



Gerald Grinstein

With Delta Reeling, Chief Plans Unusual Bet on Premium Routes

As Losses Mount, Mr. Grinstein Pairs Cost Cuts With Extras; Leather Seats in Coach

Big Risks in Crowded Skies

By EVAN PEREZ

ATLANTA -- One sweltering day in June, Delta Air Lines Chief Executive Gerald Grinstein tried to pep up a crowd gathered to mark the struggling airline's 75th anniversary. His best shot: the tale of how Delta overcame disaster when the stock-market crash of 1929 grounded its first attempt to evolve from crop dusting to carrying passengers.

Seven months after taking over as CEO of the third-largest U.S. airline, the 72-year-old Mr. Grinstein is working feverishly to save Delta from catastrophe again. Already in trouble before the Sept. 11 attacks and in near free-fall since, Delta has had losses of more than \$5.6 billion over the past three years and racked up \$20.6 billion in debt. If it keeps burning through cash at its current rate of more than \$4 million a day, it may be forced to file for bankruptcy in the fall, according to internal company calculations.

Like his rivals at the other traditional carriers, Mr. Grinstein has improved Delta's efficiency by taking a careful look at low-cost Southwest Airlines. But instead of simply hoping that customers won't notice the cuts, Mr. Grinstein is pairing them with service improvements, aiming to chart a new flight path for a profitable full-service airline. In a time when plane tickets have become largely a price-driven commodity, he wants to take a page from Starbucks and customize the flying experience on Delta to justify charging a modest premium.

Many specifics of Mr. Grinstein's plans remain closely guarded, and he declined to be interviewed. But according to people familiar with his thinking and to accounts of recent discussions among senior management and investors, Mr. Grinstein has plans to gamble Delta's future on an unusual strategy. It would cede some market share in the U.S.; increase spending to improve customer service and amenities; and, most radically, focus Delta on tapping the last truly rich vein of passenger aviation: flights across the Atlantic, to Latin America, and between the East and West coasts. Those long routes are the last passenger-airline sector in which major airlines have held their own against low-cost competitors, and where more passengers remain willing to pay for the comfort of spacious jets and attentive service.

"Our aim should be to become a long-haul carrier," Mr. Grinstein said in one meeting with employees earlier this summer, according to several people who were present. Quizzed by a doubter who said the idea sounded like the last-gasp strategy of now-defunct Pan Am in the 1980s, Mr. Grinstein rejoined, "No, that's the future," these people said.

How much of Mr. Grinstein's big vision for Delta will survive once the ideas meet reality isn't certain. In a meeting this week, the chief executive will begin to try to win over the board to important elements of his plan.

The risks are clear, in a business where rivals would likely move quickly to challenge any well-laid plans and where restructuring often proves difficult. In the transcontinental markets, for example, UAL Corp.'s United Airlines, the No. 2 carrier, has announced it plans a new premium service for some routes. Industry analysts say it's partly to head off Virgin Group's plans for a flashy new domestic U.S. discount carrier. Already, the premium revenue of the transcontinental market lured airlines into increasing capacity and caused a bruising competition this spring. Some of Delta's plans are similar to a strategy British Airways pursued after it embarked on its own restructuring in 2000. That project is still a work in progress.

Meanwhile, in talks with the rank and file, Mr. Grinstein has criticized prior management's mistakes and presented himself as a sharp departure, despite having been a Delta director for the past 17 years.

Leaders of Delta's pilots union have blasted the company's demand for \$1 billion in give-backs from a contract negotiated just months before Sept. 11 pushed the airline industry into its worst crisis since the 1970s. The union questioned whether Mr. Grinstein is purposely pushing the company into bankruptcy. Delta officials quickly dismissed the suggestion and asked for "cooler rhetoric."

Mr. Grinstein has tried big turnarounds before, to mixed results. The Harvard-educated lawyer and former "shadow senator," as chief aide to the late Sen. Warren Magnuson of Washington state, was a board member of Western Airlines when it turned to him as chief executive amid a financial crisis in 1985. Partly thanks to pay concessions he helped wring from employees, Western emerged as an \$860 million acquisition for Delta in 1987. After the deal, Mr. Grinstein became a major player on Delta's board.

