



Southwest Airlines Corporation

In 2001, Southwest Airlines Corporation's (Southwest) year-end results marked 29 consecutive years of profitability. Southwest, which was incorporated in Texas, commenced customer service on June 18, 1971, with three Boeing 737 aircraft serving three Texas cities: Dallas, Houston, and San Antonio. The company grew to become the fourth largest U.S. airline (in terms of domestic customers carried). In 2002, it boasted a fleet of 366 Boeing 737 jets. Southwest was the United States' only major short-haul, low-fare, high-frequency, point-to-point carrier. (Refer to Exhibit 1 for five-year financial highlights.)

Southwest had the lowest operating-cost structure in the domestic airline industry and consistently offered the lowest and simplest fares. Southwest also had one of the best overall customer service records. In 2001, the airline had 35,000 employees and generated total operating revenues of \$5.6 billion from a passenger load factor of 68.1 percent. Its stock exchange symbol was LUV, representing Southwest's home at Dallas Love Field, as well as the theme of its employee and customer relationships.

Fortune magazine consistently recognized Southwest as one of the top 10 businesses to work for in the U.S. and one of the most admired companies in the world. Among airlines, Southwest ranked on top as the most admired airline worldwide from 1997 through 2001. In 2002, *The Wall Street Journal* reported Southwest Airlines ranked first among airlines for customer service satisfaction, according to a survey by the American Customer Satisfaction Index. *Business Ethics* listed Southwest in its "100 Best Corporate Citizens," a list that ranks public companies based on their corporate service to various stakeholder groups.

The Southwest Difference

Southwest did not employ the "hub-and-spoke" approach used by other major airlines, such as United, American, and Delta. Instead, its approach was shorthaul (average flight time was 55 minutes) and point-to-point (e.g., Dallas to Houston, Los Angeles to Phoenix). Southwest had no assigned seats, paid its crews by trip, and used

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Sources: www.southwest.com; What Management Is: How it works and why it's everyone's business by Joan Magretta, ©2002 The Free Press. NUTS! Southwest Airlines' Crazy Recipe for Business and Personal Success by Kevin Freiberg and Jackie Freiberg ©1996 Bard Press, Inc.; Southwest Aims East (Condensed), case study written by Steven Sullivan under the supervision of Paul W. Harris. University of Virginia Darden School. Case no. UVA-M-0464. "The Talent Myth," *The New Yorker*, July 22, 2002.

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less congested airports (e.g., Baltimore instead of Washington's Dulles or Reagan; Manchester, N.H., instead of Boston, Mass.).

Forty-six percent of Southwest's passenger revenue was generated by online bookings via southwest.com. In 2002, the cost per booking via the Internet was about \$1, compared to the cost per booking of \$6-\$8 through a travel agent. Terra Lycos, the largest global Internet network, reported that Southwest received 50 percent more searches than any other airline.

Southwest pilots were the only pilots of a major U.S. airline who did not belong to a national union. National union rules limited the number of hours pilots could fly. But Southwest's pilots were 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 three gate agents.

CEO Herb Kelleher, who founded Southwest, was deeply committed to a philosophy of putting employees first. "If they're happy, satisfied, dedicated, and energetic, they'll take real good care of the customers. When the customers are happy, they come back. And that makes the shareholders happy."¹ Southwest's walls were filled with photographs of its employees. More than 1,000 married couples (2,000 employees) worked for the airline. The average age of a Southwest employee was 34 years. Southwest employees were among the highest paid in the industry and the company enjoyed low employee turnover relative to the airline industry.

Southwest's culture of hard work, high-energy, fun, local autonomy, and creativity was reinforced through training at its University of People, encouragement of in-flight contests, and recognition of personal initiative.

Being in the people business meant 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

¹ Joan Magretta, *What Management Is: How It Works and Why It's Everyone's Business* (The Free Press, 2002), 199.

candidates during the interview process. Southwest hired for attitude as much as aptitude. Noted CEO Kelleher, “We want people who do things well, with laughter and grace.”²

Southwest initiated the first profit-sharing plan in the U.S. airline industry in 1974 and offered profit sharing to its employees every year since then. Through this plan, employees owned about 10 percent of the company stock. In 2000, Southwest offered its employees a record-setting \$138Mm in profit sharing. This tax-deferred compensation represented an additional 14.1 percent of each employee’s annual salary.

Discussion Questions

1. What is Southwest’s strategy? What is the basis on which Southwest builds its competitive advantage?
2. How do Southwest’s control systems help execute the firm’s strategy?

² Kevin Freiberg and Jackie Freiberg, *NUTS! Southwest Airlines’ Crazy Recipe for Business and Personal Success*, (Bard Press, Inc., 1996), 65.

Exhibit 1. Comparative Financial Data on Selected Companies

	Five-Year Average: 1995-2000				
	Southwest	United	American	Delta	Continental
Five-year return on equity (percentage)	16.3	27.9	12.9	19.5	38.1
Five-year sales growth (percentage)	14.5	5.4	3.0	6.5	11.2
Five-year net income growth (percentage)	26.9	-31.4	30.2	15.2	8.8
	2000 Data				
Sales (\$B)	5.6	19.3	18.1	16.7	9.9
<i>As percentage of sales:</i>					
Cost of goods sold	76	91	87	83	89
Gross margin	24	9	13	18	11
Operating income	23.7	9.0	12.8	17.5	11.0
Net income	10.7	0.3	4.3	4.9	3.5
Return on equity (percentage)	18	12	12	17	30