James Francart, Harry Fry, Denis Grigorov, Leonard Muhammad, Regina Pelkman, Kyle Schlabach, Robin Chapman

Arizona State University

The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down.1

—Warren Buffett in a 2008 letter to Berkshire Hathaway shareholders

Some of the best minds in business have entered the commercial airline industry and failed. Included in this group is Warren Buffett, who invested in U.S. Air during the 1990s and was unsuccessful in saving the airline.2 Since the inception of commercial flight, more than 200 airlines have tried and failed in the commercial airline industry.3 These companies are a reminder that this business is tumultuous, complex, and in many cases, futile. Herb Kelleher, one of Southwest Airlines’s founders, illustrates his awareness of how difficult it is to achieve any modicum of profitability in this industry with his comment, “If the Wright brothers were alive today Wilbur would have to fire Orville to reduce costs.”4

Financial distress in the airline industry can be tied to the high costs incurred by the airlines to offer their services and low costs demanded by customers to travel. In an already extremely challenging industry, Southwest also faces dilemmas associated with its growth strategy, costs incurred to meet safety regulations on its aircraft, and a dispute with a labor union.5

These issues make the current and future decisions of the company more critical than ever. Fortunately for Southwest, the current president and CEO has a vast amount of experience within the company.

Key Leader

Gary C. Kelly replaced Herb Kelleher, one of the founders and chairman of the board, as president when he resigned in May 2008.6 Kelly began his 22-year career with Southwest in the finance department as controller.7 In that time, he has risen to the top of Southwest Airlines, holding positions such as vice president of finance, executive vice president, chief financial officer, and vice chairman.8 Kelly, with such initiatives as fuel hedging, has been instrumental in Southwest’s recent success.9

History of Southwest

Southwest Airlines, originally known as Air Southwest, was founded by Rollin King and Herb Kelleher. Southwest took its first flight in June 1971, serving three major cities: Dallas, Houston, and San Antonio.10 Within the first two years Southwest suffered operating losses and was forced to make a difficult decision: lay off employees or sell one of its four aircraft. As an early indication of Southwest’s loyalty to its employees, it chose to sell the aircraft.11 This established the company’s “no layoff policy” that is still in force.12

Southwest was able to sustain a four-aircraft schedule using only three aircraft by utilizing the “ten-minute turn.”13 Southwest turned its first annual profit in 1973. Southwest’s expansion strategy flourished after 1973. By 1977 Southwest operated six airplanes and had transported five million customers.14 New flight destinations were added such as Rio Grande Valley, Austin, Corpus Christi, El Paso, Lubbock, and Midland/Odessa.15 Between 1979 and 1980, Southwest established its first interstate service to New Orleans and Albuquerque, followed by Oklahoma City and Tulsa.16 Southwest expanded west in 1982, when it added service to Phoenix, Las Vegas, and San Diego.17 In late 1984 the first 737-300 was added to its fleet and was used to service flights to Chicago Midway and St. Louis.18

In 1986, Southwest opened a new multi-million dollar training center for flight crews.19 Since customer satisfaction was Southwest’s main focus, it began a frequent flyer program, “The Company Club,” in 1987. In 1988,
Southwest won its first monthly Triple Crown award for having the best on-time record, best baggage handling, and fewest customer complaints. All of its achievements allowed it to reach the billion-dollar revenue mark and become a major airline by 1989. In 1990, Southwest created its corporate culture committee to take the lead in preserving the airline’s unique culture.23

Southwest began to offer service to many new cities such as Nashville, Sacramento, Cleveland, and Columbus, and finally entered the east coast market in 1993 when it offered service to Baltimore/Washington International Airport.24 With the acquisition and integration of Morris Air in 1994, the company was able to add service to seven new cities, including Seattle, Spokane, Portland, Salt Lake City, and Boise. That same year Southwest became the first airline to introduce Ticketless Travel in four cities, which eventually expanded system-wide in January of 1995.25 Later in 1995, Southwest became one of the first airlines to have its own Web site, and the following year the Ticketless Travel system debuted online.26

After 25 years of service, Southwest owned a fleet of 243 aircraft and it saw an opportunity to introduce a fuel cost management program. The Asian market plummeted in 1998, causing jet fuel costs to drop to 35 cents per gallon. Southwest took advantage of this opportunity and hedged its fuel costs. Within two years fuel costs had increased as crude oil increased from $11 to $34 per barrel.

