

Bijay Kusle  
 kusleb@hotmail.com  
 DEGREE: M.S in E-commerce, M.S in Computer Science.

### MGT527 MIDTERM EXAMINATION

This is for those who did not attend class or have their team mates get their exam for them. Keep in mind that this exam also counts as your MBA comprehensive exam (pass/fail in that regard). It is expected that you spend a considerable amount of time pursuing the depth required to successfully complete it. In addition, you should read each question carefully to make sure that you respond in the appropriate manner, and note the page limits. If you have any questions, please let me know. I may not be able to help you with the answers, but I can help you understand the questions. **Please note the due date & time on the syllabus. Late exams may or may not be accepted at my discretion.**

### YOUR TASK

Analyze Southwest Airlines as a case study - Analyze the organization for your organizational project. You may use **only** (1) the information contained at the company website, (2) articles available at Findarticles ([www.findarticles.com](http://www.findarticles.com)), (3) information available at Hoovers ([www.hoovers.com](http://www.hoovers.com) contact the library for a password required to access the premium areas from off campus), (4) articles available at the *Wall Street Journal* site ([wsj.com](http://wsj.com)), articles found on the databases available on EBSCO databases from the library. It is likely that you will desire additional information that would be helpful in analyzing the case. Please note that while you are responsible for using the information available at the aforementioned web sites, but you will *not* be held responsible for material that is not available at these particular sites. I understand that this may limit your ability to fully address some of the issues; you should combine your own experience with the web material that is available at these sites and do the best you can. You should follow the template on the following pages; headings are already provided to get you started.

**NOTE ON WEB RESEARCH:** Do your web research early. Web sites and Internet service providers go down from time to time. Temporary problems with the Internet will not result in an extension of the due date, regardless of when they occur.

**NOTE ON REFERENCES:** You must provide the URL (in a footnote) for all material—NO EXCEPTIONS. For this exam, no additional information beyond the URL is needed. **NO DIRECT QUOTES FROM ANY SOURCES ARE PERMITTED FOR THIS ASSIGNMENT.**

**NOTE ON INTRODUCTION:** I did not include the introduction heading in the case analysis section below. For this exam, you are not required to introduce the firm.

**NOTE ON CORPORATE LEVEL:** Remember that if you are analyzing a firm with multiple business units, you may emphasize the primary business unit in your case. If a single business unit accounts for the vast majority of revenues, you may argue this point in the industry analysis section and spend the remainder of the analysis concentrating on that industry. In this case, the other business units should be acknowledged in the corporate strategy section and possibly other sections as well.

### PLEASE READ

**THE COMPLETE EXAM DOCUMENT (including this page) you submit can contain NO MORE THAN 11 PAGES** single-spaced, using the fonts (Arial Narrow 10) and margins provided in this document. This instruction page is included in the page limit. You should not remove anything from this page and should begin your analysis on the page 2. The following pages should be used as a template for your exam, but it should not be misinterpreted as providing any suggested lengths for each part. You should consider the page limit for the entire exam and the relative weights of the two parts in allocating space. You should rename this file and use it as the basis for completing your exam. Skip a line between paragraphs. Your exam will not be accepted if you alter the fonts or spacing. Before submitting the exam, make sure that everything you type beginning on the next page is in Arial Narrow 10 format.

**PLEASE READ AND DO NOT REMOVE THIS STATEMENT:** I am aware that this is an individual exam, not a group exercise. I have not consulted with anyone else concerning this exam other than the professor. I understand that I can only consult the course materials and the prescribed websites in the exam for assistance. I am aware that violation of this policy will result in a grade of zero for the exam and an "F" for the course. By uploading my exam, I concur with this statement.

## CASE ANALYSIS FOR South West Airlines

### Identification of the Industry

Southwest Airlines is a Domestic Airline Company incorporated in the States of Texas that provides short-haul, high frequency, point-to-point, low-fare services to its customers. It is primarily a Public Airline industry and trades on NYSE as LUV. Southwest Airlines carries a mission to dedicate itself to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit [[http://www.southwest.com/about\\_swa/mission.html](http://www.southwest.com/about_swa/mission.html)]. Since its starting on June 18, 1971, in its 33 years of services, Southwest Airlines has firmly established itself as one of the top ten US airlines. It has also enjoyed 30 straight profitable years [<http://premium.hoovers.com/subscribe/co/factsheet.xhtml?COID=11377>]. Some key facts about Southwest as an Airlines Industry are listed below:

<b>Industry Type</b>	Airlines
<b>Company Type</b>	Public
<b>NYSE Ticker Symbol</b>	LUV
<b>2002 Employees</b>	33,705
<b>1-Year Employee Growth</b>	6.7%
<b>Average Passenger Airfare</b>	\$86.23
<b>Average Passenger Trip Length</b>	729 miles
<b>Fleet</b>	381 Boeing 737 jets (as of July 2004)
<b>Destinations</b>	58 cities (59 airports) in 30 states
<b>Daily Departure</b>	Nearly 2,800 flights a day
<b>Member of Fortune 500 Companies</b>	Yes

Sources: [http://www.southwest.com/about\\_swa/press/factsheet.html](http://www.southwest.com/about_swa/press/factsheet.html)  
<http://premium.hoovers.com/subscribe/co/factsheet.xhtml?COID=11377>

Note: All information provided above are as of this writing or otherwise indicated.

