Scott Kirby has a very specific view about how the three U.S. hub-and-spoke airlines work best, having managed two of them. In his current job as president of United Continental Holdings Inc., Kirby’s role is to oversee a major overhaul of how the carrier operates, beginning with a broad restructuring of its three domestic-focused hubs in Chicago, Denver and Houston.

By United’s math, this trio has profit margins that are 10 percent below the inland domestic hubs operated by American Airlines Group Inc. and Delta Air Lines Inc. That gap is one big reason for United’s third-place finish among the three in recent years.

The troubles, Kirby explained, began shortly after United swallowed up Continental back in 2010. United’s post-merger decision to shrink, forced by investor demands that the carrier curb capacity to bolster fares and profits, was a weak choice, he said. United cut seat growth domestically by 8 percent over the next six years, while Delta and American grew 8 percent and 3 percent, respectively, according to United. That growth by its rivals put United on the defensive as they made inroads into its Middle America hubs.

Almost halfway through his second year as CEO of United, Kirby, 50, wants to reverse this trend.

“Our growth and strengthening our hubs is absolutely the critical, essential element to driving higher ... margins at United,” Kirby recently said in response to a dubious analyst. “I’m absolutely certain about it.”

Analysts and investors largely agree with his diagnosis of United’s ills, if not his prescription—sustained growth. Annual capacity expansion of as high as 6 percent until 2021, or “nearly the equivalent of another Spirit-sized airline,” JPMorgan analyst Jamie Baker said in a client note, has sparked deep discomfort in some quarters.

Such an aggressive move by a mature U.S. airline is a throwback to the 1990s, when major carriers were more than happy to throw elbows in a bid for supremacy. These days, it’s simply not done in polite aviation company. “United is, to some degree, ripping up the airline economics playbook from the past decade,” said Seth Kaplan, managing partner of trade journal Airline Weekly.

Kirby’s expansion comes at a time when the overall industry is already adding capacity. In 2018, an uptick of about 5 percent is expected despite steadily rising Brent crude oil prices that have already climbed 30 percent in the past six months. While airlines still think they can boost profits in this climate, it’s possible fares may end up falling, leaving consumers the winner.

Kirby’s strategy has several underlying principles, which United said it will use to track its progress:

**Hub strength**

Airport hubs are the key and represent the heart of a network airline’s profits. But critical to this premise is that the hub’s dominant carrier must truly dominate—and United lags markedly in this...
area compared with Delta in Atlanta and Detroit, or with American in Charlotte and Dallas.\(^1\)

“Arguably, United has no choice but to either shrink drastically or to pursue this path, and Scott Kirby wasn’t hired to shrink anything,” Wolfe Research analyst Hunter Keay wrote in a Jan. 23 client note.

**Connections**

Today, United has fewer connections, departures and destinations from Chicago, Denver and Houston compared with what American and Delta offer from their similar hubs. “A hub-and-spoke airline is really a manufacturing company and it is about manufacturing connections,” Kirby told analysts, calling these transfers “the magic elixir that makes hubs successful.” \(^2\)

In Airlines 101, connections correlate to profit because much of that traffic is starting or ending a trip at an airport with less competition, where fares are higher, or what the industry calls “high-yield flow traffic.” As part of its strategy, United is boosting connections in its three mid-continent hubs by an average of 17 percent by adjusting its flight schedules, a process it’s completed in Houston and will commence in Chicago next month.

**Small cities**

United’s domestic shrinkage involved retreats from the smaller “spoke” cities where people usually pay a premium to fly, burgs such as Champaign, Illinois, Elmira, New York, and Wilmington, North Carolina. These “high-yield” cities have gained even greater importance in an era when many routes have seen fares drop due to low-cost competition. (Such as Chicago-New York City, which United has cited.)

United has fewer small-city routes from which to glean these profits than Delta and American; 26 percent of its passengers are from large cities—where the yield is roughly 5 cents per mile below small ones—compared with 30 percent for American and Delta. So, to fix that, United is adding 31 new regional jets to its fleet this year to help penetrate smaller markets.\(^3\)

**Efficiency**

United is a far more seasonal airline than American, Delta, and even Southwest Airlines Co. in terms of how much flying it does in August, the peak, versus January, the slowest month. Given the same employees, gates and airplanes on the books all year, this low-season schedule posture...

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\(^1\) aiR footnote: a short list of who dominates which major hub, for the four major largest airlines: AAL (CLT, DFW, MIA, PHL); DAL: (ATL, MSP, SLC); UAL (KCLE, KIAD, KIAH); and SWA (KBWI, KMDW). Most other major hubs are duopolies; four that stand out are KDEN (SWA-UAL), KORD (AAL-UAL), KPHX (AAL-SWA), and KSEA (ASA-DAL).

\(^2\) aiR footnote: These connections drive airline profits at major hubs, while also driving impacts upon area residents. Neither FAA nor airport authorities feel any obligation to tamp down airline excessive scheduling for hub profits. Why not? Because, airport fee revenues and grant monies are pinned to enplanements, so airport authorities are highly incentivized to ignore impacts; also, FAA see’s its role as serving airlines first (plus, opportunities for post-retirement income in consulting also incentivize FAA employees to be ‘kind’ while pretending to regulate the airlines).

\(^3\) aiR footnote: People need to understand that, when a major carrier ‘adds regional jets’, it means the carrier is putting the screws on the pilots and other unionized employees, by outsourcing. These regional carriers offer much lower pay, so much so that employees suffer higher levels of fatigue, often necessitated by insane air-commutes. The Colgan crash in Buffalo, and Comair at Lexington, are two classic fatal disasters by fatigued regional flight crews.
is a drag on costs. Increasing “asset efficiency” through greater employee productivity, more
daily flying time and boosting gate use is key, Chief Financial Officer Andrew Levy said.
While Kirby puts his troops in motion, his two rivals aren’t sitting still. American, the largest
airline, has announced similar moves this year with new routes from its hubs, flights such as
Philadelphia-Oklahoma City and Dallas-Fort Worth-Panama City, Florida. Its growth involves
52 new nonstop routes, including international.
In separate analyst talks last week, Kirby and American CEO Doug Parker conceded that these
capacity expansions will cause each of the Big Three to lose passengers in small cities where
competition increases, with some consumers in Panama City and Rochester, Minnesota,
defecting to a rival.
Airlines have been quick to address the natural next thought. Despite more spokes extending
from more hubs, fare wars are unlikely to erupt, Kirby said, adding that capacity will adjust to
demand over time. Gary Kelly, chief executive of Southwest, the largest U.S. carrier measured
by domestic traffic, also sought to dampen talk of lower ticket prices, as did Gordon Bethune, the
former CEO of Continental Airlines. “They’re not stupid people over there at United,” Bethune
said Wednesday on CNBC, adding that “I really wouldn’t worry about the four big boys getting
into a fare war.”
Wall Street isn’t buying that at all. United’s growth plans sparked a widespread sell-off, sending
its shares plummeting by more than 13 percent last week, while American and Delta slid 8.6
percent and 7.9 percent, respectively. Southwest and Alaska Air Group Inc. shares fell about 6.5
percent.
What remains to be seen, of course, is whether United directors have the stomach for its
managers’ multi-year curatives. Investors demand return now, not in the early 2020s, and “can’t
take two spoons of castor oil today” as they wait for the airline’s domestic network to get fixed,
Bloomberg Intelligence analyst George Ferguson said. “That’s the problem—capital is fluid and
this is not a space that has a lot of patient capital inside it.”