Further expansion, tangible asset improvements, and technology upgrades continued between 1999 and 2006. Southwest expanded to serve locations such as Long Island and Raleigh-Durham. It teamed up with IBM to introduce approximately 250 self-service check-in kiosks.27 This project was “part of a nationwide effort to reduce the amount of time Southwest customers spend in line and to improve the airport experience.”28 By 2004, Southwest was offering online boarding passes via its Web site, allowing passengers to go directly to the departure gates without having to stop at the ticket counter.29 Customer convenience increased even more in 2005, when Southwest “extended online check-in to 24 hours prior to departure.”30 By 2006, Southwest was ranked number one among airlines in customer satisfaction.31

Southwest updated its boarding procedure in 2007. Passengers are now assigned a boarding letter and a number that assigns them a specific place in line.32 Select fare increases aligned with continuous cost-cutting policies resulted in the year-end revenue of $9.8 billion and $645 million in profits.33

In November 2008, Southwest purchased one of its main competitors, ATA Airlines, which allowed it to obtain boarding slots at New York’s LaGuardia Airport.34 Acquiring ATA has the potential to provide Southwest with means to connect to foreign destinations. Southwest also partnered with WestJet Airlines, a low-cost carrier, to synch flights between Canada and the United States.

Southwest followed other carriers in early 2009 by increasing fare prices $10 per leg in the domestic market and up to $40 per leg for international routes.35 Southwest’s technological innovations, procedure changes, price increases, and recent acquisitions are attempts to overcome the looming challenges in the airline industry.

**Industry Challenges**

Factors such as increased fuel costs and other high operating expenses, a decrease in business travelers due to budget cuts, and increased regulation have placed strains on airline companies. Many airlines have subsequently been forced out of business or acquired by competitors. This is illustrated by the fact that the large group of airlines that made up the industry 30 years ago has narrowed to six major firms that control a majority of the market (see Exhibit 1). These six carriers constitute five traditional airline companies (American, Continental, Delta, United, and US Airways) and Southwest, the low-cost leader.

Additionally, many airlines have been forced to file for bankruptcy. From 2005 to 2007, US Airways, UAL Corporation (United Airlines), ATA Airlines, Northwest Airlines, and Delta Air Lines all emerged from bankruptcy proceedings.36 In 2008, Frontier Airlines, Skybus Airlines, Inc., Aloha Airlines, and ATA Airlines (for the second time) filed for bankruptcy.37 All of these

### Exhibit 1 Airline Domestic Market Share (March 2009)

![Airline Domestic Market Share](http://www.transtats.bts.gov)

bankruptcies demonstrate the difficult and competitive nature of the industry.

**Competitive Environment**

Southwest considers any airline offering a flight on the same route it does a competitor, regardless of the overall size of that competitor’s operations. Since Southwest now operates in many geographic markets throughout the United States, essentially every airline that offers service to domestic cities is viewed as a competitor.36

New companies still occasionally try to replace Southwest as the low-cost leader. Many of these new airlines have disappeared as fast and unspectacularly as they flashed into existence. For example, Skybus, founded by an ex-Southwest employee, copied Southwest’s operating model and began its operations in May 2007. Within one year it discontinued operations, citing the weakened state of the economy and increasing fuel costs as the reasons for its ruin.37

Although it was able to sustain operations for a longer period of time, the final days of Frontier were no less tragic. When Frontier filed for bankruptcy in April 2008, six days after Skybus,38 it was the fourth airline to close its doors that week.39

