CHAPTER 2

DISTINGUISHED SPEAKER: EMPLOYEE OWNERSHIP, A UNION APPOINTED DIRECTOR, AND PROFITS: THE TWA STORY

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It is my pleasure to address the Academy and talk about my favorite subject—Trans World Airlines (TWA). I'll say a little bit about employee ownership as well.

TWA is an airline of significant historical value, not just to this country but to the world. We're an airline that's been in business more than 70 years. After World War II we pioneered airline service across the Atlantic, and have been flying those routes more than 50 years. We were the first airline to fly coast to coast across the United States. We were the airline of Amelia Earhart. We were the airline of Charles Lindbergh. And we were owned by Howard Hughes.

But we are also an airline that's been through a very tortuous decade and a half. It began in 1985 when Carl Icahn raided TWA. During those times, leveraged buyouts were the craze of the country; many companies were taken over by corporate raiders in an attempt to get greenmail, etc. Carl Icahn put $3 billion of debt on TWA—debt that was borrowed from Drexel, Burnham, Lambert and Michael Milken at interest rates of 16, 17, and 18 percent. The company had interest expenses of a million dollars a day. It was a decade and a half of disinvestments, and the result was inevitable. The company went bankrupt twice in the early 1990s.

Now our company is clearly on the road to recovery. A year and a half ago our CEO and chairman, Gerry Gitner, and I were asked by the board of directors to join the management team. It took us about 2 days to decide what the strategy of the company should be. TWA had put out a very poor product for a decade and a half. Of the 10 largest airlines, TWA had ranked tenth in on-time performance for 10 consecutive years. Unbelievable, but true. We de-

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cided to focus on cleanliness, timeliness, and reliability. I'm happy to say that it worked. It worked because of 22,000 employees who wanted to succeed and wanted to provide a product that could assure our company's survival.

By the second quarter of 1997, TWA had moved in 6 months from tenth in on-time performance to first. We were number one in the third quarter as well. In 1997, TWA had 21 days in which it completed every single one of its 830 daily flights. No other airline in America or the world could say that. We completed 98.6 percent of our flights for the year. And last month, J.D. Power & Associates, who surveyed 6,000 people who had flown at least 27 round trips the previous year, recognized TWA as the number one airline in the United States for long-haul travel. This is a very important accomplishment on behalf of the TWA employees because they were recognized by the people who are important to every airline—the frequent business traveler.

Also in the last 6 months, we've raised $600 million, showing that Wall Street now has faith in our company. By the end of 1999, one-third of our fleet will be new. At the end of 1996, our average fleet age was 19 years. At the end of 1999, with our known aircraft orders, the fleet age will be 11 ½ years. We are on the verge of profitability.

Now to say you're on the "verge of profitability" is not much of an accomplishment in a capitalistic society, because all companies are supposed to be profitable. But for TWA that statement is news. In the 28 years since 1970, our company has lost $1.265 billion. How can a company do that in a capitalistic society and still survive? TWA did that by burning the furniture and seeking and gaining concessions from our employees.

So here we are on the verge of profitability. Had I addressed this group 3 years ago, I would have addressed you not as president and chief operating officer of TWA, but as the master chairman of the master executive council at the Air Line Pilots Association. When I told people that title, I always felt that I should be wearing a Shriner's cap. I don't know how they ever determined master chairman of the master executive council, but I was the elected leader of the TWA pilots. My transition from union leader to a management person began 30 years ago when I started my very stable career as a 21-year-old pilot with TWA: hired in '68, furloughed in '71, recalled in '72, furloughed in '74, recalled in '76, furloughed in '81, recalled in '84. I got my first inkling that I had a union bias during the second furlough. I also learned my first major lesson in labor-management negotiations.