### Industry Profitability

In its 33 years of services as Airlines Industry, Southwest Airlines has enjoyed 30 straight years of profit and has established itself as one of the 10 best Airlines in the United States. The reason for its success is due to its firm determination to serve its customers accordingly to its objectives. Most Southwest flights are less than two hours and it usually uses small airports in order to avoid congestion at competitors' large hub. Its fleet of 381 Boeing consists of the same 737 jets so that much less is spent on training and maintenance costs. The company existed the year 2002 with a net income of \$240 million and total operating revenue of \$5.5 billion. Total passengers carried were 63 millions with a Passenger load factor of 65.9%. A brief six year financial projection of the company is listed below.

	Operating Revenue	Operating Expenses	Operating Income	Operating Margin	Net Income	Net Margin	Stockholders Equity
<b>2002</b>	\$5,521,771	\$5,104,433	\$417,338	7.6%	\$240,969	4.4%	\$4,421,617
<b>2001</b>	\$5,555,174	\$4,924,052	\$631,122	11.4%	\$511,147	9.2%	\$4,014,053
<b>2000</b>	\$5,649,560	\$4,628,415	\$1,029,145	18.1%	\$625,224*	11.1%	\$3,451,320
<b>1999</b>	\$4,735,587	\$3,954,011	\$781,576	16.5%	\$474,378	10%	\$2,835,788
<b>1998</b>	\$4,163,980	\$3,480,369	\$683,611	16.4%	\$433,431	10.4%	\$2,397,918
<b>1997</b>	\$3,816,821	\$3,292,585	\$524,236	13.7%	\$317,772	8.3%	\$2,009,018

(Dollars in Thousands)

Note: Excludes cumulative effect of change in accounting principle of \$22.1 million (\$0.04 per share)

Source: [http://www.southwest.com/investor\\_relations/annual\\_reports.html](http://www.southwest.com/investor_relations/annual_reports.html)

Southwest has always adopted cost-cutting strategies to boost its revenue but at the same time provides the service it has practices for a long time. For example in the year 1994 it launched a ticketless system and adopted its own passenger reservation system to cut costs. One of its most successful cost-cutting and revenue-generating strategies was the development of online ticket booking system, [www.southwest.com](http://www.southwest.com), a first of its kind in airline industry. Southwest's cost per booking via the Internet is less than \$1, and the cost per booking via a travel agent is in the \$6 range. Over \$2.5 billion, of its passenger revenue



Source: [http://www.southwest.com/investor\\_relations/fs\\_stock\\_quote.html](http://www.southwest.com/investor_relations/fs_stock_quote.html)

## The Macroevironment

### Political-Legal Forces

For an airline industry, major Political-Legal Forces are Federal Regulations, Safety Rules, Tax Laws and Federal Aviation Administration. Government sets rules and regulations for aviation industry to secure passengers' safety. These rules are adjusted and amended as per the demand of current situations. Even prior to tragic incident of September 11, airline industry of United States went through number of terrorist attacks that clearly reflected airport security negligence. The Pan Am Flight 103 bombing had sounded increasingly forceful alarm. A 1990 report by the President's Commission on Aviation Security and Terrorism, appointed by then-President Bush, concluded as "The U.S. civil aviation security system is seriously flawed and has failed to provide the proper level of protection for the traveling public". Necessary adjustments and changes were then made by the Bush Commission. Even after that, just before the 1996 Olympics, TWA Flight 800 went down off the coast of Long Island in what was initially believed to be a bombing or missile attack. Post September 11 saw major upgrades and changes in airport security from FAA. Those emergency measures, though, didn't solve the underlying problems. A month after the hijackings, a passenger made it through the security checkpoint in New Orleans International Airport and onto a Southwest flight carrying a loaded derringer. [Adapted from an article by Barry Yeoman, Bill Hogan, Issue: Jan-Feb, 2002. from [www.findarticle.com](http://www.findarticle.com)]

The airline industry is subject to taxation at federal, state, and local levels. Each ticket is comprised not only of the fare Southwest Airlines charges from one destination to another, but also includes four taxes imposed directly on every purchase. These taxes are:

1. Federal Excise Tax - 7.5% of the base price.
2. Federal Flight Segment Taxes (Fee) - An additional \$3.00 fee (adjusted upward annually for inflation) for each flight segment (takeoff and landing) on your itinerary,
3. Federal Security Fee - A new \$2.50 fee on each passenger "enplanement" and
4. Passenger Facility Charges (PFC) - local airports assess fee of up to \$4.50 from each airline passenger.

In addition to these taxes, Southwest also pays a federal fuel tax of 4.3 cents per gallon and is not charged on passenger ticket. In another word, Southwest Airlines has to make 5,417 flights at an average load factor of 70% to pay the federal fuel tax! That is on top of what it pays for the actual fuel itself. [Source: [www.southwest.com](http://www.southwest.com)]

for 2002 was generated by online bookings via **southwest.com**. For second quarter 2003, passenger revenue generated by online bookings reached 53 percent (<http://www.southwest.com/>). A current snapshot of NYSE shown on the left hand side reveals the position of Southwest with its rivals: Jet Blue Airways (JBLU), AMR (AMR) and Delta Airlines (DAL)

Despite the downturn in US economy and problem faced by other Airlines due to unwillingness of customers for air travel after sep-11-2001, Southwest posted profit for 2001 and 2002.

