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Enhancing Service at Southwest Airlines

Gary Kelly clicked the "DING" icon and smiled as the laptop screen filled with the familiar Southwest Airlines website. "More peanuts?" the flight attendant poked him with a smile. Kelly looked up and pointed to his screen. "The internet at 30,000 feet—that goes great with peanuts!" Scarcely five years at the helm of Southwest Air, Kelly was navigating the high-flying airline through the biggest crisis in its 38 years of service. By focusing on simplicity and keeping cost low, Southwest had posted profits in every year for over three decades and had grown to be the fifth largest U.S. carrier. It had even logged a 12% increase in revenue in 2008 as the U.S. plunged into recession. But the winter and spring of 2009 had been torturous, with passenger traffic dropping 10%. Fare wars had begun in earnest, with offers as low as $99 for coast to coast travel. Across the industry, executives looked eagerly to summer, hoping for some relief.

While Southwest was no stranger to low prices, Kelly was also looking closely at the airline's services. He wanted to be ready when passengers returned and believed that Southwest needed to constantly refine its value proposition. His flight that day was on one of four planes testing satellite-based WiFi Internet access. Other refinements, such as more-extensive wine and coffee service and even new international alliances with foreign carriers were all under consideration. In each case, the offering would be scrutinized to see if it fit within the Southwest strategy and its legendary operating model.

History

Southwest began operating in 1971 out of Dallas' Love Field airport after a four year legal battle with its local competitors. Arguing before a Texas court that that there was not enough demand to sustain three intrastate airlines, the now defunct Braniff and Texas International Airlines slowed Southwest's entry but strengthened its resolve. Fighting them in court and later in price-bruising competition forced the upstart airline to build an operating model that could survive. And survive it did. From rock bottom fares to playful advertising built around a "Luv" theme, Southwest developed a reputation for fun and value.

This case was written by Professors M. Eric Johnson and Joseph M. Hall of the Tuck School of Business at Dartmouth. It was written as a basis for class discussion and not to illustrate effective or ineffective management practices. Version: May 8, 2009.

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That cheap but fun image was deeply engrained into the Southwest culture and visible in everything from executive offices that looked little better than a janitor's closet to the elaborate practical jokes employees played on each other. Founder and long-time CEO Herb Kelleher carefully built that culture, one company party at time. Known for his love of bourbon and cigarettes, employees also knew he loved the airline and them. Kelly, a buttoned-down accountant, had a hard act to follow when he succeeded Kelleher in 2004. But when he showed up at the company Halloween party dressed as a character from the musical Hairspray complete with a pink dress and big hair, Southwest employees knew he was one of them. Even serious issues like safety were seen as opportunities for fun and with no passenger fatalities in its history, Southwest could brag that low-cost and fun didn't mean unsafe. By 2009, Southwest was the fifth largest airline (in terms of passengers) in the U.S. but the largest in terms of market capitalization (see Exhibit 1 for financial information).

A Simple Operating Model

Within every element of its business strategy, Southwest sought to differentiate itself through simplicity. In its early years, the differentiation was stark—no meals, no assigned seats, no first class service, and no coordination with other airlines. While flying coast to coast, the airline stayed close to its roots as a short-haul, high-frequency, low-cost competitor. Beyond its value, many customers enjoyed Southwest's playful culture. With jokes and songs, its casually dressed flight attendants entertained as they welcomed customers aboard, reviewed safety instructions, and served snacks.

Marketing

Southwest's marketing positioned the airline as fun, with low prices that allowed frequent, convenient travel. From the beginning, its advertising was playful, often poking fun at the competition and emphasizing its low-price and convenience (see Exhibit 2).

Year after year, Southwest steadily expanded its network, entering new markets with a predictable impact on customers and competitors—referred to by analysts as the "Southwest effect." The company would identify markets that appeared underserved and overpriced. To keep costs low and avoid the harshest competition, it focused much of its early expansion on medium-sized cities and secondary airports of major cities. Through heavy advertising and low introductory fares, it would immediately initiate a price war with incumbent carriers, stimulating overall market demand. Often the introductory fares would be 50% less than existing fares in that market and would be competitive with bus fares and the cost of driving. The low fares would grow the overall demand at that airport, which Southwest would fill through further expansion. Typically Southwest would enter the new city with at least 10 flights operating from two gates and quickly move to double that to 20 flights. As Southwest matured, it successfully pushed this same strategy into many entrenched hubs of its competitors like Philadelphia (USAir) and Denver (United).

