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Recession forces airlines to rethink first class

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NEW YORK: A couple of years ago, airlines seemed to be falling over themselves to offer the best amenities to their first-and business-class customers on international flights.

They featured seats that turned into beds, gourmet food, personal televisions, even designer sleepwear. And no wonder. Those passengers may have occupied just the front of the plane but they represented a significant part of airline revenue.

The economic downturn changed all of that, as the number of travelers buying those premium tickets on long flights dropped precipitously.

So now, to try to stem losses, some airlines are considering shrinking their business-and first-class sections or even eliminating first-class service, as Continental, Delta and others already have done. One option for some airlines is introducing, or expanding, a level of service called premium economy, which falls between economy and business class in price and amenities. United Airlines, Cathay Pacific and Qantas are among those weighing such changes.

"In building up their premium classes, airlines have been building themselves a castle in the air that's ultimately unsupportable," said Peter Morris, the chief economist in London for Ascend Worldwide, an aviation consulting company. "Unless the business world carries on expanding its needs for these services, the castle, to some extent, will come crashing down."

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Financial companies, which once thought nothing of paying thousands of dollars to send a banker from New York to London on a day's notice, are now watching their expenses more closely. And fewer deals are being done. Business travel to Asia plummeted in the general financial collapse, as consumers bought fewer products from that region and the capital markets dried up.

"With cuts in corporate travel budgets, there is now much less willingness to pay up to eight times the fare on long haul for the extra leg room and champagne offered by business class," Morris said.

In its latest global forecast, issued last week, the International Air Transport Association, an industry trade group, predicted that airlines worldwide would lose \$11 billion this year, a loss \$2 billion greater than it forecast in June. A major contributor to the loss, it said, would be a 20 percent drop in the number of first-and business-class passengers.

Nor has the damage to airlines' bottom lines been distributed equally. The association found that premium traffic on North Atlantic routes was 15.8 percent lower in the first seven months of 2009 than in the same period of 2008, while trans-Pacific premium traffic was down 26.6 percent in the first seven months of this year from 2008.

In July alone, revenue from passengers traveling in premium classes was 35 to 40 percent below July 2008, the association estimated.

Airlines charge a lot more to sit in the front of a plane. To get a sense of how much more, consider these prices that United Airlines charges for a round-trip flight between O'Hare International Airport in Chicago and Hong Kong. An economy-class seat is listed at \$810, a business-class seat at \$8,770 and a first-class ticket, \$17,524. For what it calls Economy Plus on that flight, the price is \$1,068. All fares are nonrefundable.

Henry H. Harteveltdt, travel analyst for Forrester Research, said first- and business-class

passengers on airlines' international flights generated 30 percent or more of passenger revenue, while Corrine Png, Asian aviation analyst for JPMorgan in Singapore, estimated that business- and first-class passengers represented 40 percent of passenger revenue at Cathay Pacific and Singapore airlines, among others.

While the global economy is beginning to show signs of recovery, industry officials and analysts say they do not expect revenue from international premium air travel to return to the old level soon – if ever. "While yields can easily fall, they almost never recover," Giovanni Bisignani, director general of the International Air Transport Association, said last week. "So the fall in yields could be a long-lasting structural change."

Morris said he expected that airlines would look at creating more products and services that fall between first class and economy "to reflect the new reality, particularly for corporate travelers."

One of those options is premium economy, which Harteveltdt described as "less than half the price of business class, but it's pretty good, often with a first-class amount of legroom, a seat as wide as that in first class on domestic flights, and sometimes a footrest."

Air France and KLM, its sister airline, have announced that they are introducing premium economy-class services on long flights. Air France's service will occupy its own section; KLM's will be in the front of the economy section.

Brian Pearce, the chief economist at the International Air Transport Association, said other airlines were considering changing their cabins around, "But it's expensive to reconfigure."

Similarly, Harteveltdt said, "Airline executives are telling me that for the foreseeable future, the day of the \$10,000 business-class ticket is gone, and, in some cases, I'm hearing airline executives question if they should keep first class."

Tony Tyler, chief executive of Cathay Pacific, told an aviation conference this month that his airline had created a full-time team to "look at our business model in light of the economic changes we've been experiencing."

One step it is considering, he said in a telephone interview, is replacing some business-class seats with economy seats on aircraft like the 777-300 that operate within Asia.

In May, Qantas stopped offering first-class service on flights from Sydney to Buenos Aires and to San Francisco, and on the Melbourne-to-Hong Kong-to-London route, through Oct. 31. And Alan Joyce, the chief executive of Qantas, told The Australian in June that his airline is also considering reducing the size of business class on some of the 16 A380 aircraft it has on order from Airbus.

"Ideally, with the amount of aircraft we have coming, we would like less business-class seats and more premium economy," Joyce said.

In a recent conference call with airline analysts, John P. Tague, the executive vice president of the UAL Corp., the parent of United Airlines, said, "We're going to have to see where corporate travel settles out between the Economy Plus cabin, for example, internationally, and business class." United has opportunities, he added, to "enhance what comes along with the Economy Plus if we see a sustained appetite for long-haul corporate interest there."

Damien Horth, airline analyst for UBS in Hong Kong, said: "The question is, How long will it take premium traffic to come back? Everyone is remaining focused on it. It's quite possible airlines will change the product; they will re-evaluate it next year. What the industry needs to understand is what is the new normal for premium-class demand." But Pearce, the transport association economist, said that competition could prevent some airlines from changing in-flight services. "If they are offering a lesser product than a competitor, they will lose customers," he said. "It's a complicated issue to decide upon."

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