Southwest Airlines Co

By: Stephen Leavenworth

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As noted in the case Southwest Airlines Co case (Case #11 in Organizational Theory, Design, and Change, 4th Edition), Southwest Airlines Co. ("Southwest") is a major domestic airline that provides predominantly short haul, high frequency, point-to-point, low-fare service. Southwest was incorporated in Texas in 1967 and commenced Customer Service on June 18, 1971 with three Boeing 737 aircraft serving three Texas cities - Dallas, Houston, and San Antonio.

As of November 2004, Southwest operated 388 Boeing 737 aircraft and provided service to 60 airports in 59 cities in 31 states throughout the United States.[1] Southwest Airlines topped the monthly domestic passenger traffic rankings for the first time in May 2003 and has led ever since. Based on monthly data from May through August 2004 (the latest available data), Southwest Airlines is the largest carrier in the United States based on originating domestic passengers boarded and scheduled domestic departures.

One of Southwest's major competitive strengths continues to be its low operating costs. Southwest has the lowest costs, adjusted for stage length, on a per mile basis, of all of the major airlines. Among the factors that contribute to its low cost structure are a single aircraft type, an efficient, high-utilization, point-to-point route structure, and hardworking, innovative, and highly productive employees. The airline flies only Boeing 737's to keep maintenance training and parts inventories low. Southwest serves no

[1] Southwest Airlines Form 10-K submitted 3/31/04 with the US Securities and Exchange Commission.

meals, only snacks, to keep overhead down. Southwest does not charge nuisance fees like penalties for changing same fare tickets. It has no assigned seats and no electronic entertainment onboard its planes. Instead, Southwest relies on highly energized and fun flight attendants to amuse passengers in flight.

Southwest's formula has proven to be resilient. For example, consider Southwest's success in California against US Airways. According to industry consultant Michael Roach, when Southwest entered the San Francisco – Southern California market in the late 1980's, US Airways had a 58% market share in those routes. By the mid-1990's, Southwest had driven US Airways completely out of the market. In the mid 1990's Southwest entered Baltimore Washington International Airport (BWI) where US Air had a significant presence. According to the same consultant, US Airways is down to 4.9% of the traffic at BWI, while Southwest ranks number one with a 47% share.[2]

Fortune magazine has consistently recognized Southwest as one of the top 10 businesses to work for in the United States and one of the most admired companies in the world. Only Berkshire Hathaway, General Electric, and Microsoft have joined Southwest as six time members of Fortune's Most Admired Companies.[3] Among airlines, Southwest ranked on top as the most admired airline worldwide from 1997 through 2001 and again in 2003. In 2002, The Wall Street Journal reported Southwest Airlines ranked first among airlines for customer service satisfaction, according to a survey by American Customer Satisfaction Index. Business Ethics listed Southwest in its "100 Best Corporate

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[2] Serwer, Andy. Southwest Airlines: The Hottest Thing In the Sky. Fortune. New York. March 8, 2004 Vol 149 Iss 5 page 86

[3] Serwer, Andy. Southwest Airlines: The Hottest Thing In the Sky. Fortune. New York. March 8, 2004 Vol 149 Iss 5 page 86

Citizens," a list that ranks public companies based on their corporate service to various stakeholder groups.[4]

Southwest does not employ the "hub and spoke" approach used by other major airlines, such as United, American, and Delta. Instead its approach is short haul (average flight time over around 1 hour) and point to point (e.g. Dallas to Houston, L.A. to Phoenix, Albany to Boston). Southwest pays its crews by trip and uses "second tier" airports (like Baltimore instead of Washington D.C. or Manchester N.H. and Providence, R.I. instead of Boston) with the recent exception of Philadelphia. Given the point-to-point nature of the flights, pilots and crewmembers can sleep in their own beds at night, and as a result they are willing to earn less than their counterparts at major airlines.