JetBlue, also founded by an ex-Southwest employee, emerged in 1999 and is one of the few new entrants to successfully become a principle competitor to Southwest both in terms of route coverage and low-cost, low-fare strategies.40 It is currently the seventh-largest airline in the United States and holds 4 percent market share compared to Southwest’s 13 percent. It operates mostly with point-to-point routes and reaches 52 destinations in 19 states as well as South and Central America and the Caribbean. It just opened its own terminal at JFK airport in New York and claims it has started a new airline category, the “value airline” based on service, cost, and style.41

Traditional carriers have recently also adopted cost-cutting practices to more effectively compete with their low-cost counterparts.42 More than 200 aircraft were grounded in 2008, Continental cut 3,000 jobs, and airlines offered fewer flights.43 Although the major carriers are still offering higher fares overall, their business models are beginning to mirror those of low-cost rivals. Thus, Southwest has to increasingly improve its marketing efforts to differentiate itself.

**Marketing Strategy**

Due to the industry-wide move to promote value, Southwest aims to differentiate itself from its competitors by utilizing quirky, humor-driven advertising.44 One of its first ads, featuring the slogan, “How do we love you? Let us count the ways” illustrated that by offering many flights throughout the day to its first three destinations, Southwest loved its customers (see Exhibit 2).

Another example relates to the recent checked bags fees charged by most other airlines. In response, Southwest began promoting a “no fees” policy in its advertisements such as with its “The Other Side” ad, illustrating a desk clerk with two faces: one face offering only the competitor’s airfare; the other face demanding additional fees.

To further develop its unconventional niche in the airline industry and achieve success as a low-cost provider, Southwest distinguishes itself using both quantitative and qualitative characteristics.

**Low Costs**

An efficiency technique that has consistently saved Southwest both time and expense is the standardization of its airline fleet. It was the first company to put into practice the “one-model-fleet” tactic,45 meaning that it has focused on purchasing only one aircraft model. It started in 1971 with a fleet of Boeing 737-200s, and it has used the Boeing 737 model ever since, being one of the launch customers for the Boeing 737-700, 737-500, and 737-300 series.46 This model has been deemed “the workhorse of the aviation industry” and has gained a reputation of being excellent in the areas of cost, reliability and flexibility.47 “Having a single airplane model in a fleet also lowers inventory, record keeping and maintenance costs, and it minimizes the number of technical manuals, tools and spare parts. Also, fleet management is greatly simplified [and] maintenance crews do not have to modify their routines to service different models.”48

Another tactic that Southwest employs to maintain its low costs is fuel hedging. Southwest began this practice in the late 1990s and it has played a major role in its 36 years of profitability.49 Although Southwest is renowned for using this methodology, the idea of oil futures contracts is nothing new in the airline industry (see Exhibit 3). “All the major airlines have hedged fuel prices since the 1980s, but as the major carriers have run into financial difficulties in recent years, they have no longer had the cash—or the creditworthiness—to play the oil-futures market.”50 Nonetheless, Southwest has successfully hedged “at least 70 percent” of its fuel consumption, saving the company $727 million in 2007.51 Fuel costs fluctuated significantly during 2008, starting out at $91, hitting $151 during the summer, and closing the year at $51. The significant change in oil prices did not provide Southwest with cost savings like those in 2007, but it
did allow it to secure a good hedging contract through 2013 based on the fourth quarter fuel prices ($51). This is expected to save $600 million in fuel costs annually compared to 2008.52

Southwest exercised other cost-saving measures concerning fuel consumption, such as the implementation of blended winglets on all of its 737-700s.53 These blended winglets would "improve performance by extending the airplane's range, saving fuel, lowering engine maintenance costs and reducing takeoff noise."54 (See Exhibit 4 for estimates on fuel savings.) Testing on the blended winglets demonstrated "gross fuel mileage improvement ... in the range of 4 to 5 percent."55 In 2003, Southwest announced that performance-enhancing "blended winglets" would be installed on all existing and future aircrafts, though this action was not carried out until 2007.56