In that second furlough, I went abroad to continue my trade. You may remember that the airline business was regulated until 1978. So if you were a pilot and you lost your job there was nowhere to go in the United States to continue your trade. You had to go abroad. I went to Nigeria and flew Muslim pilgrims from Lagos, Nigeria, to Mecca. And this is where I got my union bias, my first labor-management negotiating skills. When we were hired—we meaning the pilots and flight attendants—we'd all been promised that we'd be paid every 2 weeks. Having been there 6 weeks with no pay, we decided that we had to take some action. I was scheduled to ferry the airplane from Lagos on the west coast of Africa to Amman, Jordan, for maintenance. I suggested to all the cabin crews and the cockpit crews that if they would join me at the airport with an overnight bag, I would assure that they would all get paid. We filed a flight plan for Amman. When we left Nigerian air space, we made a left turn and we flew to Heathrow Airport in London. We transported ourselves to the Metropole Hotel in downtown London where I called the managing director of Nigeria Airways and told him, "I've got 100 percent of your crews and 33 percent of your fleet. If you want either back you need to pay us tomorrow." Needless to say, the next day the managing director showed up in London with a briefcase of $100 bills U.S. and we all got paid. From that point on we were paid on time every 2 weeks.

My second inkling of a developing union bias came after I was recalled from the third furlough in 1984. One year after that Carl Icahn did his raid on TWA. He was able to secure from TWA employees—both voluntarily and involuntarily—$200 million a year in concessions in exchange for 10 percent equity in the company. I was disenchanted with the deal and ran for the Negotiation Committee, later becoming its chairman, and then the elected leader of TWA pilots.

In 1988, Carl Icahn took the company private, an amazing deal. He went from 70 percent ownership to 90 percent ownership. He issued to himself $350 million worth of merger preferred stock and he took $400 million in cash out of the company. When he came to TWA, Carl Icahn was probably worth $90 million. He's a billionaire now, a fortune built on the backs of TWA and its employees.

There was no way TWA could service the $3 billion of debt. It was absolutely mathematically impossible. Icahn had to continue burning the furniture. He sold TWA's London routes from New York, Boston, Philadelphia, Baltimore, Chicago-O'Hare, and Los Angeles. In an instant, the company's revenue dropped $1 billion per year. The result was inevitable. TWA declared bankruptcy in 1992 and the 10 percent ownership that the employees had was wiped out in those proceedings.

The creditors and the employees got together to try to save the company. The creditors agreed to forgive $1 billion in debt and the employees agreed to give up 15 percent of their wages. That concession amounted to $200 million a year, in addition to the $200 million they provided Icahn when he came along. In exchange, the employees got 45 percent ownership of the company, board representation, and the surrender of ownership by Carl Icahn. Along with a requirement that Icahn lend the company $200 million, they also secured the resignation of Icahn's board of directors.

Although the company emerged from bankruptcy, it found thereafter that not enough of the debt had been eradicated. In 1994–1995, the company entered another bankruptcy. In those proceedings half a billion dollars in debt was eradicated and the employees made work rule concessions totaling $100 million. Remember, they had already conceded $200 million 2 years earlier, and $200 million a decade earlier. Also, the 45 percent ownership they took in the first bankruptcy was wiped out. Employees came out of the second bankruptcy with 30 percent ownership of the company.

Operating performance continued to be bad coming out of each bankruptcy, as I indicated earlier with reference to on-time performance, the flight completion factor, and the customer product. The board of directors decided to make a change in management. They asked Gerry Gitner to come on as the chairman and CEO. He was an independent board member. The board also asked me to leave my position as a union board member and take a position in senior management. It was a courageous move by our board and you can imagine what the reaction was on Wall Street: "Oh great! TWA's got a union leader running the company now." But, nevertheless, TWA is now the number one on-time airline. According to J.D. Power & Associates, TWA is now the best airline in the country. TWA now has more cash than it has had in half a decade. TWA now has a modernized fleet. And TWA now had demand for its product. A year ago our load factors lagged the industry by 6 percentage points. I'm happy to say today that we have premium in load factors in the industry of 2 percentage points. Led by its employees, TWA has made a dramatic turnaround.