In 1989, Mr. Grinstein became CEO of Burlington Northern Inc., where he had a harder time trying to rescue a problem-plagued business. He left soon after he oversaw the railroad's 1995 acquisition of Santa Fe Pacific Corp. -- a deal that grew messy and expensive after rival Union Pacific Corp. tried to make its own bid for Santa Fe.

Delta was about to go through its own trials. In the late 1990s, at the height of the road-warrior business culture, Delta was churning out record profits under CEO Leo Mullin. But its fortunes soured amid rising competition from discounters and the economic slowdown before and after the terrorist attacks in the U.S. Mr. Mullin laid off 16,000 employees. At the same time, however, Delta's board granted Mr. Mullin and other executives special retention bonuses and retirement accounts.

Last November, Mr. Mullin announced his retirement amid stalled early contract talks with pilots and the festering controversy over the management perks. The board turned to Mr. Grinstein in January, tasking him with getting a deal with the pilots and pulling Delta out of its dive. At Delta's shareholders' meeting in April, Mr. Grinstein acknowledged the anger of employees and shareholders alike. "It seems to me that what we have is a delicate situation where the bonds between management and employees have been damaged and need to be restored," he said.

Mr. Grinstein, who maintains a grandfatherly demeanor despite demanding bone-crushing concessions, is still working to get some at Delta to follow his lead. Even as he stressed to employee groups the importance of being more passenger-friendly, the airline faced anger from many of its high-mileage "Medallion" frequent fliers, who were contending with fewer perks in its SkyMiles loyalty program.

"They drove away God knows how many silver and gold Medallion members, which is sheer lunacy," says one heavy Delta flier, Robert Shostack, a New York textile executive. One group of Medallion members bought billboard and newspaper ads to protest the cutback in perks.

Delta defends the changes. Meghan Glynn, a spokeswoman, says roughly the same number of customers earned Medallions after the changes, but they generate more revenue "as a result of customers purchasing a slightly higher mix of fares in order to maintain or improve their status."

In recent weeks, Mr. Grinstein has stepped up a campaign to rally managers and the rank and file around his vision. At the heart of the design is the question of whether, after a decade in which air travel has become as commoditized as coffee, an airline can "pull a Starbucks" and charge more for premium offerings.

Mr. Grinstein's conclusion is that Delta can, especially at a time when security concerns have helped reduce the pleasure of flying to a new low. Mr. Grinstein believes Delta can customize itself enough to support prices 10% to 15% higher than those of the low-fare challengers.

It doesn't have much time. Mr. Grinstein has bluntly said the era of big national carriers -- with many major hubs, multiple classes of service and flights to most cities -- is over. In recent sessions with employees, he has stated that only two of the six major airlines will survive the next five years. One may be AMR Corp.'s American, the No. 1 carrier, he has said, before adding "let's hope" Delta is the other.

Delta burned through an average of nearly \$4.1 million a day during the first half of this year, and it said in a filing last week that it expected to continue draining cash at such a clip for the rest of the year. At that rate, reserves of unrestricted cash would fall by the end of October to \$1.5 billion, a level at which a bankruptcy-court filing might be inevitable, according to internal company calculations.

Mr. Grinstein has argued internally that salvation lies in coupling savings -- extracted from labor and through streamlining -- with big improvements to service and comfort. Some steps are already under way. Mr. Grinstein says the airline has cut \$1.8 billion in costs in the past 18 months. This month, the company began cycling aircraft through the maintenance hangar every 30 days instead of every 70, in an effort both to extend the planes' life and to improve their appearance. Next month, Delta will unveil new cabin interiors that include leather seats throughout coach class.

Delta has been a leader in allowing customers to print boarding passes at kiosks or with their computers. Now it's installing machine readers that let passengers who miss their connections in Atlanta insert their boarding passes and automatically get new flight arrangements -- plus, if needed, vouchers for meals and a hotel.

Such technology also helps agents sell open seats when it's clear customers won't make their connections, says Michael Palumbo, Delta's chief financial officer since May.

