CASE 25

Southwest Airlines in 2016: Culture, Values, and Operating Practices

Arthur A. Thompson
The University of Alabama

John E. Gamble
Texas A&M University–Corpus Christi

In 2016, Southwest Airlines was the world's second-largest airline in terms of total passengers boarded (144.6 million in 2015), trailing only Delta Air Lines, which boarded just over 180 million passengers in 2015 (counting those on flights operated by Delta's regional and international joint venture partners). However, based on the most recent data available from the U.S. Department of Transportation, the number of originating domestic passengers boarding Southwest flights exceeded those of Delta and its other two biggest rivals—American Airlines and United Airlines (see Exhibit 1). Southwest also had the enviable distinction of being the only major air carrier in the world that had been profitable for 43 consecutive years (1973–2015). In 2015, Southwest was named to *Fortune*'s list of the World's Most Admired Companies for the 22nd consecutive year, coming in at number seven.

From humble beginnings in 1971 as a scrappy underdog with quirky practices that once flew mainly to "secondary" airports (rather than high-traffic airports like Chicago O'Hare, Los Angeles International, Dallas–Fort Worth International, and Hartsfield–Jackson International Airport in Atlanta), Southwest had climbed up through the industry ranks to become a major competitive force in the domestic segment of the U.S. airline industry. It had weathered industry downturns, dramatic increases in the price of jet fuel, cataclysmic falloffs in airline traffic due to terrorist attacks and economy-wide recessions, and fare wars and other attempts by rivals to undercut its business, all the while adding more and more flights to more and more airports. The number of passengers flying Southwest had increased from 72.6 million in 2000 to 144.6 million in 2015. At year-end 2015, Southwest had a fleet of 704 Boeing 737 aircraft serving 97 destinations in 40 states, the District of Columbia, Puerto Rico, Mexico, Costa Rica, Belize, Jamaica, the Bahamas, Aruba, and the Dominican Republic. Southwest planned to begin flights to Cuba in 2016, if approved by the U.S. Department of Transportation.

In 2015, Southwest earned record after-tax profits of $2.2 billion on revenues of $19.8 billion, easily surpassing the 2014 record after-tax profits of $1.2 billion on revenues of $18.6 billion. In May 2016, Southwest's board of directors authorized a $2.0 billion share repurchase program (on top of a recently completed $1.5 billion share repurchase program announced in May 2015) and increased the quarterly dividend to $0.10 per share starting June 2016, up from $0.075 per share (starting in June 2015) and $0.06 per share in 2014. The June 2016 dividend payment marked the 159th consecutive quarter Southwest had paid a dividend to shareholders.

COMPANY BACKGROUND

In late 1966, Rollin King, a San Antonio entrepreneur who owned a small commuter air service, marched into Herb Kelleher's law office with a plan to start a low-cost/low-fare airline that would shuttle passengers between San Antonio, Dallas, and Houston.[1] Over the years, King had heard many Texas business executives complain about the length of time that it took to drive between the three cities and the

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EXHIBIT 1 Total Number of Domestic and International Passengers Traveling on Selected U.S. Airlines, 2000, 2005, 2010, 2013–2015 (in thousands)

	Total Number of Enplaned Passengers (including both passengers paying for tickets and passengers traveling on frequent flyer awards)					
Carrier	2000	2005	2010	2013	2014	2015
American Airlines (see Note 1)						
Domestic	68,319	77,297	65,774	65,070	66,384	93,280
International	17,951	20,710	20,424	19,962	24,444	25,010
Total	86,270	98,007	86,198	85,032	87,828	118,290
Delta Air Lines (see Note 2)						
Domestic	97,965	77,581	90,141	98,590	106,220	114,904
International	7,596	8,359	19,390	18,925	21,798	22,828
Total	105,561	85,940	109,531	117,515	128,018	137,732
Southwest Airlines (see Note 3)						
Domestic	**72,568**	**88,436**	**106,270**	**115,323**	**126,695**	**142,408**
International	**—**	**—**	**—**	**—**	**500**	**2,167**
Total	**72,568**	**88,436**	**106,270**	**115,323**	**127,195**	**144,575**
United Airlines (see Note 4)						
Domestic	72,450	55,173	43,323	65,221	64,668	69,179
International	10,625	10,356	9,727	22,209	25,203	25,713
Total	83,075	65,529	53,050	87,430	89,871	94,892

Note 1: American Airlines and US Airways merged in December 2013, but continued to operate under their separate names through 2014. Previously, US Airways had merged with America West in September 2005.
Note 2: Delta Air Lines and Northwest Airlines merged in October 2008; however, combined reporting did not begin until 2010.
Note 3: Southwest Airlines acquired AirTran in late 2010; starting in 2013 and continuing into 2014, AirTran flights were rebranded as Southwest Airlines flights. Southwest's first international flights began when some of AirTran's international flights were rebranded as Southwest flights in 2013.
Note 4: United Airlines acquired Continental Airlines in 2010, and the two companies began joint reporting of passenger traffic in 2012. Prior to 2012, traffic count data are only for United flights.

Source: U.S. Department of Transportation, Bureau of Transportation Statistics, Air Carrier Statistics, Form T-100.

expense of flying the airlines currently serving these cities. His business concept for the airline was simple: Attract passengers by flying convenient schedules, get passengers to their destination on time, make sure they have a good experience, and charge fares competitive with travel by automobile. Kelleher, skeptical that King's business idea was viable, dug into the possibilities during the next few weeks and concluded a new airline was feasible; he agreed to handle the necessary legal work and also to invest $10,000 of his own funds in the venture.

In 1967, Kelleher filed papers to incorporate the new airline and submitted an application to the Texas Aeronautics Commission for the new company to begin serving Dallas, Houston, and San Antonio.[2] But rival airlines in Texas pulled every string they could to block the new airline from commencing operations, precipitating a contentious four-year parade of legal and regulatory proceedings. Kelleher led the fight on the company's behalf, eventually prevailing in June 1971 after winning two appeals to the Texas Supreme Court and a favorable ruling from

U.S. Supreme Court. Kelleher recalled, "The constant proceedings had gradually come to enrage me. There was no merit to our competitors' legal assertions. They were simply trying to use their superior economic power to squeeze us dry so we would collapse before we ever got into business. I was bound and determined to show that Southwest Airlines was going to survive and was going into operation."[3]

In January 1971, Lamar Muse was brought in as the CEO to get operations underway. Muse was an aggressive and self-confident airline veteran who knew the business well and who had the entrepreneurial skills to tackle the challenges of building the airline from scratch and then competing head-on with the major carriers. Through private investors and an initial public offering of stock in June 1971, Muse raised $7 million in new capital to purchase planes and equipment and provide cash for startup. Boeing agreed to supply three new 737s from its inventory, discounting its price from $5 million to $4 million and financing 90 percent of the $12 million deal. Muse was able to recruit a talented senior staff that included a number of veteran executives from other carriers. He particularly sought out people who were innovative, wouldn't shirk from doing things differently or unconventionally, and were motivated by the challenge of building an airline from scratch. Muse wanted his executive team to be willing to think like mavericks and not be lulled into instituting practices at Southwest that imitated what was done at other airlines.