In 2008, Southwest initiated a contract with Pratt & Whitney to use its EcoPower® engine wash services. EcoPower uses atomized water to wash aircraft engines and prevent potential contaminant runoff. This system is more efficient and effective than traditional engine washing processes and extends on-wing time for Pratt & Whitney, International Aero Engines, General Electric, Rolls-Royce, and CFMI engines. By using this engine wash, Southwest anticipates saving "more than $20 million in fuel costs [at 2008 prices]."57

The following measures not only help Southwest save on costs, but also to retain its reputation for being reliable and punctual.
### Southwest’s Profitable Bet

Percentage of each airline’s fuel needs that are hedged against higher fuel prices and have been disclosed, with the price caps of their hedges.

<table>
<thead>
<tr>
<th></th>
<th>2007 4th quarter</th>
<th>2008 full years</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>HEDGED</td>
<td>PRICE CAP</td>
<td>HEDGED</td>
<td>PRICE CAP</td>
</tr>
<tr>
<td>Alaska¹</td>
<td>50%</td>
<td>$62</td>
<td>32%</td>
<td>$64</td>
</tr>
<tr>
<td>American</td>
<td>40</td>
<td>69</td>
<td>14</td>
<td>n.d.†</td>
</tr>
<tr>
<td>Continental²</td>
<td>30</td>
<td>93</td>
<td>10*</td>
<td>93</td>
</tr>
<tr>
<td>Delta²</td>
<td>20</td>
<td>99</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>JetBlue²</td>
<td>47</td>
<td>83</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Northwest¹</td>
<td>50</td>
<td>73</td>
<td>10*</td>
<td>84</td>
</tr>
<tr>
<td>Southwest¹</td>
<td>90</td>
<td>51</td>
<td>70</td>
<td>51</td>
</tr>
<tr>
<td>United²</td>
<td>18</td>
<td>93</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>US Airways</td>
<td>1</td>
<td>73</td>
<td>15</td>
<td>73</td>
</tr>
</tbody>
</table>

¹Price based on crude oil.
²Price based on heating oil, which is more expensive.
*First quarter only. †Price not disclosed.


### Exhibit 4 Improvements from Winglets

**Figure 6**

**Average of eastbound and westbound block fuel improvement**

- 737–800
- BBJ

**Weights**
- Cruise: LRC
- OEW: 91,660 lb
- Passengers: 162
- Mission rules: Typical mission
- 5% contingency
- 200-nmi alternate
- 30-min hold at 1.5 k
- None

**Source:** Aero 17 – Blended Winglets, fig. 6, [http://www.boeing.com/commercial/aeromagazine/aero_17/winglet_story](http://www.boeing.com/commercial/aeromagazine/aero_17/winglet_story).
Punctuality

Timeliness has been a defining characteristic for Southwest since its beginning. In the 1970s, the company had a 10-minute turnaround time for aircraft while the industry average was four to six times longer.58 Southwest’s “turnarounds now average 23 minutes, but that’s still . . . half the time it takes other airlines.”59 It is able to maintain this quick turnaround rate because it uses point-to-point service (curtailing connection times and luggage transfers) and secondary airports for the bulk of its flights (reducing potential congestion).60 Instead of point-to-point service most legacy carriers use a hub-and-spoke system where small feeder airlines from smaller cities feed into larger international airports such as Delta’s hub in Atlanta.

The boarding process with unassigned seating is another of Southwest’s differentiating qualities, but one for which it has received mixed reviews from customers.61 Although this tactic aids in quicker gate turnaround,62 it is flawed from a customer service standpoint and has a reputation as “cattle call” check-in. It favors customers who are able to arrive at the gate early, no matter when the ticket was purchased (even with an “A” boarding pass—see Exhibit 5). In response to customer complaints Southwest initiated a new check-in process in 2007. Kelleher believes, “Customers are like a force of nature: You can’t fool them, and you ignore them at your own peril.”63 The new method gives passengers a group letter (A, B, C) and a number (1 to 60) based on order of check-in, thus it reserves more of a semblance of a place in line than the previous process.64 Even though this distinction creates perceived value for the customer in terms of time savings, there is still controversy about this method among Southwest customers. Recently, adjustments were made to accommodate families with small children, who did not receive priority seating when the change was first made.65