In a move strongly counter to longtime conventional wisdom in the industry, Mr. Grinstein also is suggesting that Delta abandon some domestic routes into its regional hubs in order to invest in expanded schedules and amenities for transcontinental and transoceanic flights. Currently, 70% of Delta's passengers make connections through one of its domestic hubs. And international operations account for 24.2% of the company's revenue: \$772 million of its \$3.96 billion in the second quarter.

A large number of Delta's about 4,500 daily flights are simply unprofitable. Like other big airlines, Delta has subsidized many regional routes because they feed passengers into profitable connecting flights between hubs. Keeping the money-losing flights was also seen as a defensive move against competitors.

But Mr. Grinstein wants Delta to shed some of the hopelessly unprofitable spokes. Those into its Dallas hub are likely to be at the top of the list.

Mr. Grinstein's often off-the-cuff remarks during sessions with employees and retirees have unnerved some, particularly when he has appeared to brazenly encourage talk of bankruptcy. "Delta, as it is now structured, cannot survive," the CEO said in a recent memo to pilots.

A spokeswoman for the carrier says it is "working hard to make Delta viable outside of bankruptcy." Delta's shares have fallen during Mr. Grinstein's tenure, from \$12 in January to \$3.41 in New York Stock Exchange 4 p.m. composite trading Friday.

At the same time, Mr. Grinstein has thrilled employees disillusioned with previous executive teams. He has gutted the ranks of senior management and according to the company cut 41% of aggregate compensation for officers, thanks to the departure of so many.

At a farewell gathering for Mr. Mullin in December, the carrier's then-president and chief operating officer, Frederick Reid, who'd been passed over for the top job, ended his remarks without introducing Mr. Grinstein. "What? No introduction, Fred? How's that for job security?" joked the new CEO, evoking tense laughter, according to people present at the event. Mr. Reid was gone three months later, and now heads Virgin Group's effort to launch a new U.S. discount airline. Mr. Reid declined to comment.

At some employee gatherings, Mr. Grinstein follows his criticism of prior management with a scathing critique of some current initiatives. Usually standing alone, without an entourage or written comments, Mr. Grinstein methodically reels off complaints. Marketing has been atrocious, he says -- sometimes with marketing officials in the audience. He hates the carrier's stale "luggage tag" ad campaign plastered on billboards in key markets. He dislikes an aircraft paint job introduced just last year, though he says changing it again isn't feasible. Delta's shift to lower-cost regional jets on some flights of over two hours, such as between Dallas and New York's JFK, is an "abuse" that customers shouldn't have to put up with. A Delta spokeswoman says such flights are a minority of its regional jet schedule.

Mr. Grinstein also has harshly criticized Song, a low-fare airline-within-an-airline experiment Delta launched with great to-do last year at a cost of \$65 million. At recent meetings, according to people present, Mr. Grinstein has called Song and a previous incarnation, Delta Express, "mistakes," joking that he'd like to add "Swan" before Song's name. The unit's improved performance this summer has won it

several more months of testing time, and Mr. Grinstein has recently said Song has been useful as a laboratory to test initiatives such as onboard food sales and faster turnaround times for aircraft.

Perhaps Mr. Grinstein's most remarkable achievement has been to convince many employees that he represents a clean departure from prior management -- no small feat given his many years as a powerful board member. He had played a key role in pushing aside former CEO Ron Allen in the mid-1990s and helped recruit Mr. Mullin. Mr. Grinstein also was on the board when, in January 2002, Delta spent \$45 million on special bankruptcy-proof pensions for 35 top executives while laying off workers and cutting employee benefits.

Mr. Grinstein has eluded questions from employees and retirees on whether he voted for the compensation packages and has left the impression with some listeners that he opposed them but was out-voted. Delta won't disclose the board vote.

Some workers take comfort that at his age and wealth Mr. Grinstein doesn't need this job. He could be fly-fishing -- a favorite hobby -- or spending time in a 12,000-square-foot house he built in 1999 in Washington state after demolishing one once owned by Bill Gates. Mr. Grinstein said when he took the CEO job in January that he wouldn't accept a contract, would stay only about three years and would limit his salary to \$500,000 a year.