During my stint as a union leader, I believed in employee ownership. I continue to believe in employee ownership, and have negotiated for it on two different occasions. The jury is still out as to whether employee ownership does or does not work. But the theory makes all the sense in the world, especially in the airline business, which is highly leveraged, and in which a profit of 5–8 percent of revenue is viewed as extraordinary in a world where 15 and 20 percent returns are normal. Labor costs at virtually every airline amount to one-third of their expenses. In our industry, there's not much that differentiates air carriers. All of the U.S. airlines are safe. All of them have similar fares. All of them fly the same type of aircraft. What differentiates the successful carriers from those that are not is customer service: how customers are treated. And the theory of employee ownership addresses that very aggressively. When employees become shareholders, they also become interested in the financial returns of the company. They begin to understand that everything comes from the customer. If you treat the customer with care, that customer will take care of you as the company and you as an employee.

To this point, however, employee ownership has not worked to the degree that it should—for a variety of reasons. One, I believe, is that the employees do not view it as a part of their compensation package. Generally, the stock is put into an employee stock ownership plan or a retirement program. Employees cannot buy new cars, new refrigerators, or pay the rent with that stock until they've retired or left the company. There's got to be a way to get the stock into the hands of the employees prior to their leaving the company.

Also, management has not done a very good job of educating the work force as to the value of employee ownership. Unions have used employee ownership not as a goal or objective, per se, but simply as the only quid pro quo that people could get as a part of the concession. It was something that was taken, because it was something that could be gotten. And the company did not give employee ownership because they believed in it, but because that's all they had to give.

Some view employee ownership as power. I view it as opportunity. I viewed it that way as a labor leader, and I view it that way as a manager. There are no guarantees, no instant gratification. But employee ownership provides a framework for progressive labor-management relationships. Will it work in a day? It will not. Will it work in a month? It will not. Will it work in a year? It probably will not. Will it work in 5 or 10 years? I believe that it will. You will always have the conventional requirements of labor. They must negotiate the contracts for their members, they must attend to and represent the employees. And you will always have the conventional responsibilities of management. But employee ownership brings one thing. It brings opportunity. Opportunity to enhance an employee network. Opportunity to influence but not drive the direction of the company. Opportunity to educate management and the board. That's very important. There's a lot American industry management can learn from employees. I'm fond of saying if you want to know how to load the rear belly of a DC-9, ask the individual who 8 hours a day, 5 days a week, 50 weeks a year loads the rear belly of a DC-9. It's an opportunity for management. It's an opportunity for labor to change the process of producing and delivering the product. It's an opportunity to influence corporate strategy. It's an opportunity to understand the reality of the company's finances and the capability for increased wages and benefits. It's an opportunity to discover that there are not two sets of books. I didn't learn that until I came over to the management side. Employee ownership is also an opportunity to foster cooperative versus adversarial relationships. That is very important in a low-margin business. An airline is a very low-margin business with a large number of uncontrollable costs, from fuel to parts to landing fees to aircraft.

Historically, the labor-management relationship in the airline business has been very adversarial. I don't know if that is a result of the regulative environment or of the cyclical nature of the business. But most certainly it is the result of the distrust between the parties—management not trusting labor and labor not trusting management.

Employee ownership and board representation put labor and management on more level footing, where both sides have the same level of information. I believe that given the same level of information, people will reach the same conclusions 90 percent of the time. Problems occur when there are different levels of information.

When I came onto the TWA board of directors in 1993 as one of four labor representatives, there was a high level of distrust on the board. Management did not trust the labor representatives, and vice versa.

Labor representatives now have been sitting on the TWA board for 5 years. Most of our directors clearly recognize the value of such representation. But it is only as valuable as the individuals the union selects. If the union puts on a constructive individual, that individual will engender respect and influence the direction of the company. But if the union selects someone with a narrow, parochial view, that person will not gain respect or influence, and the negotiated value of the board position to the union will be lost. The labor seat provides peripheral vision for both labor and management. It gives labor representatives a better understanding of a very complicated business. But it also gives them an opportunity to shape the strategy and the vision of the company. I believe in employee ownership. I believe in board representation for labor. I'm extremely proud of the 21,000 TWA employees and the unions that represent them. I touched briefly on the tortuous decade and a half where our employees had to make very tough and uncomfortable decisions over and over again. And they did it consciously to avoid the fate of Braniff, Eastern, and Pan Am, and to live for a better day. The better days are upon us at TWA.