Exceptional Customer Service Begins at Home

A unique aspect of Southwest’s customer service perspective is that the end-user is not the primary focus, the employees are; “If [Southwest] can effectively make employees feel good about what they’re doing on a daily basis, satisfied employees will deliver [a] . . . sense of friendliness and care to Southwest passengers.”66

In 2008, Southwest was the highest-rated airline in Fortune’s list of “America’s Most Admired Companies.”67 It ranked first in the categories “people management” and “quality of management.” Southwest’s reputation for being a great employer is further illustrated by the fact that in 2007, Southwest received 329,200 resumes from job seekers.68 In 1973, the airline adopted the first profit-sharing plan in the U.S. airline industry, and employees now own at least 8 percent of the company stock.69 It would be safe to assume that these factors are key contributors to the low employee turnover rate that Southwest enjoys.70 However, there have been some recent issues related to union activities and contract negotiations that could possibly tarnish Southwest’s reputation as an employer (see the Additional Challenges section).

Exhibit 5 Southwest’s Boarding Process

### How it worked before:
- Each passenger’s boarding pass was assigned to Group A, B, or C, based on check-in.
- A and B groups had 45 passengers, with everyone else in Group C.
- Families with young children boarded before the groups were called.
- In the gate area, passengers in each of the groups lined up, often 30 to 45 minutes before boarding, in either the A, B, or C line.
- Passengers boarded by group letter.
- Seats were unassigned.

### The new boarding drill:
- Passenger boarding passes will have a group letter (A, B, or C) and a number (1 to 60), based on order of check-in.
- In combination, the letter and number reserves passengers’ places in line, leaving them free to relax or get something to eat.
- Groups A and B contain 60 passengers each; those remaining are in Group C.
- Families with young children must now wait until the A group has boarded, unless they hold A passes.
- At the gate, six stainless steel columns divide passengers into groups of five on each side. For example, the first column has passengers holding 1–5 passes on one side and those with 31–35 on the other. The second column has spaces for those holding 6–10 and 36–40.
- Electronic monitors indicate which group is boarding. Those with A passes standing on the first side of the column will board, followed by those on the other side. As the second half boards, Group B will assemble.
- Seats are still unassigned.

**Reward Programs**

Nearly every major airline has attempted to increase customer loyalty through reward programs. These programs offer repeat customers perks such as an accelerated check-in process, upgrades, and even free flights and hotel stays. However, it is debatable how effective these programs are. Leisure travelers may not travel enough to allow these programs to influence their purchasing decisions; and business and other frequent travelers, who are much more concerned about convenience and scheduling, are often members of many, if not all, frequent flyer programs from each airline. The end result is that Rewards programs have not had a major impact on Southwest’s bottom line.

**Financial Results**

Southwest Airlines reported an operating profit of $449 million for the year 2008, despite rising operating expenses marking 71 consecutive quarters of profitability. Total operating expenses for the year increased 16 percent compared to 2007 and were driven primarily by higher fuel costs (44 percent), as well as ongoing maintenance costs (see Exhibit 6). However, Southwest did make 2008 its thirty-sixth consecutive year with annual operating profits.\(^7\)

In 2008, Southwest boasted an operating profit margin (4 percent) much higher than its competitors such as Delta (−36 percent), JetBlue (3.2 percent),