## Economic Forces

Airlines industry is very competitive. With customers' willingness to switch airlines to save some money shows that brand loyalty has little meaning in this business. To lure passengers, airlines have adapted numerous strategies and bonus packs like frequent flyer points. While other airlines took cost cutting methods like laying off workforces or reducing services, Southwest on the other hand, worked to control costs like switching to online reservations system. With its low price and no-frill approach, it quickly dominates whatever market it enters. Slowing down of economy, higher fuel price and September 11 incident have all contributed for economic concerns of airlines industry. Even in the gruesome first quarter of 2001, Southwest reported an after-tax profit of \$121 million [Money; Aug2001, Vol. 30 Issue 8, p46, 2p, 1 chart, 1c].

## Social Forces

Social forces can be broadly divided into two categories: External Forces that happen outside the firm, and Internal Forces that happens inside the firm. Southwest has done a better job in targeting the cost conscious customers; let it be a low cost tickets or a no frill flight. Because of this excellent customer service, according to Fortune magazine, Southwest came out on top as the most admired airline in the world for 1997, 1998, 1999, 2000, 2001, 2002, and 2003 [[www.southwest.com](http://www.southwest.com)].

Apart from good customer service, Southwest maintains a good relationship with its employee. A thank-you advertisement in USA Today on Boss's Day, bought with \$60,000 collected from 16,000 employees is a gesture of good company-employee relationship [Across the Board, Mar95, Vol. 32 Issue 3, p56, 1p]. The airline, nearly 85% unionized, has had only one strike. Employees own about 13% of the company [[www.hoovers.com](http://www.hoovers.com)].

## Technological Forces

Technology has changed the way we do business. Organizations have to adjust and update to latest technologies in order to compete in global market. Conventional ways of doing business have time and again lacked in efficiency and cost as compared to digital ways. Southwest flies all Boeings 737 so that its engineers can gain more expertise while focusing on one technology only. This is a great cost saving advantages. The airline has its own reservation system. On March 1995, Along with a couple of other airlines, Southwest went ticketless [Across the Board; Mar95, Vol. 32 Issue 3, p56, 1/2p]. Southwest became the first airlines to establish a home page, [www.southwest.com](http://www.southwest.com), on internet. Its online booking system has successfully reduced cost [[www.southwest.com](http://www.southwest.com)].

## Successes and Failures in the Industry

Airline Industry has been through lots of ups and downs in the history of aviation. All macroenvironmental forces, like drop in number of passengers and rising cost of fuel, have forced companies to layoff massive work force and trim services. Within a week of start of recent war in Iraq, traffic fell by 10% and advance bookings by up to 40%. As a percentage of GDP, airline revenue has fallen 20 % to 30 % from levels of the past 25 years. Despite the hope of airlines executive of profit to bounce back during economic recovery, revenues may remain depressed. September 11 surely was a turning point for US airlines industry. Even after huge adjustments and reorganizations, for the third year running every major carrier except Southwest is expected to lose money in 2003, with combined losses approaching \$7 billion. For the industry to break even, a hefty revenue growth by 10% is needed. United Airlines' bankruptcy filing on Dec-2002 was another example of industry downfall. Cost is one of the main factors that decides the success or the failure of an airline. Low-cost carriers like Southwest, AirTran, Frontier, and JetBlue are taking market share away from the network Goliaths and growing at rates compare to that of Internet startup. According to Gary Chase of Lehman Brothers Inc, the network carriers' costs are a staggering 66% higher than the low-cost airlines. It seems that there won't be any smooth take-offs back into profitability as most US carriers are still incurring heavy losses. [adopted from: [www.hoovers.com](http://www.hoovers.com) Business Week, 4/7/2003 Issue 3827, p52, 2p, 1 graph, 1c; U.S. News & World Report, 9/15/2003, Vol. 135 Issue 8, p34, 3p, 1 chart, 1 graph, 2c]

## Current Firm-level Strategy

Southwest holds a corporate mission of "dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit". It is equally committed to provide its employees a stable work environment with equal opportunities for learning and personal growth and will be provided the same concern, respect, and caring attitude within the organization that they are expected to share externally with every Southwest Customer [[www.southwest.com](http://www.southwest.com)].

Through profit-sharing plan introduced in 1974, its employees own at least 10 percent of the Company stock. Management works relentlessly to ensure that employees feel respected and have the necessary skills to perform their jobs at a high level. Southwest's theory is that if you serve employees well, they'll serve customers well.

It has always been able to seize quickly a strategic opportunity whenever it arises. Growth strategy of Southwest employs a conservative growth pattern, a cost-containment policy, and the commitment of its employees. Southwest tends to avoid the more congested major airports in favor of smaller satellite fields. Even after 33 years in business it has not had a single crash although it flies the same jet as its competitors. Thus it remains the safest airlines so far. As a fact, according to 1996 statistical report on low-cost carriers released by the Federal Aviation Administration (FAA) had to exclude Southwest from its statistical sample because the airline's low accident rate skewed data for the rest of the cut-rate carriers. It has a close-knit corporate culture, operation in less-congested markets, and slow expansion: more experienced people can show the newer people how things are done. By comparison other low-cost airlines have grown so fast that they have been forced to hire people without much experience [Christian Science Monitor; 5/20/96, Vol. 88 Issue 122, p3, 1c]. Southwest believes that information is power. The firm believes power is a resource that enables employees to do their job better. In 1997, Southwest Airlines added a 24-hour emergency medical service for its customers for in-flight medical emergencies.