Southwest's Struggle to Gain a Market Foothold

In June 1971, Southwest initiated its first flights with a schedule that soon included 6 roundtrips between Dallas and San Antonio and 12 roundtrips between Houston and Dallas. But the introductory $20 one-way fares to fly the Golden Triangle, well below the $27 and $28 fares charged by rivals, attracted disappointingly small numbers of passengers. To try to gain market visibility and drum up more passengers, Southwest undertook some creative actions to supplement its ad campaigns publicizing its low fares:

- Southwest decided to have its flight attendants dress in colorful hot pants and white knee-high boots with high heels. Recruiting ads for Southwest's first group of attendants headlined "Attention, Raquel Welch: You can have a job if you measure up." Two thousand applicants responded and those selected for interviews were asked to come dressed in hot pants to show off their legs—the company wanted to hire long-legged beauties with sparkling personalities. Over 30 of Southwest's first graduating class of 40 flight attendants consisted of young ladies who were cheerleaders and majorettes in high school and thus had experience performing skimpily dressed in front of people.
- A second attention-getting action was to give passengers free alcoholic beverages during daytime flights. Most passengers on these flights were business travelers. Management's thinking was that many passengers did not drink during the daytime and that with most flights being less than an hour's duration it would be cheaper to simply give the drinks away rather than collect the money
- Taking a cue from being based at Dallas Love Field, Southwest began using the tagline "Now There's Somebody Else Up There Who Loves You." The routes between Houston, Dallas, and San Antonio became known as the Love Triangle. Southwest's planes were referred to as Love Birds, drinks became Love Potions, peanuts were called Love Bites, drink coupons were Love Stamps, and tickets were printed on Love Machines. The "love" campaign set the tone for Southwest's approach to its customers and company efforts to make flying Southwest Airlines an enjoyable, fun, and differentiating experience. (Later, when the company went public, it chose LUV as its stock-trading symbol.)
- In order to add more flights without buying more planes, the head of Southwest's ground operations came up with a plan for ground crews to off-load passengers and baggage, refuel the plane, clean the cabin and restock the galley, on-load passengers and baggage, do the necessary pre-flight checks and paperwork, and push away from the gate in 10 minutes. The 10-minute turnaround became one of Southwest's signatures during the 1970s and 1980s. (In later years, as passenger volume grew and many flights were filled to capacity, the turnaround time gradually expanded to 25 minutes—because it took more time to unload and load 125 passengers, as compared to a half-full plane with just 60 to 65 passengers. Even so, the 25-minute average turnaround times

at Southwest during the 2000–2009 period were shorter than the 30–50 minute turnarounds typical at other major airlines.)

- In late November 1971, Lamar Muse came up with the idea of offering a $10 fare to passengers on the Friday night Houston–Dallas flight. With no advertising, the 112-seat flight sold out. This led Muse to realize that Southwest was serving two quite distinct types of travelers in the Golden Triangle market: (1) business travelers who were more time sensitive than price sensitive and wanted weekday flights at times suitable for conducting business, and (2) price-sensitive leisure travelers who wanted lower fares and had more flexibility about when to fly.[4] He came up with a two-tier on-peak and off-peak pricing structure in which all seats on weekday flights departing before 7 PM were priced at $26 and all seats on other flights were priced at $13. Passenger traffic increased significantly—and systemwide on-peak and off-peak pricing soon became standard across the whole airline industry.
- In 1972, the company decided to move its flights in Houston from the newly opened Houston Intercontinental Airport (where it was losing money and where it took 45 minutes to get to downtown) to the abandoned Houston Hobby Airport located much closer to downtown Houston. Despite being the only carrier to fly into Houston Hobby, the results were spectacular—business travelers who flew to Houston frequently from Dallas and San Antonio found the Houston Hobby location far more convenient and passenger traffic doubled almost immediately.
- In early 1973, in an attempt to fill empty seats on its San Antonio–Dallas flights, Southwest cut its regular $26 fare to $13 for all seats, all days, and all times. When Braniff International, at that time one of Southwest's major rivals, announced $13 fares of its own, Southwest retaliated with a two-page ad run in the Dallas newspapers headlining "Nobody is going to shoot Southwest Airlines out of the sky for a lousy $13," and containing copy saying Braniff was trying to run Southwest out of business. The ad announced that Southwest would not only match Braniff's $13 fare but that it would also give passengers the choice of buying a regular-priced ticket for $26 and receiving a complimentary fifth of Chivas Regal scotch, Crown Royal Canadian whiskey, or Smirnoff vodka (or, for nondrinkers, a leather ice bucket). Over 75 percent of Southwest's Dallas–Houston passengers opted for the $26 fare, although the percentage dropped as the two-month promotion wore on and corporate controllers began insisting that company employees use the $13 fare. The local and national media picked up the story of Southwest's offer, proclaiming the battle as a David versus Goliath struggle in which the upstart Southwest did not stand much of a chance against the much larger and well-established Braniff; grassroots sentiment in Texas swung to Southwest's side.

All these moves paid off. The resulting gains in passenger traffic allowed Southwest to report its first-ever annual profit in 1973.

More Legal and Regulatory Hurdles

During the rest of the 1970s, Southwest found itself embroiled in another round of legal and regulatory battles. One battle involved Southwest's refusal to move its flights from Dallas Love Field, located 10 minutes from downtown, to the newly opened Dallas–Fort Worth Regional Airport, which was 30 minutes from downtown Dallas. Local officials were furious because they were counting on fees from Southwest's flights in and out of DFW to help service the debt on the bonds issued to finance the construction of DFW. Southwest's position was that it was not required to move because it had not agreed to do so or been ordered to do so by the Texas Aeronautics Commission—moreover, the company's headquarters were located at Love Field. The courts eventually ruled Southwest's operations could remain at Love Field.

A second battle ensued when rival airlines protested Southwest's application to begin serving several smaller cities in Texas; their protest was based on arguments that these markets were already well served and that Southwest's entry would result in costly overcapacity. Southwest countered that its low fares would allow more people to fly and grow the market. Again, Southwest prevailed and its views about low fares expanding the market proved accurate. In the year before Southwest initiated service, 123,000 passengers flew from Harlingen Airport in the Rio Grande Valley to Houston, Dallas, or San Antonio; in the 11 months following Southwest's initial flights, 325,000 passengers flew to the same three cities.