---

**Exhibit 6  Southwest Airlines—Consolidated Statement of Income**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Revenues:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Passenger</td>
<td>$9,457</td>
<td>$8,750</td>
<td>$7,279</td>
</tr>
<tr>
<td>Freight</td>
<td>130</td>
<td>134</td>
<td>133</td>
</tr>
<tr>
<td>Other</td>
<td>274</td>
<td>202</td>
<td>172</td>
</tr>
<tr>
<td>Total operating revenues</td>
<td>9,861</td>
<td>9,086</td>
<td>7,584</td>
</tr>
<tr>
<td><strong>Operating Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries, wages, and benefits</td>
<td>3,213</td>
<td>3,052</td>
<td>2,782</td>
</tr>
<tr>
<td>Fuel and oil</td>
<td>2,536</td>
<td>2,138</td>
<td>1,341</td>
</tr>
<tr>
<td>Maintenance materials and repairs</td>
<td>616</td>
<td>468</td>
<td>446</td>
</tr>
<tr>
<td>Aircraft rentals</td>
<td>156</td>
<td>158</td>
<td>163</td>
</tr>
<tr>
<td>Landing fees and other rentals</td>
<td>560</td>
<td>495</td>
<td>454</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>555</td>
<td>515</td>
<td>469</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>1,434</td>
<td>1,326</td>
<td>1,204</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>9,070</td>
<td>8,152</td>
<td>6,859</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>791</td>
<td>934</td>
<td>725</td>
</tr>
<tr>
<td><strong>Other Expenses (Income):</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense</td>
<td>119</td>
<td>128</td>
<td>122</td>
</tr>
<tr>
<td>Capitalized interest</td>
<td>(50)</td>
<td>(51)</td>
<td>(39)</td>
</tr>
<tr>
<td>Interest income</td>
<td>(44)</td>
<td>(84)</td>
<td>(47)</td>
</tr>
</tbody>
</table>
United (−21.9 percent), and American (−7.9 percent). This is an indication of Southwest’s ability to control costs in an industry that has historically struggled in this area. Continued emphasis on cost cutting has allowed Southwest to avoid filing for bankruptcy, unlike many of its competitors (see Exhibit 7).

In the airline industry, a high ROA indicates a company’s ability to generate high income proportionate to its held assets, which are primarily composed of aircraft and other flight equipment, property (including airport operating slots), and fuel hedge contracts. In 2008, Southwest operated with an ROA of 1.2 percent, double that of the next-closest competitor, JetBlue (−1.3 percent). This demonstrates Southwest’s outstanding ability to avoid excess capacity and service outages.

Many airlines rely heavily on debt financing, since many investors avoid sinking cash into this industry. Southwest has been able to maintain low levels of debt and position itself with the lowest D/E ratio (77.6) among major airlines (the industry average D/E is 330). Southwest has been able to generate income, have positive profit margins, and maintain low debt levels because it puts great effort into wisely carrying out its strategies.

Part of Southwest’s efforts to maintain positive operating margins and low debt levels is to expand its service to greater destinations.

**Expansion Plans**
Kelly has expressed a desire to expand Southwest beyond the 64 cities it currently serves, calling the airline “an adolescent” in the airline industry. Although the airline is cutting certain less profitable routes, the net result of the additional flights will increase the company’s overall flights by nine.

In March 2009, flights between Chicago and Minneapolis were added. “The people of Minnesota have been asking for Southwest Airlines’ service for many years, and we can’t wait to introduce them to our legendary customer service, as well as our low fares, on-time flights, and no hidden fees.” Even though its strategy is primarily limited to domestic expansion with a push into Denver, Southwest is exploring ways to launch services to the Caribbean and England. It recently announced the addition of flights to Mexico through code-sharing with Volaris. “Volaris has a stellar reputation for being a highly efficient airline with a dedication to customer service, which makes it a natural fit for Southwest Airlines.” Growth initiatives also include possible acquisitions of flights once belonging to now defunct airlines such as Ted (United Airlines attempt at a lower cost approach).