### Current Business-level Strategy

Southwest Airlines will fly any plane, as long it's a Boeing 737, and let passengers sit anywhere they like, as long as they get there first. Sticking with what works, Southwest has expanded its low-cost, no-frills, no-reserved-seats approach to air travel throughout the US to serve about 60 cities in 30 states [[www.hoovers.com](http://www.hoovers.com)]. Southwest is the United States' only major short haul, low-fare, high-frequency, point-to-point carrier. The reason behind its success is not just by luring passengers from other airlines but by creating a new market of consumers who now fly instead of drive. When it started flying from Kansas City to St. Louis in 1991, the average fare for that trip dropped from \$142 to \$55 in just one quarter. At the same time, the number of passengers flying that route more than doubled from about 2,100 to about 5,300 [[Across the Board](#); Mar95, Vol. 32 Issue 3, p56, 1/2p]. Its success can be explained as a shrewd business model paired with a smart operating strategy. The company avoids large, congested, and competitive airports for smaller ones. It's no-frills, low-fare airline that offers happy-face customer service and delivers on-time performance [T+D; Mar2002, Vol. 56 Issue 3, p85, 1p].

Its ability to cut price drastically as compared to other airlines is due its saving on in-flight food menu. Passengers do not expect to get a full meal during their flights that are mostly short distanced, about one to two hours in duration. The flight attendances hardly get enough time serving drinks and snacks. Only serving peanuts and refreshments have labeled Southwest's strategy as nuts. On 2001 it served 91.2 million bags of its famous peanuts to passengers. The extra space thus saved is utilized to add more seats and hence more number of passengers boarding each flight. With a full year profit of \$241 million, or 30 cents per share, it shows that the company's business strategy -- low fares and low-cost operations -- works even in the tough economic environment facing all airlines [Fort Worth Star-Telegram; 01/23/2003].

### Business Strategies of Major Competitors

The low-price, no-thrill strategy of Southwest has emerged as a serious threat for big carriers like American Airlines. JetBlue Airways, one of the top competitors of Southwest as a discount airline, has concocted a winning formula: new planes, no lines, on-time arrivals, live TV onboard and some of the lowest prices around. By the end of 2002, JetBlue's load factor, reached an industry high of 83% (the average is 71%) as its profits soared 43%, to \$55 million. Even in the wake of war with Iraq, Jetblue feels no sudden threat as according to its CEO, David Neeleman, 93% of its business consists of long-haul flights, so people who choose cars over planes won't affect it as compared to Southwest Airlines' short haul flight where people tend towards driving instead of flying. The cost of JetBlue, at 6.4¢ a mile, is lower than that of Southwest's 7.4¢. JetBlue's market value, at \$1.7 billion, is nearly as large as United's, American's and Delta's combined but it still does not consider to grow by purchasing a competitor because it expects to expand more internally at 50% this year and 30% to 40% next year [Money; Apr2003, Vol. 32 Issue 4, p56, 2p, 1 graph, 1c].

For some airlines like United, filing for bankruptcy was the only option in order to restructure itself due to sharp decline in economic conditions. Nearly 600 aircraft, about 15 % of the U.S. fleet, are parked in desert holding pens, their engines shrink-wrapped to keep out blowing sand. Overall, the total supply of seats in the air this year will be about 6 percent lower than in 1999. United was able to force once-unthinkable pay cuts on pilots and other workers, while the threat of a similar fate at American persuaded its employees to give up some pay and benefits this spring. Even then, United announced recently that its

emergence from Chapter 11 would be delayed until next year [U.S. News & World Report; 9/15/2003, Vol. 135 Issue 8, p34, 3p, 1 chart, 1 graph, 2c].

With sudden threats of being left behind in the tough airlines and loosing the market to discount airlines like Southwest and JetBlue Airways, competitors like Delta and United also plan to start a low-cost flights soon.

## **Current Functional Strategies**

### **Marketing Strategy**

Southwest's target market is clearly economic customers. It exists to make a profit, achieve job security, and make flying affordable for more people. The company's executives decided that the strategy for these goals would be to provide the best service and lowest fares to the short-distance, frequent-flying, point-to-point traveler [Hudson Valley Business Journal; 04/09/2001-04/16/2001, Vol. 12 Issue 2, p4, 3/8p, 1bw]. Southwest has created the benchmark against which all other airlines set their standards. They have done this by keeping a single-minded focus on their market position. They position themselves as a low-cost, regional airline and work hard to maintain this status. Southwest does not consider other airlines to be an immediate threat or its major competitor. Instead, their competition is with ground transportation like the automobile and the bus. It is against this backdrop that they price and market their service.

When it comes to low cost, it is hard to beat Southwest. One example is when Southwest started its service between Buffalo and Baltimore/Washington, it offered an unrestricted fare of \$65 one-way, which is 81% savings off the \$334 one-way fare for nonstop service then offered by other airlines. This fare was not an introductory fare-it was available on every seat, every flight, every day between Buffalo and Baltimore/Washington. Every work day, it offers more than 2,750+ nonstop flights, ranging from short hops to nonstop, coast-to-coast service from Baltimore/Washington to San Jose, Los Angeles, and San Diego. Its point-to-point service pattern (as opposed to other airlines' hub operations) gets a majority of its Customers to their destinations with one takeoff/one landing [www.southwest.com].