Believing that Braniff and Texas International were deliberately engaging in tactics to harass Southwest's operations, Southwest convinced the U.S. government to investigate what it considered predatory tactics by its chief rivals. In February 1975, Braniff and Texas International were indicted by a federal grand jury for conspiring to put Southwest out of business—a violation of the Sherman Antitrust Act. The two airlines pleaded "no contest" to the charges, signed cease-and-desist agreements, and were fined a modest $100,000 each.

When Congress passed the Airline Deregulation Act in 1978, Southwest applied to the Civil Aeronautics Board (now the Federal Aviation Administration) to fly between Houston and New Orleans. The application was vehemently opposed by local government officials and airlines operating out of DFW because of the potential for passenger traffic to be siphoned away from DFW. The opponents solicited the aid of Fort Worth congressman Jim Wright, then the majority leader of the U.S. House of Representatives, who took the matter to the floor of the House of Representatives; a rash of lobbying and maneuvering ensued. What emerged came to be known as the Wright Amendment of 1979: no airline may provide nonstop or through-plane service from Dallas Love Field to any city in any state except for locations in Texas, Louisiana, Arkansas, Oklahoma, and New Mexico. Southwest was prohibited from advertising, publishing schedules or fares, or checking baggage for travel from Dallas Love Field to any city it served outside the five-state "Wright Zone." The Wright Amendment continued in effect until 1997 when Alabama, Mississippi, and Kansas were added to the five-state Wright Zone; in 2005, Missouri was added to the zone. In 2006, after a heated battle in Congress, legislation was passed and signed into law that repealed the Wright Amendment beginning in October 2014. With the repeal of the Wright Amendment, Southwest Airlines increased flight activity from Dallas Love Field by 50 percent to add 20 new nonstop destinations with 180 daily departures to a total of 50 nonstop destinations.

The Emergence of a Combative Can-Do Culture at Southwest

The legal, regulatory, and competitive battles that Southwest fought in these early years produced a strong esprit de corps among Southwest personnel and a drive to survive and prosper despite the odds. With newspaper and TV stories reporting Southwest's difficulties regularly, employees were fully aware that the airline's existence was constantly on the line. Had the company been forced to move from Love Field, it would most likely have gone under, an outcome that employees, Southwest's rivals, and local government officials understood well. According to Southwest's former president, Colleen Barrett, the obstacles thrown in Southwest's path by competitors and local officials were instrumental in building Herb Kelleher's passion for Southwest Airlines and ingraining a combative, can-do spirit into the corporate culture:[5]

> They would put twelve to fifteen lawyers on a case and on our side there was Herb. They almost wore him to the ground. But the more arrogant they were, the more determined Herb got that this airline was going to go into the air—and stay there.
>
> The warrior mentality, the very fight to survive, is truly what created our culture.

When Lamar Muse resigned in 1978, Southwest's board wanted Herb Kelleher to take over as chair and CEO. But Kelleher enjoyed practicing law and, while he agreed to become board chair, he insisted that someone else be CEO. Southwest's board appointed Howard Putnam, a group vice president of marketing services at United Airlines, as Southwest's president and CEO in July 1978. Putnam asked Kelleher to become more involved in Southwest's day-to-day operations, and over the next three years Kelleher got to know many of the company's personnel and observe them in action. Putnam announced his resignation in fall 1981 to become president and COO at Braniff International. This time, Southwest's board succeeded in persuading Kelleher to take on the additional duties of CEO and president.

Sustained Growth Transforms Southwest into the Domestic Market Share Leader, 1981–2015

When Herb Kelleher took over in 1981, Southwest was flying 27 planes to 14 destination cities and had $270 million in revenues and 2,100 employees. Over the next 20 years, Southwest Airlines prospered under Kelleher's leadership. When Kelleher stepped down as CEO in mid-2001, the company had 350 planes flying to 58 U.S. airports, annual revenues of $5.6 billion, over 30,000 employees, and 64 million fare-paying passengers annually.

Under the two CEOs who succeeded Kelleher, Southwest continued its march to becoming the market share leader in domestic air travel, growing to 2015 revenues of $19.8 billion and 49,600 employees, flying 704 planes to 97 airports in 40 states and 7 destinations outside the United States, and transporting some 118 million-plus fare-paying passengers and some 144 million-plus passengers (including those traveling on frequent flyer awards) in 2015. In the process, the company won more industry Triple Crown awards for best on-time record, best baggage handling, and fewest customer complaints than any other U.S. airline. While Southwest fell short of its on-time performance and baggage handling goals in some years, it still led the domestic airline industry in customer satisfaction and received other awards and recognitions, including Best Domestic Airline for Customer Service by *Executive Travel* magazine's Leading Edge Awards, Brand of the Year in the Value Airline Category by the Harris Poll, and the top ranking by *InsideFlyer* magazine for Best Customer Service and Best Loyalty Credit Card.

Exhibit 2 provides a five-year summary of Southwest's financial and operating performance. Exhibit 3 provides selected financial and operating data for major U.S. air carriers during 1995–2015.

HERB KELLEHER: THE CEO WHO TRANSFORMED SOUTHWEST INTO A MAJOR AIRLINE

Herb Kelleher majored in philosophy at Wesleyan University in Middletown, Connecticut, graduating with honors. He earned his law degree at New York University, again graduating with honors and also serving as a member of the law review. After graduation, he clerked for a New Jersey Supreme Court justice for two years and then joined a law firm in Newark. Upon marrying a woman from Texas and becoming enamored with Texas, he moved to San Antonio where he became a successful lawyer and came to represent Rollin King's small aviation company.

When Herb Kelleher took on the role of Southwest's CEO in 1981, he made a point of visiting with maintenance personnel to check on how well the planes were running and talking with the flight attendants. Kelleher did not do much managing from his office, preferring instead to be out among the troops as much as he could. His style was to listen and observe and to offer encouragement. Kelleher attended most graduation ceremonies of flight attendant classes, and he often appeared to help load bags on "Black Wednesday," the busy travel day before Thanksgiving. He knew the names of thousands of Southwest employees and was held in the highest regard by Southwest employees. When he attended a Southwest employee function, he was swarmed like a celebrity.