### Additional Challenges

**Technology**
The airline companies’ widespread integration of the Internet into the booking process acts as a double-edged sword. Customers value the ease provided by online booking, which in turn draws in customers. Southwest obtained first-mover advantage using this technology when it became the first airline to offer the service. However, now that this has become the industry

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**Exhibit 6** Southwest Airlines—Consolidated Statement of Income (Continued)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other (gains) losses, net</strong></td>
<td>(292)</td>
<td>151</td>
<td>(90)</td>
</tr>
<tr>
<td><strong>Total other expenses (income)</strong></td>
<td>(267)</td>
<td>144</td>
<td>(54)</td>
</tr>
<tr>
<td><strong>Income before income taxes</strong></td>
<td>1,058</td>
<td>790</td>
<td>779</td>
</tr>
<tr>
<td><strong>Provision for income taxes</strong></td>
<td>413</td>
<td>291</td>
<td>295</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$645</td>
<td>$499</td>
<td>$484</td>
</tr>
<tr>
<td><strong>Net income per share, basic</strong></td>
<td>$.85</td>
<td>$.63</td>
<td>$.61</td>
</tr>
<tr>
<td><strong>Net income per share, diluted</strong></td>
<td>$.84</td>
<td>$.61</td>
<td>$.60</td>
</tr>
</tbody>
</table>

standard, it has significantly increased consumer ability to apply some pressure on ticket prices. Travel search engine sites such as Expedia.com, Travelocity .com, Orbitz.com, Kayak.com, and others have further exasperated this issue for the airlines. Southwest has long refused to submit pricing information or allow the purchase of its tickets from these sites. Since there are many airlines and negligible switching costs, this is truly an industry that has long lacked customer loyalty.

Violations of Safety Requirements. Early in 2008, it was revealed that Southwest had flown at least 117 aircraft that were in violation of mandatory safety checks.\footnote{2008, Southwest Airlines 2007 Annual Report, http://www.southwest.com.} As a result, the airline had to temporarily ground 47 of its aircrafts for re-inspection, and the Federal Aviation Administration charged the airline with $10.2 million in fines.\footnote{2008, AMR Corporation 2007 Annual Report, http://www.aa.com.} Southwest claims, “[it] discovered the missed inspection area, disclosed it to the FAA, and promptly reinspected all potentially affected aircraft in March 2007. The FAA approved our actions and considered the matter closed as of April 2007.” FAA inspectors contest that Southwest continued to use the planes in question before inspections were complete, thus the airline did not take immediate corrective action.\footnote{2008, Delta Air Lines, Inc. 2007 Annual Report, http://www.delta.com.} Gary Kelly states, “Our interpretation of the guidance that we got from the FAA at the time was that we were in compliance with all laws and regulations … the important point is that at no time were we operating in an unsafe manner, and I think our history proves it.”\footnote{2008, UAL Corporation 2007 Annual Report, http://www.united.com.}

Union Walkout
The company that once enjoyed superior employee relations compared to its competitors ran into problems in 2008. Complaints of unequal pay for members of ground crew and no raises since 2005 prompted a walkout by the labor union on November 20, 2008.\footnote{2008, Southwest Airlines 2007 Annual Report, http://www.southwest.com.}
2009 an agreement was reached. The union president admitted that the negotiations were conducted with a spirit of cooperation that is part of Southwest’s culture: “Southwest Airlines flight attendants have always been an integral part of the airline’s success and it is great news that together they have negotiated a contract that recognizes their contribution.”* Flight attendants will gain wage increases and a boost in 401k contributions, but only to the degree that such increases will allow Southwest to keep its low-cost advantage.

Questions to Address

As the airline industry as a whole suffers, due to threats from fuel price increases, ever-escalating operational costs, potential security threats, and the current global economic crisis, can Southwest maintain its 36-year streak of profitability? With fluctuating oil prices, can Southwest continue to depend on fuel hedging as an important source of cost control? As it expands its domestic flight operations, will “point-to-point” methodology still prove to be useful? As the major traditional airlines become more like their low-cost counterparts, will they ultimately become more of a competitive threat to Southwest? Using its current strategy, will Southwest be able to expand internationally? Can it maintain its positive relations with employees and avoid future union walkouts and negotiations? If the current economic crisis persists, how will the present expansion plans by Southwest fare? As environmental uncertainties mount, what overall strategies and as well as competitive tactics should Southwest consider to maintain its low cost position and perception of customer loyalty?

NOTES

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