### **Production & Purchasing Strategies**

Southwest flies only one type of aircrafts, Boeing 737 jets. Boeing is one of the few major suppliers for airlines industry. The 737 lines of production has been struggling to boost its commercial jet output in 1997. With other lines of products, including defense systems, military jets, satellite system, and propulsion delivery systems, airlines industry is not a major customer for Boeing. When it comes to purchasing an aircraft, airlines do have number of choices to make depending upon factors like fuel consumption, capacity, speed, etc. Fuel expenses, account for the second largest share of operating costs, and rose by nearly 100% last year, 2002 [Money; Apr2003, Vol. 32 Issue 4, p56, 2p, 1 graph, 1c]. Southwest had hedged against higher fuel prices by locking in 75 percent to 85 percent of its expected 2003 consumption at prices lower than current market levels [Fort Worth Star-Telegram; 04/13/2002]. The choice of aircraft thus has a direct impact on technical, operating and maintenance cost. Southwest's choice to use only Boeing 737 jets is a strategy to reduce cost in training, technology and maintenance. Moreover dealing with only one vendor makes it easier for technical support and spare parts. At present Southwest has more than 355 of the newest jets in the nation, with an average age of 8.75 years [www.southwest.com]

In-flight services and food also constitute a purchase for airlines. While some airlines have excellent in-flight food menu, Southwest used to serve only peanuts and refreshments. But very recently, for those traveling more than 1,120 miles on a Southwest flight, they are likely get a snack that includes, among other things, a bag of Oreos instead of just a small pouch of dry-roasted nuts, or Cheese Nips instead of pretzels. And, for those traveling more than the 450, but less than 1,120 miles on a Southwestjet, they are likely to be given Lorna Doone or Snackwell cookies in the morning or, later in the day, a salty Nabisco snack. It has cut a deal with Kraft Foods to begin serving some of its brand names snacks on the carrier's longer flights [Fort Worth Star-Telegram; 04/13/2002].

### **Human Resource Strategy**

Working environment within an organization does make a big difference in its existence. Proper coordination and understanding among employees working as a team is vital. In an airline industry where service is an integral part, companies strive hard to have the best workforce. Southwest hires only a small percentage of job applicants because it's serious about only taking on people who like to serve other people and who are committed to working in teams. Southwest vets candidates thoroughly and provides excellent training. Management works relentlessly to ensure that employees feel respected and have the necessary

skills to perform their jobs at a high level. Southwest's theory is that if you serve employees well, they'll serve customers well [T+D; Mar2002, Vol. 56 Issue 3, p85, 1p]. Southwest is the only major US carrier to gain profit and still maintain a full flight schedule without any layoffs after September 11 [www.hoovers.com]. Southwest received 243,657 resumes and hired 5,042 new Employees in 2002 and at presently employs more than 33,000 staffs. It has approximately 1,000 married couples, or approximately 2,000 Southwest Employees have spouses who also work for the Company [www.southwest.com]

### Information Systems Strategy

Southwest has always embraced technology as a means of its growth. It was the first airlines to establish a home page on the internet. It has a characteristic of a simple city-to-city product and sold heavily on the Internet, which cuts out travel agents' commissions; each route it flies has to depend on demand in the local area [Economist; 11/18/2000, Vol. 357 Issue 8197, p74, 2p, 1 chart, 1bw]. In 2002, over \$2.5 billion, approximately 49% of its passenger revenue was generated by online bookings via its website southwest.com. For second quarter 2003, passenger revenue generated by online bookings reached 53 percent. Southwest's cost per booking via the Internet is less than \$1, and the cost per booking via a travel agent is in the \$6 range. The cost per booking to Southwest via the airline's reservations agents lies somewhere in between. Initially only five developers comprised its development team and at present it employs more than sixty staffs on the airline's interactive marketing team, with about half of them working on the software development team. More than 3.8 million people subscribe to Southwest's weekly Click 'N Save e-mails. On May 30, 2002, the Jupiter Media Metrix named Southwest the airline that best utilizes the Internet and provides brand synergy between its main line and online presence [www.southwest.com].

Southwest believes in providing accurate information to its customer. One way to achieve this is to have a database controllable by Southwest only. On 2001, it removed its information from the Airline Tariff Publishing Co., which collects and distributes fare information to travel agents and Internet travel sites, a bold move that makes Southwest's own site the only place on the Web where travelers can see the airline's schedules and fares. It sued Orbitz in federal court in May, 2001, alleging that the company displayed inaccurate information about its routes, connections and fares. Users will have to either call the airline or check the company's Website for information. [The Dallas Morning News; 07/07/2001]

### Financial Position of the Firm

Fiscal Year-End	December
Financial Filings	<a href="#">SEC</a>
Auditor	Ernst & Young LLP
Last Close 26-Sep-2003	\$17.61
52-Week High	\$18.99
52-Week Low	\$11.23
Basic EPS	\$0.47
Price/Earnings Ratio	37.47
Current Ratio	1.56
R&D Expenditures (mil.)	--
Ad Expenditures (mil.)	\$156.40
% Owned by Institutions	76.50%

Source: [www.hoovers.com](http://www.hoovers.com)

Note: All data are current as of Sep 2003.