For example, to initiate Southwest's June 2009 entry into New York's LaGuardia airport, the firm announced it would offer eight flights/day to both Chicago Midway and Baltimore-Washington airports. Operating from gates and runway slots it purchased from bankrupt

ATA, the opening followed the well-established formula. With a blitz of advertising and introductory fares of less than half that of the incumbents (American, United, and USAir), the early demand for $89 one-way flights to Chicago and $49 Baltimore-Washington was brisk.

Many might be surprised it took Southwest so long to directly enter the massive New York market. While it had operated for years from Long Island's Islip airfield, the congestion and competition of New York's three main airports kept Southwest out. Taking nothing for granted, Southwest worked to squeeze everything it could out of its new investment. Bill Owen, Lead Planner in the schedule planning department remarked:

> "How were we able to schedule eight departures a day? Simple. Southwest received 14 daily slots for our operations at LGA (each takeoff and each landing requires a slot), which gives us authority for seven departures daily. As a bonus—we're able to add an eighth flight by scheduling our first LGA-MDW departure in before slot controls start (prior to 7:00 a.m.) and putting the last MDW-LGA arrival after slot controls stop (after 9:59 p.m.). Oops, I misspoke: We were able to negotiate with the FAA for one additional slot for our first departure, and the last arrival reaches LGA after slot controls stop at 9:59 p.m. (Slot control begins at 6:00 a.m.). So even though we're new to this whole slot-controlled thing—we're already working to maximize our presence at LaGuardia. Who knows what the future may bring!"

Digital Strategy

Southwest was an internet-ready firm long before the internet. It started out selling direct—keeping costs low by not paying sales commissions to travel agents. In 1995, when the web was still in its infancy, Southwest was the first airline to launch a site. A few months later, it began offering customers the ability to quickly purchase ticketless flights. Southwest continued innovating on the web—developing the consumer application DING that notified customers of special low fares and SWABIZ, Southwest's free online booking tool that allowed business travelers to plan, purchase, and track business travel. In 2008 a staggering 78% of its tickets were purchased via **southwest.com**, which remained the exclusive on-line ticket outlet. In 2009, **southwest.com** was ranked the 4th largest travel site and largest airline site in terms of unique visitors. Besides planning and purchasing air travel, hotels, and rental cars, customers also used the site to check-in (77% did so online or at a kiosk) and track the status of their flights.

At first, the Southwest fare structure was nearly flat—without the complex pricing models used by many airlines that employed revenue optimization. It offered simple point-to-point pricing that did not require a round trip or a Saturday night stay to obtain low priced fares. That model stuck and while the network of destinations grew tremendously, it maintained a simple fare structure. In 2009, it still offered low-price *Anytime* fares that were fully refundable along with *Business Select* fares that allowed early boarding (ensuring a good seat). It also practiced a simple version of revenue optimization for advanced-purchased fare classes sold at lower prices (see Exhibit 3 for fare rules). As a plane filled, the lowest-fare classes (that had scheduling restrictions and were not fully refundable) would sell-out leaving

the highest price *Anytime* fare for last-minute purchasers. In addition, it offered internet fare specials at very low promotional prices that often sold out quickly. Interestingly, its simple web pricing was largely transparent—allowing customers to see the different prices that were available for each flight, even when that fare was sold-out (see Exhibit 3).

Besides the web-site, Southwest was quick to adopt other digital conveniences such as cashless payment for on-board drinks, saving time handling cash. They also provided mobile device applications that allowed travelers to track flights on the cell phone. In some airports they installed laptop counters in gate areas to allow travelers to power-up and work on their computers while waiting for flights.

Service

For the first 30 years, service at Southwest was shockingly different than its competitors. With no meals, no seat assignments, and a single class of service, many travelers thought Southwest was the "bus" of air travel. Often the point of many jokes, it only offered peanuts, simple snacks, and drinks while other airlines historically provided full meals and lavish treatment in business and first class cabins. But by 2009, the service in coach for most U.S. airlines was little different than Southwest, with the exception of an assigned seat.

Rather than emphasize meals and differentiated service, the Southwest model focused on fun. Presenting the image of a happy family, its playful approach included on-board games (such as guess the flight attendant's weight) and jokes that made even serious aspects of flying (such as emergency evacuation instructions) fun. For example, when describing how to inflate the life vests, a cheeky flight attendant might say, "blow into the tubes like you would a breathalyzer"; when instructing parents on the use of oxygen masks, they might say "first put a mask on yourself and then your children—starting with your favorite child"; when talking about emergency exits, they might say "find the closest available exit and move quickly off the plane. We will follow with the beer and wine."

