Case Study 8.3

United Airlines

In July 1994, United Airlines (UA), which has now merged with Continental Airlines to form United Continental Holdings, publicly launched its Employee Stock Ownership Plan (ESOP). The ESOP (which is a financial instrument used to transfer ownership of a company, in the form of shares, to employees) purchased 55% of the company's shares, making UA's 85,000 employees the company's largest shareholders and UA became, for a time, the largest employee owned company in the world. In December 2002, with shares in the company only worth $0.82, UA filed for Chapter 11 bankruptcy in the US, resulting in the biggest bankruptcy in American airline history and bringing an end to the company's brief flirtation with employee ownership.

How the ESOP came about

The eventual launch of the ESOP in 1994 was actually the 4th attempt to introduce employee ownership to UA. During the mid 1980's, the Air Line Pilots Association (ALPA), the union that represented the pilots in UA, mooted the possibility of employee ownership in response to a strike around that time.

The ESOP implemented in 1994 arose out of a need to restructure labour contracts in the face of economic turbulence in the airline industry. Southwest Airlines, with its disruptive new business model of high volume flights and low costs (replicated by Ryanair and Easyjet to name a few), forced other airlines to adapt or face ruin. The management of UA saw it necessary to cut their labour costs, among other initiatives, to remain competitive in a rapidly evolving industry. Anticipating this loss in wages and benefits, a number of the more powerful unions in UA, in particular ALPA and the International Association of Machinists (AIM), proposed transferring some of the equity to the employees of the company. After negotiations with senior management, a deal was announced in July 1994 and the ESOP was publicly announced. In exchange for a 55% equity stake in the company, the unions agreed to wages and benefits concessions of $4.88bn.

Early performance

Between the launch of the ESOP and the end of 1996, UA 'soared'. The share price rose to its highest in the history of the company in 1995, increasing the collective value of all the shares in UA by over $4bn. Both management and the unions embraced the concept of employee ownership during this time and this was reflected in the operations of the company. Firstly, three employees were entitled to sit on the board of directors (out of twelve seats in total), giving employees a significant stake in the governance of the organisation. UA incorporated employee ownership into its marketing strategy, changing its slogan from 'Come fly the friendly Skies' to 'Come fly *our* friendly skies'. Increased employee participation also generated savings in the company, including an estimated $20m reduction in fuel costs in 1995 due to a solution proposed by a panel consisting of pilots, ramp workers and managers. Most of the benefits outlined below stemmed from the creation of cross-functional BOB ('Best of Business') teams, who's purpose was to find solutions to organisational problems through increased collaboration between different employee groups. CEO Jerry Greenwald and other senior managers were championing employee ownership at every opportunity and the company went from strength to strength.

Table 1-Performance benefits 1995

Increase in share price (%)	120%
Reduction in absenteeism (%)	17%
Increased revenue per employee (%)	10%
Reduction in employee grievances (%)	74%
Reduction in compensation claims (%)	17%

Source: Business week

Issues

The record levels of profit generated by the airlines in 1995 (over $2bn) and a bull run in the stock market helped to mask the early issues with the ESOP, outlined below. As soon as the share price began to fall due to volatile trading conditions, these issues surfaced and proceeded to erode the initial benefits of the ESOP.

Firstly, The Association of Flight Attendants, the union representing the UA's flight attendants, never opted into the ESOP as they felt that their members (some 20,000 of them) could not afford concessions ranging from 15% - 24% and also has a mistrust of management stemming from an ongoing dispute. Therefore, the 55% equity the ESOP held in the company was not representative of the entire employee base (it could be argued that the flight attendants were the group who most deserved to be employee-owners as they interacted with the customers on a daily basis).

Problems also arose in upper management and in the leadership at the trade unions. Initial senior management support faded after the first two years and changes in the leadership of ALPA resulted in two of the initial champions of the ESOP, Rick Dubrinsky and Roger Hall, being removed from their positions in the union. Similarly, senior management who were originally opposed to the ESOP grew more vocal in their criticism and some privately admitted to thinking employee ownership was a bad idea.

A new marketing campaign abandoned using the concept of employee ownership as a competitive advantage and decided to use the slogan "United Rising", which transpired to be a highly unsuccessful marketing campaign that only further served to irk customers).

Finally, the length of the ESOP caused some consternation amongst employees. The ESOP was designed so that after five years, no more shares would be purchased and distributed to employees. This meant that any employees who joined the company after this time would not receive any shares nor would existing employees gain more shares.

This is the end…

UA's problems worsened throughout the late 1990's and tough economic conditions, as well as the terror attacks on September 11, brought the company to its knees. On December 9th 2002, UA filed for Chapter 11 Bankruptcy with 83,000 staff and a net loss of $1.74bn to September. Employee ownership critics were quick to point out that the company's failing was due to the ESOP and now the company is part of United Continental Holdings, which operates an employee share scheme; in 2010 the company expects to distribute $224m in profit sharing to its workers.

Rick Dubinsky, formerly of the pilots union and one of the chief architects of the ESOP, summed up UA's ESOP with a striking metaphor. He described the ESOP as a$4.88bn dollar gift with a ribbon attached. The gift was situated in a stadium with 85,000 participants. In seven years, not one of those participants figured out how to untie the ribbon and open the gift.