Southwest has staked its business model on a set of commonsense beliefs: that people pay to get from one place to another as quickly as possible, and that planes don't make any money when they are sitting empty at a gate.[5] While this might seem obvious, consider that Southwest was the only airline to make money in 2001. Also consider that in 2003, Southwest earned $442 million more than all the other airline companies combined. The stock market has rewarded Southwest with a market value that is $11.7 billion higher than all of its competitors combined.[6]

The stories about Southwest's corporate culture of fun are legendary. The company is lead by Executive Chairman Herb Kelleher, who Fortune describes as follows:

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[4] Statistic found on www.southwest.com
[5] Pfeffer, Jeffrey. Dare to be Different... Business 2.0. San Francisco. Sept 2004 Vol 5 Iss 8 page 58
[6] Serwer, Andy. Southwest Airlines: The Hottest Thing In the Sky. Fortune. New York. March 8, 2004 Vol 149 Iss 5 page 86

> "As brilliant as he is batty, Kelleher is half P.T. Barnum, half Will Rogers, half Clarence Darrow, and half Jack Welch. (Yes that adds up to two men – but if you drank as much Wild Turkey and smoked as many cigarettes as Kelleher does, you'd be seeing double too.)"[7]

The walls of the company headquarters just off Love Field in Dallas, TX are covered with more than ten thousand picture frames containing photos of employee's pets, Herb Kelleher dressed like Elvis or in drag, or stewardesses in miniskirts, or Southwest planes "eating" competitor's planes. Newly appointed CEO Gary Kelly (an 18 year veteran of Southwest) calls the corporate culture "almost like a religion." However for all the fun and games, the company is conservative about safety and its finances. Southwest has never had a fatal crash, and is the only airline to have an investment grade rating on its debt. During the rock bottom of bad times, post 9-11-01, the airline industry laid off thousands of employees and lost more that $22 billion over the past three years. Southwest did not furlough a single employee and remained profitable every quarter. In fact, Southwest has not posted a year-end loss in 31 straight years or a quarterly loss in 51 straight quarters.[8]

Like most airlines, Southwest's horizontally coordinated ground employees must work under tight time schedules and high stress. Contrary to its competitors, Southwest has not created a flat organization based on individual performance managed under low supervision like those of its competitors. These flat individual structures tend to lend themselves toward excessive finger pointing and ill will among employees. Rather Southwest has created a horizontal organization based on cross-functional teams to diffuse blame, with adequate staffing to provide coaching, feedback, and learning.

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[7] Serwer, Andy. Southwest Airlines: The Hottest Thing In the Sky. Fortune. New York. March 8, 2004 Vol 149 Iss 5 page 86

[8] Southwest Airlines Form 10-K submitted 3/31/04 with the US Securities and Exchange Commission.

An example of the comparison between the two management styles can be viewed everyday during flight departure. A departure is deemed successful from the airline's point of view if the customer is on time with his or her baggage and without excess staffing or gate time for the airplane. Based on lost revenues alone, the cost of a hypothetical five-minute increase in gate time was estimated at $1.6 billion, or $4,700 per employee, for the ten major U.S. airlines over a one-year period.[9]

Most major airlines, for example American Airlines, focus intensely on individual accountability. Negative focus (stimulus) accompanies the delays in the form of a manager who seeks to find out who caused the delay and why it occurred. The bigger the stakes, the more people involved. If a mistake causes planes to miss their intended connection in another city, then a minor mistake adds up to millions of lost dollars. If this scenario occurred inside of American Airlines, it was said that former CEO Robert "Crandall wanted to see the corpse" of the employee who make the mistake.[10] Therefore, while the customer was alleged to be the center of focus, it was really the negative repercussions to the employee.