Holidays like Easter or Halloween were occasions for unusual craziness. At such times, it was not usual to see a flight attendant dressed as a bunny or gate agents standing behind elaborately decorated counters and dressed as witches. When making routine announcements, some flight attendants would sing. Others would rap. Short poems or rhymes were also common. To relieve passenger tension during landings, attendants would make jokes like "whew… we made it" upon touch-down or "whoa…… big fellow……whoa" as the plane shook from hard braking. First time customers would often roar with laughter at such antics and applause upon take-off and landing was not uncommon. Flights to vacation destinations like Las Vegas or Orlando were particularly rowdy. For example, on a flight to Orlando, a flight attendant shouted "to infinity and beyond" as the plane lifted off and passengers instantly joined the cheer.

Maintaining playful service required ongoing attention to the corporate culture and careful employee selection. Southwest could afford to be very selective in hiring. In 2008 it received 199,200 resumes for 3,350 new positions. Kelly argued that people were the most important element of Southwest's success and refused to consider downsizing while other carriers shed workers through 2009.

Operations

Southwest's operations also significantly differed from other U.S. airlines. Most noticeable, they firm only flew Boeing 737 jets. Other major airlines flew a portfolio of planes from small regional jets to wide-body jumbo jets. For example, United used regional jets for low-volume routes, like Manchester, N.H. to Washington, D.C. and much larger jets for New York to Los Angeles or Washington, D.C. to London. The 737 was among Boeing's smallest jets, seating about 130 passengers depending on the configuration. As Southwest expanded, it simply added more flights to each link and bought more 737s. By 2009, it maintained a fleet of 539 planes (see Table below) flying over 3,300 flights a day with an average passenger load factor (in 2008) of 71.2 percent (United's was 81% during the same period).

Table: A breakdown of SWA's 539 Boeing 737 jets *(as of April 16, 2009)*.

Type	Number	Seats
737-300	184	137
737-500	25	122
737-700	331	137

The firm's fleet was one of the youngest in the industry, with an average age of about ten years. The average trip was 635 miles, requiring an average of one hour and 55 minutes including taxi time (e.g., about the time required to travel from Baltimore to Chicago). A plane would fly an average of 6.2 flights per day, or almost 12 hours and 9 minutes per day. A 737-700 cost approximately $60 million. With its uniform fleet, Southwest worked to find cost savings in every area from maintenance to reduced fuel consumption (through such innovations as single-engine taxi and reduced use of the thrust reversers on landing).

Using the small jets, Southwest focused on point-to-point travel rather than building a hub-and-spoke system. Airlines such as American built large hub-and-spoke networks with airports like Dallas-Fort Worth representing major hubs. For example, passengers traveling from Denver to Kansas City would pass through Dallas. Southwest would fly many such "low-volume" links directly. Over time, Southwest did develop mini hubs—for example Baltimore (for the east coast), Oakland (for the west Coast), and Chicago to facilitate frequent connections for longer east/west or north/south travel (see Exhibit 4). However its focus remained point-to-point travel.

With its point-to-point model, Southwest also preferred smaller, less congested airports in medium sized cities (like Manchester NH instead of Boston) or secondary airports (like Midway in Chicago rather than O'Hare). Smaller airports provided many benefits including reduced runway costs and the ability to lease multiple gates to support a growing schedule of flights. In highly congested airports like Atlanta and Chicago O'Hare, runway capacity was limited and congestion often resulted in delays. Runway delays translated into higher fuel costs, more employee time, and customer dissatisfaction. Smaller airports saved flight time—possibly as much at 15-20%, depending on the airport. However, this also made it difficult for passengers to connect to other airlines. In fact, Southwest further discouraged

such connections by not providing baggage transfers to other airlines. One executive commented, “Southwest does not coordinate its service with other airlines.”

Southwest also differentiated itself in its ability to ‘turn’ a plane. A turn was defined as the time a plane spent at the gate, from moment it was secured until it was pushed back from the gate with a new set of passengers. During that time, passengers were unloaded, the plane cleaned, restocked with snacks and beverages, and loaded with a new set of passengers. Outside, baggage was unloaded and loaded, fuel added, and the plane would be visually inspected. Likewise, unplanned maintenance was also performed. Much like a pit stop in a NASCAR race, Southwest studied and practiced turns—always looking for ways to improve.