	Annual Sales (\$ mil.)	Annual Net Income (\$ mil.)
2002	5,521.8	241.0
2001	5,555.2	511.1
1999	5,649.6	603.1
1998	4,735.6	474.4

Even though the annual sales of Southwest is only \$5,521.8 million, which is low as compared to major carriers like AMR's \$17,299.1 million and Delta's 13,305.0 million, it has a higher market value of \$13,787.4 million as compared to AMR's \$1,782.2, and Delta's \$1,12.4 million. Southwest has a higher Gross Profit Margin of 61.98% as compared to that of industry's 55.59% and Market's 49.05% but lower than Delta's 71.42% and Jet Blue's 69.07%. The 12-month revenue growth of Southwest is 6.7% which is higher than AMR's (0.6%) and Delta's 2.7%. At present Southwest has become the fourth largest major airline in America [www.southwest.com].

For more information on Southwest Profitability please refer to 'Industry Profitability' section of this writing.

## SWOT Analysis

Much of Southwest's strategies and policies, its success and failure, marketing and customers, have been explained in the above sections. Following will be a brief listing of SWOT analysis.

### Strengths

- One of the biggest strengths of Southwest is definitely its leadership in low-cost tickets.
- With the current market value of \$13,787.4, very large as compared to that of its competitors and its continuous profit turnover shows that it is in a strong financial condition.
- Southwest offers a good customer service in terms of time and value. It has ranked number one in fewest Customer complaints for the last twelve consecutive years as published in the Department of Transportation's Air Travel Consumer Report [www.southwest.com].
- It has a slow and steady growth rate and hence is able to train its employees properly.
- When major carriers concentrated on long-hauled, business travelers for profit, Southwest targeted and continues to do so for short-hauled economic passengers. This market sector has paid off well.
- Convenience: Every work day Southwest offers more than 2,750 nonstop point-to-point flights. Flying from smaller airports it has quick turnaround time and hence saves valuable time of customers.
- It provides some rapid reward programs like frequent flyer points based on number of flights taken.

### Weaknesses

- Since it has an open seat policy, some customers having specific seating choices might find this policy less welcoming – especially for those who do advanced booking. Traveling by Southwest sometimes is like traveling in a local bus.
- Due to its low-cost tickets, lack of in-flight entertainment is a major disadvantage. It also does not provide any meals. So Southwest is not an airline for a long business trip.
- Since it flies from smaller airports it lacks the comfort and facilities of a large airport service.
- Since all reservations have to go through Southwest, no bargain is available through third-party vendors.
- Southwest does not allow pets [Mississippi Business Journal; 12/20/99, Vol. 21 Issue 51, p10, 2/3p]
- It has a limited number of long-hauled flights. So it still is not a number one choice for long business travel.
- Serves only 30 domestic states.

### Opportunities

- Southwest is a leader in low-cost, short-hauled flights. Long-hauled flights are still dominated by larger carriers. Southwest with its policies and dedications to make flying possible and cheap can explore more into the sector of non-stop long flights. One big advantage is its brand name and customers will try this service.
- Assigning a seat plan will definitely not create a financial overhead. Southwest's low price coupled with a proper seating plan will make it more attractive and more disciplined airlines.
- Growing popularity of Southwest can be used as a tool to launch a price war at destinations still not served by it but by other expensive competitors. Customers love its low price as long as they reach their destination on time. According to one report, Southwest's entry in the East Coast, price of flights to Cleveland and Chicago, Illinois dropped from more than \$300 to \$19 to \$34 [Aviation Week & Space Technology, 9/6/93, Vol. 139 Issue 10, p37, 1/4p].
- Explore more domestic market and also start services in remaining 21 states.
- Southwest can also start expanding its wing in the international market. If it can be successful in the domestic stage then it might also do very well in the global arena.

### Threats

- Southwest is currently the nation's fourth largest carrier in terms of customers boarded [www.hoovers.com]. It is the leader in low-cost, no-frills airlines and has been in profit for thirty straight years. How long can it stay in profit despite the recent economic downturn? What if some other new or already established airline company imitates its business strategy? This is not only a threat to Southwest Airlines but to every successful business growing rapidly.
- With success comes competition. New airlines like Jet Blue are a threat to Southwest. Southwest no doubt is able to capture the business with its low-cost policy wherever it sets its target. But competitors like United and Delta also decrease their ticket cost to compete with Southwest.

- Government rules and regulations, FAA rules, Airport Security, Tax policies, Terrorist Attacks have been a major concern after September 11 incident. These factors affect the overall pricing policy of a business and Southwest is not an exception.
- Customer Behavior depicts that "Cheaper means Low Quality". With Southwest's tickets priced very low as compared to its competitors', the company might not be able to successfully convince this consumer sector.
- Southwest employs more than 33,000 staffs and is rapidly growing. As a firm grows, proper management of resources becomes a challenge. With Kelleher, one of the founders of Southwest, stepped down as president and CEO in 2001, new management took over. With a change in management, changes in business practice might change.
- Recent Economic downturn and drastic increase in the price of jet fuel will directly affect its ticket price.