Southwest's culture emphasizes teamwork over individual effort. Southwest uses a procedure called "team delay" which is a less precise reporting of the cause of delays with the goal of diffusing blame and encouraging learning. The team delay is used to point out problems between two or three different employee groups in working together. For example, if customers were still in the jetway at departure time, then the delay was

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[9] Gittell, Jody Hoffer, "Cost Quality Tradeoffs in the Departure Process? Evidence from the Major U.S. Airlines," Transportation Research Record, 1480 (1995) as reported in Gittell, California Management Review Spring 2000

[10] Gittell, Jody Hoffer, "Paradox of Coordination and Control" California Management Review. Spring 2000

declared a station delay. If customers were on-board at departure time, then it was a flight crew delay. During a team debriefing, all members of the crew would meet to determine the cause of the delay and learn how not to have it happen again. Southwest headquarters emphasizes the theme of "learning from mistakes."

Southwest's culture also emphasizes small supervisory spans of control compared to the major airlines. For example, Southwest president Colleen Barrett claims that the major airlines have 30 to 40 front-line workers to each supervisor whereas Southwest has only 8 to 9. A Southwest supervisor is on the job to help the 8 or 9 front-line employees do their jobs better, not police the duration of someone's lunch hour. The supervisors at the major airlines perform largely administrative functions.

After the supervisory level, Southwest has a single layer of middle management (directors) before the Vice President level. Unlike the major airlines there is no geographic breakdown of management responsibility. The Vice Presidents hold responsibility for specific functions such as: Special Marketing, Schedule Planning, Properties, Fuel, Treasury, Purchasing, Maintenance, Customer Relations, Reservations, Marketing, Ground Operations, Legal, Labor Relations, and Planning. Each Vice President reports to one of eight Senior Vice Presidents. In turn, each SVP reports to one of two Executive Vice Presidents, one for Customer Operations and the other for Aircraft Operations. The two Executive Vice Presidents, along with Southwest's president (whose duties are mostly related to investor issues and public discourse) report to Gary Kelly, CEO.[11]

[11] Corporate structure found at http://www.southwest.com/investor_relations/fs_corporate_governance.html

Southwest pilots are the only pilots of a major U.S. airline who do not belong to a national union. National union rules limit the number of hours pilots can fly. But Southwest's pilots are unionized independently, allowing them to fly far more hours than pilots at other airlines.

Other workers at Southwest were nationally unionized, but their contracts were flexible enough to allow them to jump in and help out, regardless of the task at hand. From the time a plane landed until it was ready for takeoff took approximately 20 minutes at Southwest, and required a ground crew of four plus two people at the gate. By comparison turnaround time at United Airlines was closer to 35 minutes and required a ground crew of 12 plus 3 gate agents.[12]

Southwest has a rigorous approach to hiring new employees. In 2001, Southwest reviewed 194,821 resumes and hired 6,406 new employees. The company's hiring process was somewhat unique: Peers screened candidates and conducted interviews; pilots hired pilots, and gate agents hired gate agents. To better understand what the company sought in candidates, Southwest interviewed its top employees in each job function (e.g. pilots, gate agents, baggage handlers, ground crew) and identified their common strengths then used these profiles to identify top candidates during the review process. Southwest then hired for attitude as much as aptitude.[13]

While Southwest is most famous for its culture, not everything has been perfect. In late 2000, Herb Kelleher, then 69, recognized the need to implement a succession plan.

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[12] Magretta, Joan. What Management Is: How It Works and Why It's Everyone's Business (The Free Press, 2002), page 199.

[13] Freiberg, Kevin and Freiberg, Jackie. NUTS! Southwest Airlines' Crazy Recipe for Business and Personal Success (Bard Press, Inc.), page 65

In August of 2001, James Parker, then a 15-year veteran of Southwest was named Chief Executive Officer. Mr. Kelleher remained Chairman of the company that he co-founded in the early 1970s.

Unfortunately for Mr. Parker, he assumed the CEO position one month before 9-11-01 and shortly before several labor contracts were to expire. While his ambitious plans to expand operations into Philadelphia (Southwest's first expansion into a "first tier city") were lauded by investors, the Philadelphia expansion plan became a point of leverage for the 7,300 flight attendants who worked for Southwest and were engaged in "protracted and contentious" negotiations for a new contract for nearly six months before Mr. Parker ascended to CEO.