Kelleher had an affinity for bold-print Hawaiian shirts, owned a tricked-out motorcycle, and made no secret of his love for smoking and Wild Turkey whiskey. He loved to make jokes and engage in pranks and corporate antics, prompting some people to refer to him as the "clown prince" of the airline industry. He once appeared at a company gathering dressed in an Elvis costume and had arm-wrestled a South Carolina company executive at a public event in Dallas for rights to use "Just Plane Smart" as an advertising slogan.[6] Kelleher was well known inside and outside the company for his combativeness, particularly when it came to beating back competitors. On one occasion, he reportedly told a group of veteran employees, "If someone says they're going to smack us in the face—knock them out, stomp them out, boot them in the ditch, cover them over, and move on to the next thing. That's the Southwest spirit at work."[7] On another occasion, he said, "I love battles. I think it's part of the Irish in me. It's like what Patton said, 'War is hell and I love it so.' That's how I feel. I've never gotten tired of fighting."[8]

While Southwest was deliberately combative and flamboyant in some aspects of its operations, when it came to the financial side of the business Kelleher insisted on fiscal conservatism, a strong balance sheet, comparatively low levels of debt, and zealous attention to bottom-line profitability. While believing strongly in being prepared for adversity, Kelleher had an aversion to Southwest personnel spending time drawing up all kinds of formal strategic plans, saying "Reality is chaotic; planning is ordered and logical. The meticulous nit-picking that goes on in most strategic planning processes creates a mental straightjacket that becomes disabling in an industry where things change radically from one day

EXHIBIT 2 Summary of Southwest Airlines's Financial and Operating Performance, 2011–2015

	Year Ended December 31				
	2015	2014	2013	2012	2011
Financial Data (in millions, except per share amounts):					
Operating revenues	$19,820	$18,605	$17,699	$17,088	$15,658
Operating expenses	15,704	16,380	16,421	16,465	14,965
Operating income	4,116	2,225	1,278	623	693
Other expenses (income) net	637	409	69	(62)	370
Income before taxes	3,479	1,816	1,209	685	323
Provision for income taxes		680	455	264	145
Net income	1,298	$1,136	$754	$421	$178
Net income per share, basic	$3.30	$1.65	$1.06	$0.56	$0.23
Net income per share, diluted	$3.27	$1.64	$1.05	$0.56	$0.23
Cash dividends per common share	$0.2850	$0.2200	$0.1300	$ .0345	$0.0180
Total assets at period-end	$21,312	$19,723	$19,345	$18,596	$18,068
Long-term obligations at period-end	2,541	2,434	2,191	2,883	3,107
Stockholders' equity at period-end	7,358	6,775	7,336	6,992	6,877
Operating Data:					
Revenue passengers carried	118,171,211	110,496,912	108,075,976	109,346,509	103,973,759
Enplaned passengers	144,574,882	135,767,188	133,155,030	133,978,100	127,551,012
Revenue passenger miles (RPMs) (000s)(1)	117,499,879	108,035,133	104,348,216	102,874,979	97,582,530
Available seat miles (ASMs) (000s)(2)	140,501,409	131,003,957	130,344,072	128,137,110	120,578,736
Load factor(3)	83.6%	82.5%	80.1%	80.3%	80.9%
Average length of passenger haul (miles)	994	978	966	941	939
Average length of each flight (miles)	750	721	703	693	679
Trips flown	1,267,358	1,255,502	1,312,785	1,361,558	1,317,977
Average passenger fare	$154.85	$159.80	$154.72	$147.17	$141.90
Passenger revenue yield per RPM (cents)(4)	15.57¢	16.34¢	16.02¢	15.64¢	15.12¢
Operating revenue per ASM (cents)(5)	13.98¢	14.20¢	13.58¢	13.34¢	12.99¢

(*Continued*)

	Year Ended December 31				
	2015	2014	2013	2012	2011
Passenger revenue per ASM (cents)(6)	13.02¢	13.48¢	12.83¢	12.56¢	12.24¢
Operating expenses per ASM (cents)(7)	11.18¢	12.50¢	12.60¢	12.85¢	12.41¢
Operating expenses per ASM, excluding fuel (cents)	8.61¢	8.46¢	8.18¢	8.07¢	7.73¢
Operating expenses per ASM, excluding fuel and profit sharing (cents)	8.17¢	8.19¢	8.01¢	7.98¢	7.65¢
Fuel costs per gallon, including fuel tax	$1.90	$2.93	$3.16	$3.30	$3.19
Fuel consumed, in gallons (millions)	1,901	1,801	1,818	1,847	1,764
Active full time equivalent employees	49,583	46,278	44,381	45,861	45,392
Aircraft in service at period-end(8)	704	665	681	694	698

(1)A revenue passenger mile is one paying passenger flown one mile.
(2)An available seat mile (ASM) is one seat (empty or full) flown one mile. Also referred to as "capacity," which is a measure of the space available to carry passengers in a given period.
(3)Revenue passenger miles divided by available seat miles.
(4)Calculated as passenger revenue divided by revenue passenger miles. It represents the average cost paid by a paying passenger to fly one mile.
(5)Calculated as operating revenue divided by available seat miles. It is a measure of operating revenue production based on the total available seat miles flown during a particular period.
(6)Calculated as passenger revenue divided by available seat miles. It is a measure of passenger revenue production based on the total available seat miles flown during a particular period.
(7)Calculated as operating expenses divided by available seat miles. Also referred to as "unit costs" or "cost per available seat mile," this is the average cost to fly an aircraft seat (empty or full) one mile.
(8)Includes leased aircraft and excludes aircraft that were not available for service, in storage, held for sale, or held for return to the lessor.

Sources: Southwest Airlines 10-K report, 2013, 2015.

to the next." Kelleher wanted Southwest managers to think ahead, have contingency plans, and be ready to act when it appeared that the future held significant risks or when new conditions suddenly appeared and demanded prompt responses.

Kelleher was a strong believer in the principle that employees—not customers—came first:[9]

> You have to treat your employees like your customers. When you treat them right, then they will treat your outside customers right. That has been a very powerful competitive weapon for us. You've got to take the time to listen to people's ideas. If you just tell somebody no, that's an act of power and, in my opinion, an abuse of power. You don't want to constrain people in their thinking.

Another indication of the importance that Kelleher placed on employees was the message he had penned in 1990 that was prominently displayed in the lobby of Southwest's headquarters in Dallas:

> The people of Southwest Airlines are "the creators" of what we have become—and of what we will be.
>
> Our people transformed an idea into a legend. That legend will continue to grow only so long as it is

EXHIBIT 3 Selected Operating and Financial Data for Major U.S. Airline Carriers, 1995, 2000, 2005, 2010, 2013–2015

	1995	2000	2005	2010	2013	2014	2015
Passengers (in millions)	559.0	666.2	738.3	720.5	740.9	761.0	796.9
Flights (in thousands)	8,062	9,035	11,564	9,521	9,152	8,954	8,895
Revenue Passenger Miles (in billions)	603.4	692.8	778.6	798.0	834.8	858.0	899.0
Available Seat Miles (in billions)	807.1	987.9	1,002.7	972.6	1,004.1	1,028.5	1,073.1
Load Factor	67.0	72.4	77.7	82.0	83.1	83.4	83.8
Passenger Revenues (in millions)	$69,470	$93,622	$93,500	$103,978	$120,641	$128,705	$126,170
Operating Profit (Loss) (in millions)	$ 5,852	$ 7,014	$ 447	$ 10,517	$ 12,519	$ 16,674	$ 30,777
Net Profit (Loss) excluding one-time charges and gains (in millions)	$ 2,283	$ 2,486	($ 5,782)	$ 3,665	$ 12,711	$ 8,502	$ 26,398
Total Employees	546,987	679,967	562,467	531,224	552,581	558,368	576,139

Sources: Air Transport Association, *2005 Economic Report,* p. 7; U.S. Department of Transportation, Bureau of Transportation Statistics, Airline Traffic Data Press Releases, various years.

nourished—by our people's indomitable spirit, boundless energy, immense goodwill, and burning desire to excel.