The short turn time was born out of necessity when the struggling airline was forced to sell one of its four airplanes in 1972 to avoid bankruptcy. Wanting to maintain the service it had developed between Dallas, Houston, and San Antonio, founder Herb Keller suggested that if they could turn the planes faster they could save time and squeeze more flights out of each plane. That was the birth of the famous ten-minute turn. Twenty years later, Southwest had grown from a tiny Texas carrier with three planes hopping short flights to 124 aircraft servicing 32 cities, and still maintained turn times of 15-20 minutes (with average flights of about 65 minutes). By 2009, Southwest’s turn time had slipped to 25 minutes, still far below the industry average of about an hour.

Labor flexibility helped Southwest speed the turn process. Even though they were unionized (77 percent of employees), flight attendants and even pilots often helped turn planes, including cleaning cabins, moving baggage, and loading passengers. Labor rules for other unionized airlines typically prohibited such practices—limiting plane cleaning to cleaners. If a cleaning crew was not immediately available when a plane arrived the departure could be delayed. Not so at Southwest, where everyone would help out when needed.

Southwest was probably best known by passengers for its unique way of boarding planes. Prior to September 11, 2001, Southwest used only plastic, reusable boarding cards to load its planes. Customers arriving at the airport would receive a numbered card upon check-in with numbers starting at 1 for the first person to check-in and running to 130. At the gate, customers would line up according to the boarding number on their card. Those with low numbers would be first and would have their choice of seats while those who arrived late for check-in would end up with high numbers and limited choice—likely a middle seat!

New security procedures in U.S. airports challenged this procedure, requiring a paper boarding document with the passenger’s name. Southwest quickly adapted, allowing passengers to check-in on-line via the website while still using the numbering. Twenty-four hours before the flight, passengers could print their own boarding pass with the boarding number again assigned using a first-come-first-served approach. However, the new web-based process also allowed Southwest to reserve some low numbers for frequent travelers—allowing them to check-in later without fear of a bad seat. Passengers who do not check-in via the web still have the option of obtaining a boarding card at the airport. However, those checking in at the airport were likely to receive a high number when arriving only an hour or two before the flight.

At the gate, Southwest also experimented with different corral configurations. Initially ridiculed for long lines that snaked out into the terminal, Southwest developed orderly corrals that kept lines compact, but maintained the virtual order (see Exhibit 5). Breaking the passengers into three major boarding groups (A, B, C) and then further subdivided into batches of 30, flyers typically lined up along a series posts, each with numbers (1-10, 11-20, 21-30) on one side and (31-40, 41-50, 51-60) on the other. First, A1-30 would board, followed by A31-60, then B1-30 and so on with group C boarding last.

Service Decisions

Throughout its history, Southwest constantly evaluated its model to look for areas of improvement. Services, like assigned seats, had been evaluated many times in the past. While customers liked assigned seats, Southwest concluded over and over again that it would slow its service causing greater customer dissatisfaction than the good will an assigned seat would generate.

With such a rich history of cost consciousness and convenient service, Kelly thought about the proposed services as he crunched on his peanuts. Would high-quality wines or greater beverage selection conflict with their operating model? Was free WiFi consistent with their fun service? Could international partners help Southwest continue to grow without slowing down its operations? Every one of these enhancements would have to be scrutinized.

Pulling into the gate, the flight attendant teased the passengers to stay in their seats. “Wait for it……wait for it……wait for it.” When the bell chimed, the attendant cried “get out!”

Exhibit 1a: Southwest Airlines Financial Information

(In millions)	12/31/06	12/31/07	12/31/08
ASSETS:			
Current assets:			
Cash and cash equivalents	$1,390	$2,213	$1,368
Short-term investments	369	566	435
Accounts and other receivables	241	279	209
Inventories of parts and supplies, at cost	181	259	203
Fuel derivative contracts	369	1,069	-
Deferred income taxes	-	-	365
Prepaid expenses and other current assets	51	57	313
Total current assets	2,601	4,443	2,893
Property and equipment, at cost:			
Flight equipment	11,769	13,019	13,722
Ground property and equipment	1,356	1,515	1,769
Deposits on flight equipment purchase contracts	734	626	380
	13,859	15,160	15,871
Less allowance for depreciation and amortization	3,765	4,286	4,831
	10,094	10,874	11,040
Other assets	765	1,455	375
	$13,460	$16,772	$14,308
LIABILITIES AND STOCKHOLDERS' EQUITY:			
Current liabilities:			
Accounts payable	$643	$759	$668
Accrued liabilities	1,323	3,107	1,012
Air traffic liability	799	931	963
Current maturities of long-term debt	122	41	163
Total current liabilities	2,887	4,838	2,806
Long-term debt less current maturities	1,567	2,050	3,498
Deferred income taxes	2,104	2,535	1,904
Deferred gains from sale and leaseback of aircraft	120	106	105
Other deferred liabilities	333	302	1,042
Stockholders' equity:			
Common stock	808	808	808
Capital in excess of par value	1,142	1,207	1,215
Retained earnings	4,307	4,788	4,919
Accumulated other comprehensive income	582	1,241	(984)
Treasury stock, at cost: 24,302,215 shares in 2006	(390)	(1,103)	(1,005)
Total stockholders' equity	6,449	6,941	4,953
	$13,460	$16,772	$14,308

