft, which normally can carry 130 passengers, with 56 all leather, all first class seats. American Airlines sued in federal court to prevent Legend Airlines from operating out of Love Field under the provisions of the Wright Amendment. Each time Legend's right to fly was upheld by a court, American immediately appealed the decision to a higher court. The constant legal struggle was a serious drain on the fledgling company's financial resources and was a major factor in the Legend's eventual failure.

LEGEND AIRLINE'S VALUE PROPOSITION

Customer experience can be described as the satisfaction derived from the right combination of quality, customer service, and price. Legend Airline's value proposition was a direct result of applying creativity and innovation to solve consumer problems and to leverage opportunities that people face every day. Their value proposition was a result of a process of blending together quality, design, features and style into a need satisfying bundle, which, if costs are controlled, can be sold for a reasonable profit. Value-oriented firms, like Legend Airlines, do not make the mistake of being all things to all people, but instead make a promise to a specific segment that can and will be fulfilled.

The idea for Legend Airlines was born when a group of individuals who were fed up with the hassles of air travel felt it was time for an airline that offered business travelers a stress-free and productive travel *experience. They envisioned this airline would offer non-stop, long-haul service to major business destinations in the U.S with two wide seats per side, with footrests and satellite television available at each seat. Real food (prawns in butter sauce, or filet mignon recently) served on real china plates with complimentary wine or champagne. Upbeat flight attendants, and pilots who actually take the time to thank you for choosing their airline. And act like they really mean it* - all with the convenience of Dallas Love Field's proximity to downtown Dallas and in compliance with the existing federal laws governing Love Field. A Legend Airlines public relations release communicated the following:

Legend has built an executive terminal to cater to the business traveler, easing stress and increasing productivity with features such as curb side valet parking and instant check-in. Guests on Legend flights enjoy one of the lowest passengers to flight attendant ratios in the industry. Don't want to valet? That's OK, because Legend boasts the closest parking garage to a terminal of any major airport in the U.S. - it's practically at the front door. Inside, you will find luxury amenities such as club seating in a lounge-type environment, complete with DirecTV®, laptop connections and telephones, as well as a full-service business center, all to ensure you can take care of business before boarding your flight. All of this is offered at no greater cost than the typical coach fare on the other major airlines.

It was American's nightmare, but was a "dream come true" in comfort and service for those who spend way too much time in the air. Legend's founder, T. Allan McArtor, former head of the Federal Aviation Administration and former head of Federal Express' global airline, made two major points in an interview:

The decline in service levels, the uncomfortable and crowded seats, parking and baggage hassles, and the overall stress inherent in air travel was the opportunity for Legend to offer the harried business traveler a much-needed alternative.

Most business travelers view air transportation as a necessary evil. It has become public transportation, basically a taxicab with wings. Legend signals a return to style and service, but at a price within reach of the business traveler.

A Legend Airline PR release encapsulates the value proposition as:

- *Legend Airlines' Promises to our Customers Value: We promise to offer better products and services at competitive fares.*
- *Personalized Service: We promise to respect you both as a valued customer and as an individual.*
- *Reliability: We promise to provide consistent delivery of high-value, business-oriented services, ensuring you arrive at your destination safely…every time.*
- *Honesty: We promise to be honest and courteous in everything we say and do.*
- *Productivity: We promise to offer a stress-free travel experience by providing room to work and saving you time in addition to offering frequent non-stop flights to major business destinations.*
- *Downtown airport location, roomy seats, competitive fares and celebrity chef dining service.*

THE ECONOMIC REALITY

McArtor could not have conceived a worst nightmare for American Airlines. American Airlines chose to fight Legend Airlines in the courts rather than in the air. The economic reality that American Airline's management was dealing with is summarized below. McArtor planned to keep Legend aloft by using non-union labor and flying just one type of airline (DC-9) over a few choice routes. That way it can generate 27 cents of revenue for every seat-mile it flies, compared with about 14 cents for cost-laden airlines like American – an advantage that should allow Legend to break-even on flight that are little more than half full.

Legend's Service would be based in Dallas with flights from Love Field to Washington's Dulles (1,182 miles), Las Vegas (1,076 miles) and Los Angeles (1,251 miles), and industry estimates of some costs for these routes for the DC-9 are:

Route	Fixed costs per flight
Dallas-Washington	$8,270
Dallas-Las Vegas	7,469
Dallas-Los Angeles	8,796

Variable costs per passenger, given that Legend's cuisine such as berry crepes, poached salmon and grilled shrimp with mango sauce, fine wines and truffles, was significantly more upscale than the traditional offering of chicken "whatever" and beef "you guess what it is, that is" offered by American and other competitors would be much higher. Estimates of Legend's variable costs were $25.00 which was twice AA's cost ($12.50 per passenger).