The Local 5556 representing the flight attendants was frustrated enough to target Southwest's introduction of service into Philadelphia International Airport as point of demonstration. With Southwest headquartered at Love Field in Texas and having a New York Stock Exchange symbol of "LUV", the flight attendants used very pointed advertising regarding Southwest's entry into the "City of Brotherly Love."

The union blamed "new management's changing culture" (a direct shot at Mr. Parker's bottom line focus) at Southwest for the stalled talks. The issues were not around work rules or quality of life issues, but rather economics. The flight attendants demanded pay raises equal to those of other labor groups at Southwest. According to the union, Southwest management offered flight attendants approximately 20% increase over 6.5 years compared to a minimum of 39% over a four year period for pilots and 35% over a five year period for ramp, operations and provisioning groups.[14] The attendants also wanted duty schedules similar to that of the pilots. The existing duty schedules gave attendants a 10.5-hour duty day but no overtime pay under the 12th hour. The pilots had less time elapse before overtime pay kicked in.

In response to the overtime issue, Southwest management responded with an extension of the overtime threshold from 12 hours to 13 hours. Insisting that Southwest had put forth its best offer, management pushed the union for a vote, but the union refused to allow membership to vote. Mr. Parker took some unusual steps to try and circumvent the union's leadership. For example, Mr. Parker appealed directly to the employees on economic issues, skipping over the union leaders. Mr. Parker also sat at the bargaining table as the lead management negotiator, another highly unusual move for a CEO. However it was Mr. Parker's alleged comment at the bargaining table that effectively stalled the progress for months. According to the union, Mr. Parker said the following about the difficulty negotiating with attendants: "That's the thing about flight attendants – they are all either old and sick or young and pregnant."

According to the union president Thom McDaniel, the attendants felt that the new management under Mr. Parker was leading them down the wrong road. "We love our company, but we don't like the direction it is going," he said. "The company's management style has changed. We don't want it to be 'just another airline' whose aim is the bottom line. We want it to be proud of it. Our goal from the beginning is to

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[14] Fiorino, Frances. Culture Shock? Southwest flight attendants fight over labor contract; industry wonders if honeymoon is over for airline. Aviation Week and Space Technology. New York: April 5 2004 Vol. 160 Issue 14; page 50

preserve the culture of the company." Asked why flight attendants put up with some of the conditions they were fighting to eliminate, Mr. Kern said: "We love our jobs. We don't mind spending some extra time cleaning the aircraft or having no breaks, but we do want to be compensated fairly for the we do."[15]

After sixteen months of talks between management and the union that lead to highly personal attacks and little actual progress, Mr. Parker turned negotiations over the Mr. Helleher and Southwest president Colleen Barrett. The new negotiators reached a deal in nine weeks. Shortly thereafter, Mr. Parker, at the age of 57, stepped down after only three years on the job. Succeeding Mr. Parker was Chief Financial Officer Gary Kelly, 49 year old, and like Mr. Parker an 18 year veteran of Southwest.

Of the transition, Mr. Kelleher said: "Gary Kelly is one of our brightest stars, well respected throughout the industry and well known, over more than a decade, to the media, analyst, and investor communities for his excellence. As part of our Board's succession planning, we had already focused on Gary as Jim Parker's successor, and that process has simply been accelerated by Jim's personal decision to retire. Under Gary's leadership, Southwest has achieved the strongest balance sheet in the American airline industry; the best fuel hedging position in our industry; and tremendous progress in technology."[16]

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[15] Fiorino, Frances. Culture Shock? Southwest flight attendants fight over labor contract; industry wonders if honeymoon is over for airline. Aviation Week and Space Technology. New York: April 5 2004 Vol. 160 Issue 14; page 50
16 Southwest Press Release. DALLAS, July 15 /PRNewswire-FirstCall **Southwest Airlines Announces Executive Changes**

Question for discussion:

1. By naming the former CFO to the CEO position, has Southwest made a statement about its future direction?
2. How are the labor unions likely to react?