Exhibit 1b: Southwest Airlines Financial Information

(In millions, except per share amounts)	12/31/06	12/31/07	12/31/08
OPERATING REVENUES:			
Passenger	$8,750	$9,457	$10,549
Freight	134	130	145
Other	202	274	329
Total operating revenues	9,086	9,861	11,023
OPERATING EXPENSES:			
Salaries, wages, and benefits	3,052	3,213	3,340
Fuel and oil	2,284	2,690	3,713
Maintenance materials and repairs	468	616	721
Aircraft rentals	158	156	154
Landing fees and other rentals	495	560	662
Depreciation and amortization	515	555	599
Other operating expenses	1,180	1,280	1,385
Total operating expenses	8,152	9,070	10,574
OPERATING INCOME	934	791	449
OTHER EXPENSES (INCOME):			
Interest expense	128	119	130
Capitalized interest	(51)	(50)	(25)
Interest income	(84)	(44)	(26)
Other (gains) losses, net	151	(292)	92
Total other expenses (income)	144	(267)	171
INCOME (LOSS) BEFORE INCOME TAXES	790	1,058	278
PROVISION (BENEFIT) FOR INCOME TAXES	291	413	100
NET INCOME	$499	$645	$178
NET INCOME PER SHARE, BASIC	$0.63	$0.85	$0.24
NET INCOME PER SHARE, DILUTED	$0.61	$0.84	$0.24
WEIGHTED AVERAGE SHARES			
Basic	795	757	735
Diluted	824	768	739

Exhibit 2a: Early Southwest Ads.

Exhibit 2b: Playful Southwest Ads.

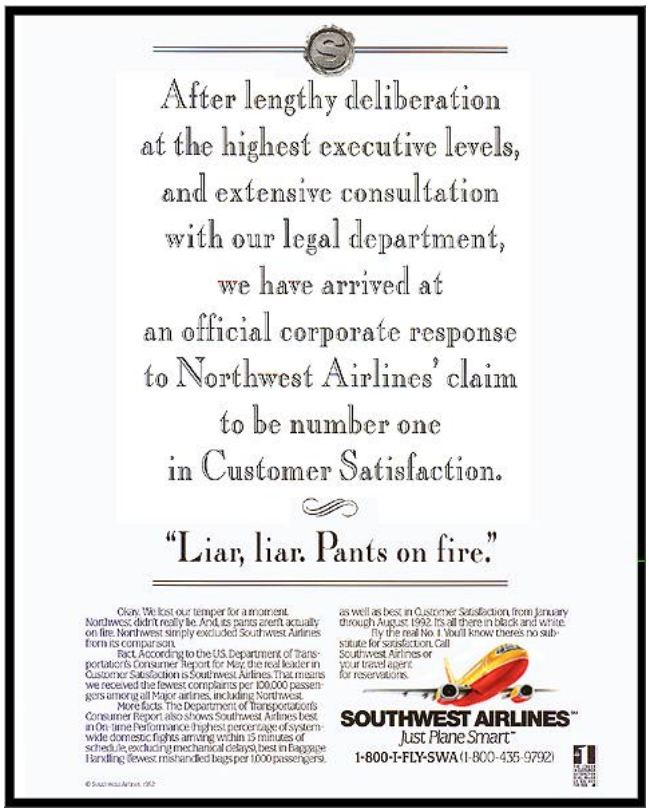

Exhibit 3: Southwest Airlines Fare Rules.

