

**Office of the Vice President
Strategic Planning and Analysis
American Airlines, AMRCorp.**

American Airlines

April 10, 2003

Strategic Analysis Group
Eastern United States Division
Attention: Chief Strategist

Re: Revenue impact of extending "More Room" to Super 80s?

In recent years, as you know, we have come under sustained and increasing pricing pressure. Southwest and other discount airlines have expanded into many of our bread-and-butter routes and web price search engines have further sensitized many passengers to price. But we can't compete with the Southwests of the world purely on price. On a route like Baltimore-St. Louis, for example, our marginal costs are about \$50 per passenger while Southwest's are about \$20. Consequently, in late 2000 we introduced "More Room Throughout Coach", an ongoing marketing campaign that highlights a retrofit of some aircraft in our fleet (mostly those flying longer routes) to have fewer seats in coach. Now, we are exploring whether to expand "More Room" to models such as the Boeing MD-80 serving shorter routes.

We've selected Baltimore-St. Louis as one of a few representative routes to study in more depth. American and Southwest both fly this route, with similar schedules – Southwest has seven 737-300 flights per day (137 seats each), we have five MD-80s (139 seats each). The folks upstairs hired a team from KPMG to come in and make recommendations, but I haven't been impressed with their work so far and want your team to get on this as well. So far, they've collected time series load data for this route at various price points to estimate the expected load per plane for both Southwest and American for given Coach prices ranging from \$100 to \$500 per leg on average round-trip Coach fares. (See attached tables.) Currently, Southwest charges \$150 while we charge \$200.

There are several issues that I need you to address. First, are these prices sustainable in the future at current capacities? Should we expect strengthening, stable, or eroding prices given current capacities? Also, I'm worried about the worst case scenario in which passengers are not willing to pay extra for the additional leg-room. In this worst case, how much will it cost us in revenue per flight to reduce the number of seats that we offer by 10% (to 125 seats)? It will be important, of course, to think about how Southwest is likely to respond in terms of pricing. To keep things from getting too complicated, please just assume that Southwest does not retrofit its cabins.

Thank you, sincerely,

Roger A. Pembroke
Vice-President, SP&A

Table I
Average number of passengers on Southwest Airlines flights

		Price Charged by American Airlines								
		100	150	200	250	300	350	400	450	500
Price Charged by Southwest Airlines	100	137	137	137	137	137	137	137	137	137
	150	73	90	120	132	134	137	137	137	137
	200	24	35	78	117	131	134	136	137	137
	250	2	5	18	77	113	119	129	131	132
	300	0	1	4	11	75	106	113	122	126
	350	0	0	1	3	9	47	84	99	118
	400	0	0	0	0	1	2	19	65	98
	450	0	0	0	0	0	0	0	9	55
	500	0	0	0	0	0	0	0	0	7

Table II
Average number of passengers on American Airlines flights

		Price Charged by Southwest Airlines								
		100	150	200	250	300	350	400	450	500
Price Charged by American Airlines	100	139	139	139	139	139	139	139	139	139
	150	125	139	139	139	139	139	139	139	139
	200	108	134	132	139	139	139	139	139	139
	250	67	99	115	129	139	139	139	139	139
	300	45	50	96	114	127	138	139	139	139
	350	14	15	16	17	25	116	137	139	139
	400	13	13	14	15	16	19	120	135	139
	450	12	12	12	13	14	14	17	89	135
	500	10	10	10	10	11	12	13	15	39

Data tables courtesy of Mike Shor, Vanderbilt University.