#### SW/OT Matrix

	<b>STRENGTHS—S</b> <ul style="list-style-type: none"> <li>• Low Cost Leadership</li> <li>• High Market Value</li> <li>• Good Customer Service</li> <li>• Slow and Steady Growth Rate</li> <li>• Target Economic Consumer Sector</li> <li>• Convenience</li> <li>• Offers Reward Programs</li> </ul>	<b>WEAKNESSES—W</b> <ul style="list-style-type: none"> <li>• Open Seating Policy</li> <li>• Lack of in-flight entertainment &amp; Meal</li> <li>• Flies from smaller airport</li> <li>• Booking Through Southwest only</li> <li>• No Pets allowed</li> <li>• Limited number of long-hauled flights</li> <li>• Only serves 30 states</li> </ul>
<b>OPPORTUNITIES—O</b> <ul style="list-style-type: none"> <li>• Provide more long-hauled flight</li> <li>• Provide proper seat plan</li> <li>• Use its low-cost policies as a competitive advantage against competitors</li> <li>• Explore remaining 21 states</li> <li>• Explore International Market</li> </ul>	<b>SO STRATEGIES</b> <ul style="list-style-type: none"> <li>• Maintain low cost leadership in long-hauled flights.</li> <li>• Continues good service with proper seat plan will add to its advantages.</li> <li>• Target International Economy class consumer sector.</li> </ul>	<b>WO STRATEGIES</b> <ul style="list-style-type: none"> <li>• Proper Seat Plan, Entertainment and Meal for long flights.</li> <li>• Start services in remaining states</li> <li>• Use larger hubs and open other booking methods for International flights.</li> </ul>
<b>THREATS—T</b> <ul style="list-style-type: none"> <li>• Rapid growth and Low-cost leadership</li> <li>• Competitive market</li> <li>• Government Rules and Regulations</li> <li>• Cheaper means Low Quality</li> <li>• Management Change and Overhead</li> <li>• Slow economy</li> </ul>	<b>ST STRATEGIES</b> <ul style="list-style-type: none"> <li>• Continue low-cost strategy/leadership</li> <li>• Continue Conservative Growth pattern to survive slow economy</li> <li>• Strictly follow Government rules to provide safety</li> <li>• Device marketing strategies to battle Consumer perception of Low Price</li> </ul>	<b>WT STRATEGIES</b> <ul style="list-style-type: none"> <li>• Explore more into untapped consumer sections and continue to draw profit even in slow economy</li> </ul>

#### Alternatives

There is nothing wrong with Southwest's present corporate and business level strategies. But for how long? Or shall it wait for a competitor to prove that it is time for Southwest to remodel its business practices? That definitely is not what a successful company wants to do. As explained in above sections, Southwest is a leader in low-cost, no-frill flights. Its strategies had positioned the firm as the fourth airlines in US in terms of passengers boarding. As it continues to grow and starts entering new market, it has to face fierce competitions form new as well as established airlines. Jet Blue Airways is one such new airline which imitates Southwest and provides more long-haul flights. It has posed as a major competitor for Southwest. AMR is a low-cost airline of American Airlines to provide and compete with reduced-cost airlines. For Southwest to continue its dominance in Low-Cost air travel it needs to explore certain alternatives as:

- Continue with its present strategies without any major and sudden changes but at the same time keep adapting to environmental factors.
- Start providing more long hauled flights and expand to every open potential market sector.
- Gradually enter global market either as a same company or form a new subsidiary.
- Strengthen Information system and booking method.

### Analysis of the Alternatives

History of Southwest reveals that its strategies are very effective. So it should continue to do what it has loved to do for 33 years in business: Customers love Southwest for this. Commitment to business values and corporate mission is one important aspect but being able to adapt quickly and timely with environment should not be neglected. Southwest's low-cost is possible due to certain factors like no meal, no in-flight entertainment, no seat assignments, online booking, only one type of aircraft, non-stop flight, low turnaround time, etc. But what if the price of fuel goes up and Government rules require certain changes to be made for security and safety? These are the factors not controllable within a firm. So continuing with its present strategies, it must keep adapting constantly to its macro environmental forces. A sudden change and diversification from its principle will only hamper its customer loyalty. This will in turn affect its long-gained strong brand image a competitor will take advantage of this opportunity.

Another alternative as a long-haul carrier should be considered as a step towards its product expansion. After being successful as a short-hauled, non-stop airline, it has an equal chance of being successful for long distance flights. Statistics show that wherever Southwest started its long-haul service, price of competitor airlines dropped drastically for their fear of being left out of market and Southwest was able to prove that its strategies are equally effective in diverse market conditions. No meal and no entertainment policy can be a drawback for lengthy flights and hence Southwest needs to develop strategies to include these needs and yet let the customer know that flight duration does not affect Low Cost air travel.

What happens after it provides its services to all potential domestic customer sectors? Does it mean that its growth should stop even with feasible opportunities? If Southwest is so successful in domestic airlines industry then why not try the same formula in global arena. Competition will be tough. With competition comes a standard to be implemented. Playing a global market is a different scenario from that of regional or domestic. Laws, policies, standards will be different. Above all customer choice will be different. But Customer Behavior and psychograph will be same: everyone is thrilled by low-cost air travel. Southwest should start some test flights linking international destinations like Europe and analyze the long-term prospect of its diversification to international market. For this it will have to modify its corporate objective that not only emphasize on highest quality service but also include making low-cost air travel possible according to market position. Southwest should consider a different strategy to provide services like meal, in-flight entertainment, seat plan and aircrafts other than Boeing 737 jets.

As Southwest grows it will need to have a strong Information System. Directing every flight booking to Southwest only will create an overload. A serious hacker attack on southwest.com could shut down the system and without any secondary backup booking system, Southwest will face a deep problem. Distributed booking systems and information system with timely update and synchronization with a central database will be a good alternative for a growing firm like Southwest. Even if one system becomes unavailable, booking can continue through other distributed centers. If Southwest plans to expand in global airline industry then it will need to establish decentralized database systems.