Our thanks—and our love—to the people of Southwest Airlines for creating a marvelous family and a wondrous airline.

In June 2001, Herb Kelleher stepped down as CEO but continued on in his role as chair of Southwest's board of directors and the head of the board's executive committee; as chair, he played a lead role in Southwest's strategy, expansion to new cities and aircraft scheduling, and governmental and industry affairs. In May 2008, after more than 40 years of leadership at Southwest, Kelleher retired as chair (but he remained a full-time Southwest employee until July 2013 and carried the title of Chairman Emeritus in 2016).

EXECUTIVE LEADERSHIP AT SOUTHWEST: 2001–2016

In June 2001 Southwest Airlines, responding to anxious investor concerns about the company's leadership succession plans, began an orderly transfer of power and responsibilities from Herb Kelleher, age 70, to two of his most trusted protégés. James F. Parker, 54, Southwest's general counsel and one of Kelleher's most trusted protégés, succeeded Kelleher as Southwest's CEO. Another of Kelleher's trusted protégés, Colleen Barrett, 56, Southwest's executive vice president–customers and self-described keeper of Southwest's pep rally corporate culture, became president and chief operating officer.

James Parker, CEO, 2001–2004

James Parker's association with Herb Kelleher went back 23 years to the time when they were colleagues at Kelleher's old law firm. Parker moved over to Southwest from the law firm in February 1986. Parker's profile inside the company as Southwest's vice president and general counsel had been relatively low, but he was Southwest's chief labor negotiator and much of the credit for Southwest's good relations with employee unions belonged to Parker. Parker and Kelleher were said to think much alike, and Parker was regarded as having a good sense of humor, although he did not have as colorful and flamboyant a personality as Kelleher. Parker was seen as an honest, straight-arrow kind of person who had a strong grasp of Southwest's culture and market niche and who could be nice or tough, depending on the situation. When his appointment was announced, Parker said:[10]

> There is going to be no change of course insofar as Southwest is concerned. We have a very experienced leadership team. We've all worked together for a long time. There will be evolutionary changes in Southwest, just as there have always been in our history. We're going to stay true to our business model of being a low-cost, low-fare airline.

Parker retired unexpectedly, for personal reasons, in July 2004, stepping down as CEO and vice chair of the board and also resigning from the company's board of directors. He was succeeded by Gary C. Kelly.

Colleen Barrett, Southwest's President, 2001–2008

Barrett began working with Kelleher as his legal secretary in 1967 and had been with Southwest since 1978. As executive vice president–customers, Barrett had a high profile among Southwest employees and spent most of her time on culture-building, morale-building, and customer service; her goal was to ensure that employees felt good about what they were doing and felt empowered to serve the cause of Southwest Airlines.[11] She and Kelleher were regarded as Southwest's guiding lights, and some analysts said she was essentially functioning as the company's chief operating officer prior to her formal appointment as president. Much of the credit for the company's strong record of customer service and its strong-culture work climate belonged to Barrett.

Barrett had been the driving force behind lining the hallways at Southwest's headquarters with photos of company events and trying to create a family atmosphere at the company. Believing it was important to make employees feel cared about and important, Barrett had put together a network of contacts across the company to help her stay in touch with what was happening with employees and their families. When network members learned about events that were worthy of acknowledgment, the word quickly got to Barrett—the information went into a database and an appropriate greeting card or gift was sent. Barrett had a remarkable ability to give gifts that were individualized and connected her to the recipient.[12]

Barrett was the first woman appointed as president and COO of a major U.S. airline. In October 2001, *Fortune* included Colleen Barrett on its list of the 50 most powerful women in American business (she was ranked number 20). Barrett retired as president in July 2008.

Gary C. Kelly, Southwest's CEO, 2004–Present

Gary Kelly was appointed vice chair of the board of directors and chief executive officer of Southwest effective July 15, 2004. Prior to that time, Kelly was executive vice president and chief financial officer from 2001 to 2004, and vice president–finance and chief financial officer from 1989 to 2001. He joined Southwest in 1986 as its controller. In 2008, effective with the retirement of Kelleher and Barrett, Kelly assumed the titles of board chair, CEO, and president.

When Kelly was named CEO in 2004, Herb Kelleher said:[13]

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

In his first two years as CEO, Kelly and other top-level Southwest executives sharpened and fine-tuned Southwest's strategy in a number of areas, continued to expand operations (adding both more flights and initiating service to new airports), and worked to maintain the company's low-cost advantage over its domestic rivals.

Kelly saw four factors as keys to Southwest's recipe for success:[14]

- Hire great people, treat 'em like family.
- Care for our Customers warmly and personally, like they're guests in our home.
- Keep fares and operating costs lower than anybody else by being safe, efficient, and operationally excellent.
- Stay prepared for bad times with a strong balance sheet, lots of cash, and a stout fuel hedge.

To guide Southwest's efforts to be a standout performer on these four key success factors, Kelly had established five strategic objectives for the company:[15]

- Be the best place to work.
- Be the safest, most efficient, and most reliable airline in the world.
- Offer customers a convenient flight schedule with lots of flights to lots of places they want to go.
- Offer customers the best overall travel experience.
- Do all of these things in a way that maintains a low cost structure and the ability to offer low fares.

In 2008–2009, Kelly initiated a slight revision of Southwest's mission statement and also spearheaded a vision statement that called for a steadfast focus on a triple bottom line of Performance, People, and Planet—see Exhibit 4.

In 2010, Kelly initiated one of the biggest strategic moves in the company's history: the acquisition of AirTran Airways, a low-fare, low-cost airline that served 70 airports in the United States, Mexico, and the Caribbean (19 of the airports AirTran served coincided with airports served by Southwest). In 2011, Kelly initiated a five-year strategic plan that featured five strategic initiatives:

- Integrating AirTran into Southwest.
- Modernizing Southwest Airlines's existing aircraft fleet.
- Adding over 100 new Boeing 737-800 aircraft to the Southwest fleet.
- Launching international service and a new reservation system.
- Growing membership in the company's Rapid Rewards® frequent flyer program.

EXHIBIT 4 Southwest Airlines's Mission, Vision, and Triple-Bottom-Line Commitment to Performance, People, and Planet

THE MISSION OF SOUTHWEST AIRLINES The mission of Southwest Airlines is dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.