As Legend and AA were utilizing the McDonnell Douglas DC-9, one of the world's most popular commercial air transports, as well as being comfortable, safe, and quiet. American Airlines had a 130 seat configuration while Legend was constrained to 56 seats.

THE ANALYSIS

If you were an analyst for American Airlines' operation center, how would you justify the argument that the Legend business model is a serious threat to the profitability of American Airlines? Consider the following.

- Compare side by side the operating income of flights between Dallas and any of the 2 Legend Airline destinations.
- What is the average fare for both airlines?
- While American Airlines has an average fare, what is the average fare for the "road warriors?"
- What is the implication of losing "road warrior" business to Legend Airlines?
- Illustrate what it is worth to provide outstanding customer service.

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TEACHING NOTES

This case provides an interesting opportunity for analysis of the competitive analysis that Legend Airlines created such a daunting advantage that American Airline took the legal route in fighting it. The key to untangling this analysis is in the sentence at the beginning of the case, *though these full-fare passengers – "road warriors," in air-lingo – make up just 10% of the typical carrier's customers, but they account for nearly half its revenue.*

- **Gathering the information**

The following information is used as input:

	Legend	**American**
Revenue per seat mile	$0.27	$0.14
Variable cost /flight/passenger	$25.00	$12.50
Seats	56	130

	DC	**Las Vegas**	**Los Angeles**
Fixed cost per flight - Dallas to	$8,270	$7,469	$8,796
Miles – Dallas to	1,182	1,076	1,251

- **Comparing Operating Income**

Legend's Situation

Capacity	100.0%			
Passengers	56			
		DC	Las Vegas	Los Angeles
	Average fare[1]	$319.14	$290.52	$337.77
	Revenue	$17,872	$16,269	$18,915
	less variable costs	1,400	1,400	1,400
	Contribution Margin	$16,472	$14,869	$17,515
	less fixed costs	8,270	7,469	8,796
	Profit Contribution	$8,202	$7,400	$8,719
	BEQ	28.1	28.1	28.1
	BE Capacity	50.2%	50.2%	50.2%

American's Situation

Capacity	100.0%			
Passengers	130			
		DC	Las Vegas	Los Angeles
	Average fare	$165.48	$150.64	$175.14
	Revenue	$21,512	$19,583	$22,768
	less variable costs	1,625	1,625	1,625
	Contribution Margin	$19,887	$17,958	$21,143
	less fixed costs	8,270	7,469	8,796
	Profit Contribution	$11,617	$10,489	$12,347
	BEQ	54.1	54.1	54.1
	BE Capacity	41.6%	41.6%	41.6%

At this point, the conclusion might be what is the issue? American Airline is quite profitable; however, digging deeper, the analysis will show the heart of the problem facing American Airlines.

[1] Average fare is calculated (Dallas to DC) as $.27 revenue per passenger mile x 1,182 miles = #319.14

- **Examining the value of the "Road Warriors"**

Let's examine just one route, Dallas to DC. The same can be shown for the other two routes. The following drives the analysis: "*"Road warriors" in air-lingo – make up just 10% of the typical carrier's customers, but they account for nearly half its revenue.*

For American Airline's DC-9 with 130 seats: 10% of seats occupied by road warriors are 13 seats. 50% of the revenue is 0.50% of $21,512 is $10,756, so average revenue per "road warrior" is $10,756 / 13 = $ 827.38. Average revenue for the rest of the plane is $10,756 / 117 = $ 91.93

A portioning of the plane shows the urgency that American Airlines faced.

	# of passengers	Average Fare	Revenue per seat mile
Road Warrior	13	$827.38	$0.700
Non Road Warrior	117	$91.93	$0.778

The road warrior to non- road warrior ratio for revenue per seat mile is about 9:1, meaning that for every road warrior lost, American will need to find nine non-road warrior fares to compensate for lost revenue. In a normal situation, this might be a viable option, but if American Airlines are at or near capacity, then the problem is exposed.

Epilogue

Since 2000, the large airlines moved towards providing a "business class" section in their planes to provide better service to their road warriors. Still the level of customer service falls short of the Legend model. There have other new startups, such as Eoa Airlines, MAXjet, L'Avion, and Silverjet, that targeted the cost conscious business traveler. On the other hand, the majors knew that steaks and champagne were a factor that attracted this market, but the critical factors were frequency and convenience, sometime the upstarts could not match.