### Recommended Alternatives

I would recommend product diversification by expanding to International Destinations. The slowing down of domestic economy signifies the right time to search for potentials in global market. Along with its product expansion in long-hauled flights, Southwest should test its low-cost philosophy, which worked so well in domestic market, to see if it is equally effective in international market. Necessary changes and adjustments should be made in its business strategy for global market. If Southwest does not want to hamper its present brand image then an alternative is to form a new subsidiary for its international business. These two entities, domestic and international airlines business, will have separate corporate, business and functional strategies but will still be controlled by Southwest and share the same goal – 'Make air travel cheap and possible'.

Distributed information and booking system will also be an added advantage when expanding to international airline industry because it is unrealistic for a person to make an international call just to buy an air-travel ticket. With subunits located in every destination country and closely operating with a head office in the United States, a closed loop business model will be formed with decision power still with Southwest.

### Implementation Control

Once a strategic formulation and a marketing plan have been established for Southwest to start its service into an international airlines industry, these plans must be put into action. For it to be successful, implementation controls must be established to make sure that the goals of the plan are achieved. The first step of the implementation process is to establish procedures for monitoring and adjusting the plan implementation. Secondly, a budget needs to be considered so as to evaluate the costs and

benefits of the plan as it is implemented. Third, the company must take into consideration sudden unforeseen changes in the market place and be prepared to take action when these changes come about. Thus, a contingency plan must be developed in order to effectively deal with this type of situation. With these guidelines in place, Southwest can best position itself to take full advantage of the strategies it developed and market itself as a 'Low-cost, no-frill international airline' company.

Global scenario changes rapidly as factors affecting the environment are diverse. Strategic formulation and marketing plans designed initially might not perfectly fit the purpose. With situation and time, plans should be reviewed, remolded and redesigned. To achieve leadership, Southwest will need to form strategic alliances with other airlines that complement or leverage its capabilities and resources. With business subunits and offices at different countries, understanding and coordination among staffs are necessary. Proper training to international staff is vital to conserve the value of the company. Dealing with an international employee requires understanding and respect of social, cultural and economical aspects of that country. Overall, Southwest's strategies will not exactly be the same as for domestic airline industry.

Another important aspect of monitoring and adjusting the plan implementation is that a timeline must be set to evaluate the plan as a whole. How long should Southwest wait before deciding that international market is favorable for survival? Southwest started to profit on its third year of its business history and continues to do so till now [www.southwest.com]. Board of directors should decide the breakeven point.

Contingency Plan: What if? It is not guaranteed that Southwest will be successful in implementing its strategies for international market. For this unexpected negative business turnover, a plan should be developed in advance so that the firm is able to handle the worst situation and take appropriate decision. A contingency plan could include a plan like to leave the unprofitable sector and reposition its strategies to another potential target country. It could also include a plan to shut down the entire international flights and concentrate only on profitable domestic market, gain substantial information, research heavily, reformulate strategies and then attack the international market at the right time right place.

#### **Future Prospects for the Firm**

Success of an airline company is not possible only with low-cost flights. The degree of service reliability contributes a lot. And Southwest is good at both. Southwest has well established itself as a brand for low-cost airline. It has won many reorganizations from reputed media including Fortune magazine, Wall Street Journal, Money magazine, Globe Finance Magazine, Air Couriers Conference of America (ACCA), etc [www.southwest.com]. It enjoys a high customer loyalty. It is able to capture the market wherever it starts its service. Southwest received a request for service form 140 destinations in 2002 [www.southwest.com]. Such is the demand for this airline. Whenever it starts its service, price from its competitors on that route drops and services at that airport improves. Even during the harsh economic condition after September 11, when major domestic airlines struggled by restructuring their organization, Southwest was the only airline to make profit without any employee layoff and still continuing with full flight services. This proves that even during the bad economy, when purchasing power of customer is low, Southwest can survive very well in the market. By the time the economy improves, Southwest will have a major portion of domestic market under its belt.

As for the competition, Southwest needs to reconsider the serious threat from other small new cut-cost imitators like Jet Blue, which is growing rapidly. With Jet Blue's strategy of low-cost, one-class-service with leather seat and DIRECTV and only electronic booking, it has a one year sales growth of 98.2%. What Southwest did to cut-cost, short-hauled flight, Jet Blue is doing the same with cut-cost, long-hauled flights. If Southwest does not react quickly to Jet Blue's strategies then it has fairly large chance of losing a long-hauled route market sector to Jet Blue. Southwest needs to increase the number of its long-hauled flight to.

The bottom line is that Southwest will continue to grow and gain profit as long as it provides low-cost, no-frill, reliable services and flies from smaller airport because of one great concept – "PAY FOR YOUR TRAVEL ONLY. BRING YOUR OWN FOOD AND ENTERTAINMENT".

\*\*\* END \*\*\*

*NOTE: All information provide on this paper are collected from Southwest Airlines Official Website ([www.southwest.com](http://www.southwest.com)), [www.hoovers.com](http://www.hoovers.com), [www.findarticles.com](http://www.findarticles.com), [www.wsj.com](http://www.wsj.com) and EBSCO database provided through Texas A&M University-Commerce Library.*