OUR VISION Become the world's most loved, most flown, and most profitable airline.

TO OUR EMPLOYEES We are committed to provide our Employees a stable work environment with equal opportunity for learning and personal growth. Creativity and innovation are encouraged for improving the effectiveness of Southwest Airlines. Above all, Employees will be provided the same concern, respect, and caring attitude within the organization that they are expected to share externally with every Southwest Customer.

TO OUR COMMUNITIES Our goal is to be the hometown airline of every community we serve, and because those communities sustain and nurture us with their support and loyalty, it is vital that we, as individuals and in groups, embrace each community with the SOUTHWEST SPIRIT of involvement, service, and caring to make those communities better places to live and work.

TO OUR PLANET We strive to be a good environmental steward across our system in all of our hometowns, and one component of our stewardship is efficiency, which by its very nature, translates to eliminating waste and conserving resources. Using cost-effective and environmentally beneficial operating procedures (including facilities and equipment), allows us to reduce the amount of materials we use and, when combined with our ability to reuse and recycle material, preserves these environmental resources.

TO OUR STAKEHOLDERS Southwest's vision for a sustainable future is one where there will be a balance in our business model between Employees and Community, the Environment, and our Financial Viability. In order to protect our world for future generations, while meeting our commitments to our Employees, Customers, and Stakeholders, we will strive to lead our industry in innovative efficiency that conserves natural resources, maintains a creative and innovative workforce, and gives back to the Communities in which we live and work.

Source: 2014 Southwest Airlines One Report, **www.southwest.com** (accessed May 20, 2016).

SOUTHWEST AIRLINES'S STRATEGY IN 2016

From day one, Southwest had pursued a low-cost/low-price/no-frills strategy to make air travel affordable to a wide segment of the population. While specific aspects of the strategy had evolved over the years, three strategic themes had characterized the company's strategy throughout its existence and still had high profiles in 2016:

- Charge fares that were very price competitive and, in some cases, appealingly lower than what rival airlines were charging.
- Create and sustain a low-cost operating structure.
- Make it fun to fly on Southwest and provide customers with a top-notch travel experience.

Fare Structure Strategy

Southwest employed a relatively simple fare structure displayed in ways that made it easy for customers to choose the fare they preferred. In 2016, Southwest's fares were bundled into four major categories: "Wanna Get Away®," "Anytime," and "Business Select®," and fares for seniors (people 65 and older):

1. Wanna Get Away fares were always the lowest fares and were subject to advance purchase requirements. No fee was charged for changing to a previously purchased ticket to a different time or day of travel (rival airlines charged a change fee of $100 to $175), but applicable fare differences were applied. The purchase price was nonrefundable but the funds could be applied to future travel on Southwest, provided the tickets were not canceled or changed within 10 minutes of a flight's scheduled departure.
2. Anytime fares were refundable and changeable, and funds could also be applied toward future travel on Southwest. Anytime fares also included a higher frequent flyer point multiplier under Southwest's Rapid Rewards® frequent flyer program than do Wanna Get Away fares.
3. Business Select fares were refundable and changeable, and funds could be applied toward future travel on Southwest. Business Select fares also included additional perks such as priority boarding, a higher frequent flyer point multiplier than other Southwest fares (including twice as many points per dollar spent as compared to Wanna Get Away fares), priority security and ticket counter access in select airports, and one complimentary adult beverage coupon for the day of travel (for customers of legal drinking age). The Business Select fare had been introduced in 2007 to help attract economy-minded business travelers; Business Select customers had early boarding privileges, received extra Rapid Rewards (frequent flyer) credit, and a free cocktail.
4. Fares for seniors were typically priced between the Wanna Get Away and Anytime fares. No fee was charged for changing a previously purchased ticket to a different time or day of travel, but applicable fare differences were applied. The purchase price was nonrefundable, but funds could be applied to future travel on Southwest, provided the tickets were not canceled or changed within ten minutes of a flight's scheduled departure. Fares for seniors were not displayed on the list of fare options at the company's website unless customers checked a box indicating that one or more passengers were 65 years of age or older.

In 2008, rival airlines instituted a series of add-on fees—including a fuel surcharge for each flight, fees for checking bags, fees for processing frequent flyer travel awards, fees for buying a ticket in person at the airport or calling a toll-free number to speak with a ticket agent to make a reservation, fees for changing a previously purchased ticket to a different flight, and fees certain for in-flight snacks and beverages—to help defray skyrocketing costs for jet fuel (which had climbed from about 15 percent of operating expenses in 2000 to 40 percent of operating expenses in mid-2008) and try to bolster their operating performance. Southwest, however, choose to forego "à la carte" pricing and stuck with an all-inclusive fare price. During 2009 and periodically thereafter, Southwest ran "Bags Fly Free™" ad campaigns to publicize the cost-savings of flying Southwest rather than paying the $20 to $50 fees that rival airlines charged for a first or second checked bag. Southwest also had run ads promoting its policy of not charging a fee for changing a previously purchased ticket to a different flight.

When advance reservations were weak for particular weeks or times of the day or on certain routes, Southwest made a regular practice of initiating special fare promotions to stimulate ticket sales to stimulate ticket sales on flights that otherwise would have had numerous empty seats. The company's use of special fare sales and Bags Fly Free ads to combat slack air travel during much of the Great Recession in 2008–2009 resulted in company-record load factors (the percentage of all available seats on all flights that were occupied by fare-paying passengers) for every month from July through December 2009.

Southwest was a shrewd practitioner of the concept of price elasticity, proving in one market after another that the revenue gains from increased ticket sales and the volume of passenger traffic would more than compensate for the revenue erosion associated with low fares. When Southwest entered the Florida market with an introductory $17 fare from Tampa to Fort Lauderdale, the number of annual passengers flying the Tampa–Fort Lauderdale route jumped 50 percent to more than 330,000. In Manchester, New Hampshire, passenger counts went from 1.1 million in 1997, the year prior to Southwest's entry, to 3.5 million in 2000 and average one-way fares dropped from just over $300 to $129. Southwest's success in stimulating higher passenger traffic at airports across the United States via low fares and frequent flights had been coined the "Southwest Effect" by personnel at the U.S. Department of Transportation. Exhibit 5 shows the cities and airports Southwest Airlines served in July 2016.

Southwest's Strategy to Create and Sustain Low-Cost Operations

Southwest management fully understood that earning attractive profits by charging low fares necessitated the use of strategy elements that would enable the company to become a low-cost provider of commercial air service. There were three main components of Southwest's strategic actions to achieve a low-cost operating structure: using a single aircraft type for all flights, creating an operationally efficient point-to-point route structure, and striving to perform all value chain activities in a cost-efficient manner.