Freedom and Flexibility

Compare Southwest's New Fares

	Business Select™ Maximum freedom and rewards.	Anytime Outstanding value and flexibility.	Wanna Get Away Lower prices and convenience.
Boarding Priority Purchasing this fare will enable you to board the plane in the first portion of the "A" boarding group.	✓		
Rapid Rewards Credits The number of Rapid Rewards credits you will receive for your purchase.	1.25 credits [1] (BWI - MDW) Credit Lookup	1 credit	1 credit
Same-Day Flight Changes On your original date of travel you are free to fly standby or make confirmed changes (if seats are available) for another flight to your destination at no additional cost.	✓	✓	Applicable fare difference applies
Refundable If you cancel your flight, you are eligible to receive 100% of your ticket value as a refund to your original form of payment.	✓	✓	
Reusable If you cancel your flight, 100% of your ticket value can be applied to future travel for up to 12 months.[2]	✓	✓	✓
A Drink One premium beverage of your choice.[3]	✓		

[1] Extra Rapid Rewards credit based on one-way Business Select travel. Changes made to the itinerary after purchase may result in a change or loss of bonus credits. Bonus credits do not count towards A-List

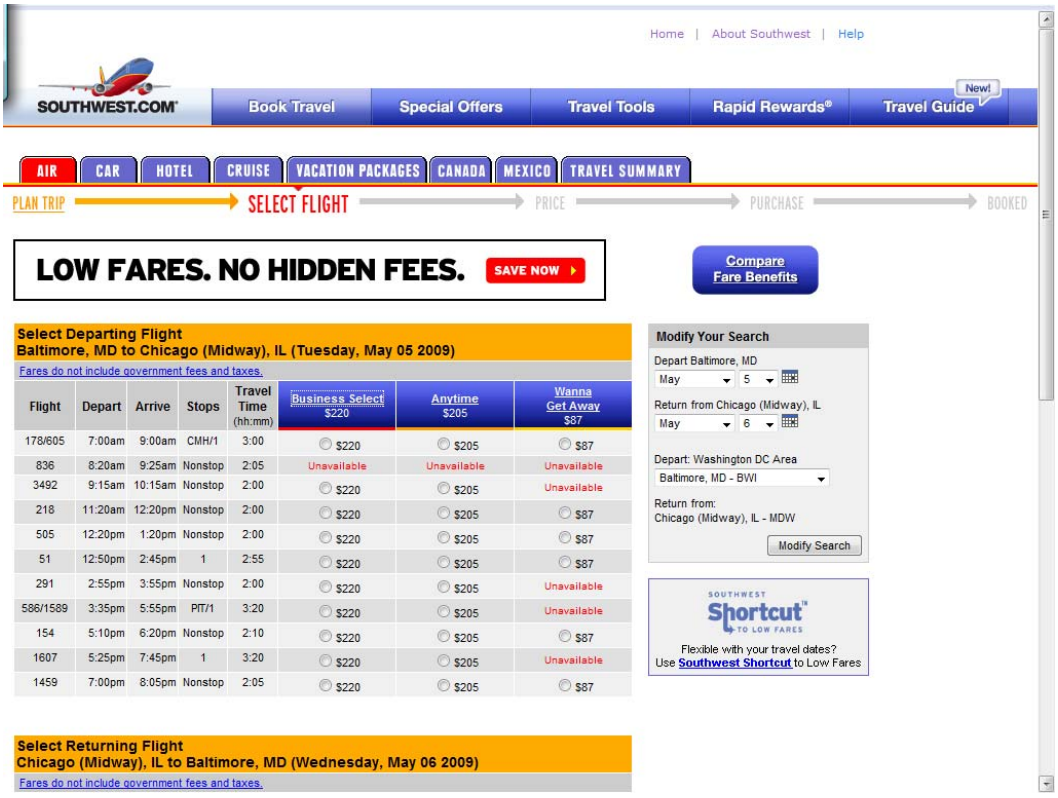

Exhibit 4: Southwest Airlines' Top Ten Airports: *(as of April 16, 2009)*

Cities	Daily Departures	Number of Gates	Nonstop Cities Served	Established
Las Vegas	234	21	56	1982
Chicago Midway	214	29	48	1985
Phoenix	187	24	42	1982
Baltimore/Washington	162	26	38	1993
Houston Hobby	135	17	29	1971
Dallas (Love Field)	134	15	15	1971
Los Angeles (LAX)	120	11	18	1982
Oakland	118	13	19	1989
Denver	115	10	32	1996
Orlando	115	12	33	1982

Exhibit 5: Boarding Areas.