Use of a Single Aircraft Type For many years, Southwest's aircraft fleets had consisted only of

EXHIBIT 5 Southwest's Aircraft Fleet as of December 31, 2015

Type of Aircraft	Number	Seats	Average Age	Comments
Boeing 737-300	118	137/143	22 years	Southwest was Boeing's launch customer for this model.
Boeing 737-500	11	122	24 years	Southwest was Boeing's launch customer for this model.
Boeing 737-700	471	143	11 years	Southwest was Boeing's launch customer for this model in 1997. All were equipped with satellite-delivered broadband Internet reception capability.
Boeing 737-800	104	175	2 years	All were equipped with satellite-delivered broadband Internet reception capability.
Total	704			

Other Fleet-Related Facts

Average age of aircraft fleet—approximately 12 years
Average aircraft trip length—750 miles, with an average duration of 2 hours and 2 minutes
Average aircraft utilization—nearly 6 flights per day and 11 hours and 10 minutes of flight time
Fleet size—1990: 106; 1995: 224; 2000: 344; 2009: 537
Firm orders for new aircraft—2016: 36; 2017–2027: 289

Sources: Company 10-K report, 2015; information posted at www.southwest.com (accessed May 18, 2016).

Boeing 737 aircraft. Operating only one type of aircraft produced many cost-saving benefits: minimizing the size of spare parts inventories, simplifying the training of maintenance and repair personnel, improving the proficiency and speed with which maintenance routines could be done, and simplifying the task of scheduling planes for particular flights. In 2013, Southwest operated the biggest fleet of Boeing 737 aircraft in the world. Exhibit 5 provides information about Southwest's aircraft fleet.

Southwest's Point-to-Point Route Structure Strategy Southwest's point-to-point scheduling of flights was more cost-efficient than the hub-and-spoke systems used by most all rival airlines. Hub-and-spoke systems involved passengers on many different flights coming in from spoke locations (and sometimes another hub) to a central airport or hub within a short span of time and then connecting to an outgoing flight to their destination—a spoke location or another hub). Most flights arrived and departed a hub across a two-hour window, creating big peak–valley swings in airport personnel workloads and gate utilization—airport personnel and gate areas were very busy when hub operations were in full swing and then were underutilized in the interval awaiting the next round of inbound–outbound flights. In contrast, Southwest's point-to-point routes permitted scheduling aircraft to minimize the time aircraft were at the gate, currently approximately 25 minutes, thereby reducing the number of aircraft and gate facilities that would otherwise be required. Furthermore, with a relatively even flow of incoming–outgoing flights and gate traffic, Southwest could staff its terminal operations to handle a fairly steady workload across a day whereas hub-and-spoke operators had to staff their operations to serve three or four daily peak periods.

Exhibit 6 shows the cities and airports served by Southwest in mid-2016. Going into 2016, Southwest had nonstop service between 637 airports. In 2015, Southwest's average passenger airfare was $154.85 one way, and the average passenger trip length was approximately 994 miles.

Striving to Perform All Value Chain Activities Cost-Effectively Southwest made a point of scrutinizing every aspect of its operations to find ways to trim costs. The company's strategic actions to reduce or at least contain costs were extensive and ongoing.

- Sharply rising prices for jet fuel over the past from the mid-2000s through 2014 that caused fuel expenses to rise from 16.5 percent of total operating expenses in 2003 to between 28 and 38 percent of total operating expenses between 2006 and 2014 had prompted a number of projects to increase fuel efficiency, including:
  - The installation of "blended winglets" on all of its planes beginning in 2007 and then, in 2014, starting to upgrade its aircraft fleet with newly designed split scimitar winglets—see Exhibit 7. These winglets reduced lift drag, allowed aircraft to climb more steeply and reach higher flight levels quicker, improved cruising performance, helped extend engine life and reduce maintenance costs, and reduced fuel burn.
  - The use of auto-throttle and vertical navigation procedures to maintain optimum cruising speeds.
  - The introduction of new engine start procedures to support using a single engine for runway taxiing.
  - Reductions in engine aircraft idle speed while on the ground.
- Southwest was the first major airline to introduce ticketless travel (eliminating the need to print and process paper tickets); by 2007 ticketless travel accounted for more than 95 percent of all ticket sales.
- Southwest was also the first airline to allow customers to make reservations and purchase tickets at the company's website (thus bypassing the need to pay commissions to travel agents for handling the ticketing process and reducing staffing requirements at Southwest's reservation centers). Selling a ticket on its website cost Southwest roughly $1, versus $3–4 for a ticket booked through its own internal reservation system and as much as $15 for tickets purchased through travel agents and professional business travel partners. Online ticket sales at Southwest's website grew swiftly, accounting for 74 percent of Southwest's revenues in 2009 and 80 percent of all company bookings in 2015.
- For most of its history, Southwest stressed flights into and out of airports in medium-sized cities and less-congested airports in major metropolitan areas (Chicago Midway, Detroit Metro, Houston Hobby, Dallas Love Field, Baltimore–Washington International, Burbank, Manchester, Oakland,

EXHIBIT 6 Airports and Cities Served by Southwest Airlines, December 2015

Southwest's Top 10 Airports by Departures

	Daily Departures	Number of Gates	Nonstop Cities Served
Chicago Midway	233	34	64
Las Vegas	214	24	59
Baltimore/Washington	208	29	61
Denver	184	22	57
Dallas (Love Field)	180	18	51
Phoenix	167	24	48
Houston (Hobby)	161	19	51
Atlanta	126	18	37
Los Angeles	124	15	26
Orlando	113	16	40

Other Airports Served by Southwest Airlines

Akron-Canton OH	Grand Rapids MI	Oklahoma City	Seattle/Tacoma
Albany	Greenville/Spartanburg SC	Omaha	Spokane
Albuquerque	Harlingen/South Padre Island TX	Ontario CA	Tampa
Amarillo	Hartford/Springfield	Orange County CA	Tucson
Austin	Indianapolis	Panama City FL	Tulsa
Birmingham	Jacksonville	Pensacola FL	Washington, DC (Dulles)
Boise	Kansas City	Philadelphia	Washington, DC (Reagan National)
Boston Logan	Little Rock	Pittsburgh	West Palm Beach
Buffalo	Long Island	Portland OR	Wichita KS
Burbank CA	Louisville	Portland ME	
Charleston	Lubbock	Providence	**International**
Charlotte	Manchester NH	Raleigh-Durham	Aruba
Cleveland	Memphis	Reno/Tahoe	Belize City
Columbus OH	Midland/Odessa TX	Richmond	Cabo San Lucas
Corpus Christi TX	Milwaukee	Rochester	Cancun
Dayton OH	Minneapolis/St. Paul	Sacramento	Liberia, Costa Rica
Des Moines	Nashville	St. Louis	Mexico City
Detroit Metro	Newark	Salt Lake City	Montego Bay
El Paso	New Orleans	San Antonio	Nassau
Flint MI	New York (LaGuardia)	San Diego	Punta Cana DOM
Fort Lauderdale	Norfolk/Virginia Beach	San Francisco	Puerto Vallarta
Fort Myers/Naples	Oakland	San Jose	San Juan

Sources: Company 10-K report, 2015; information posted at **www.southwest.com** (accessed May 18, 2016).

EXHIBIT 7 Southwest's Fuel-Saving Blended Winglets and Split Scimitar Winglets

Blended Winglets (first installations began in 2007); fuel savings of about 3.5 percent per aircraft.

© Southwest Airlines

New Split Scimitar Winglets (first installations began in 2014); fuel savings of about 5.0 to 5.5 percent per aircraft.

© Southwest Airlines

Source: Southwest Airlines.

San Jose, Providence, and Fort Lauderdale–Hollywood). This strategy helped produce better-than-average on-time performance and reduce the fuel costs associated with planes sitting in line on crowded taxiways or circling airports waiting for clearance to land. It further allowed the company to avoid paying the higher landing fees and terminal gate costs at such high-traffic airports like Atlanta's Hartsfield–Jackson International, Chicago's O'Hare, and Dallas–Fort Worth (DFW) where landing slots were controlled and rationed to those airlines willing to pay the high fees. More recently, however, having already initiated service to almost all of the medium-sized cities and less-congested airports where there were good opportunities for sustained growth in passenger traffic and revenues, Southwest had begun initiating service to airports in large metropolitan cities where air traffic congestion was a frequent problem—such as Los Angeles LAX, Boston Logan International, New York LaGuardia, Denver, San Francisco, Philadelphia, and Atlanta (when it acquired AirTran).

- To economize on the amount of time it took terminal personnel to check in passengers and to simplify the whole task of making reservations, Southwest dispensed with the practice of assigning each passenger a reserved seat. Initially, passengers were given color-coded plastic cards with the letters A, B, or C when they checked in at the boarding gate. Passengers then boarded in groups, according to the color/letter on their card, sitting in whatever seat was open when they got on the plane. In 2002, Southwest abandoned the use of plastic cards and began printing a big, bold A, B, or C on the boarding pass when the passenger checked in at the ticket counter; passengers then boarded in groups according to the letter on their boarding pass. In 2007–2008, Southwest introduced an enhanced boarding method that automatically assigned each passenger a specific number within the passenger's boarding group at the time of check-in; passengers then boarded the aircraft in that numerical order. All passengers could check in online up to 24 hours before departure time and print out a boarding pass, thus bypassing counter check-in (unless they wished to check baggage).
- Southwest flight attendants were responsible for cleaning up trash left by deplaning passengers and otherwise getting the plane presentable for passengers to board for the next flight. Rival carriers had cleaning crews come on board to perform this function until they incurred heavy losses in

2001–2005 and were forced to institute stringent cost-cutting measures that included abandoning use of cleaning crews and copying Southwest's practice.

- Southwest did not have a first-class section in any of its planes and had no fancy clubs for its frequent flyers to relax in at terminals.
- Southwest did not provide passengers with baggage transfer services to other carriers—passengers with checked baggage who were connecting to other carriers to reach their destination were responsible for picking up their luggage at Southwest's baggage claim and then getting it to the check-in facilities of the connecting carrier. (Southwest booked tickets involving only its own flights; customers connecting to flights on other carriers had to book such tickets either through travel agents or the connecting airline).
- Starting in 2001, Southwest began converting from cloth to leather seats; the team of Southwest employees that investigated the economics of the conversion concluded that an all-leather interior would be more durable and easier to maintain, more than justifying the higher initial costs.
- Southwest was a first-mover among major U.S. airlines in employing fuel hedging and derivative contracts to counteract rising prices for crude oil and jet fuel. From 1998 through 2008, the company's fuel hedging activities produced fuel savings of about $4.0 billion over what it would have spent had it paid the industry's average price for jet fuel. But unexpectedly large declines in jet fuel prices in late 2008 and 2009 resulted in reported losses of $408 million on the fuel hedging contracts that the company had in place during 2009. Since then, the company's fuel hedging activities had continued to be ineffective in reducing fuel expenses; the company recognized losses on its fuel hedging activities of $324 million in 2010, $259 million in 2011, $157 million in 2012, and $118 million in 2013. Southwest's fuel hedging strategy involved modifying the amount of its future fuel requirements that were hedged based on management's judgments about the forward market prices of crude oil and jet fuel. As of January 2016, the company had fuel derivative contracts in place for ~20 percent of its expected fuel consumption in 2016, ~65 percent of expected fuel consumption in 2017, and ~35 percent of expected fuel consumption in 2018.
- Southwest regularly upgraded and enhanced its management information systems to speed data flows, improve operating efficiency, lower costs, and upgrade its customer service capabilities. In 2001, Southwest implemented use of new software that significantly decreased the time required to generate optimal crew schedules and help improve on-time performance. In 2007–2008, Southwest invested in next-generation technology and software to improve its ticketless system and its back office accounting, payroll, and human resource information systems. During 2009, the company replaced or enhanced its point-of-sale, electronic ticketing and boarding, and revenue accounting systems. During 2010, it completed an initiative to convert to a new SAP Enterprise Resource Planning application that would replace its general ledger, accounts payable, accounts receivable, payroll, benefits, cash management, and fixed asset systems; the conversion was designed to increase data accuracy and consistency and lower administrative support costs.

For many decades, Southwest's operating costs had been lower than those of rival U.S. airline carriers—see Exhibit 8 for comparative *costs per revenue passenger mile* among the five major U.S. airlines during the 1995–2015 period. Exhibit 9 shows trends in Southwest's operating costs *per available seat mile* rather than per passenger-occupied seat.

Making It Fun to Fly Southwest: The Strategy to Provide a Top-Notch Travel Experience

Southwest's approach to delivering good customer service and building a loyal customer clientele was predicated on presenting a happy face to passengers, displaying a fun-loving attitude, and doing things in a manner calculated to provide passengers with a positive flying experience. The company made a special effort to employ gate personnel who enjoyed interacting with customers, had good interpersonal skills, and displayed cheery, outgoing personalities. A number of Southwest's gate personnel let their wit and sense of humor show by sometimes entertaining those in the gate area with trivia questions or contests such as "who has the biggest hole in their sock." Apart from greeting passengers coming onto planes and assisting them in finding open seats and stowing

EXHIBIT 8 Comparative Operating Cost Statistics per Revenue Passenger Mile, Major U.S. Airlines, 1995, 2000, 2005, 2010–2015

	Total Salaries and Fringe Benefits		Costs incurred per revenue passenger mile (in cents)							
	Pilots and Copilots	All Employees	Fuel and Oil	Maintenance	Rentals	Landing Fees	Advertising	General and Administrative	Other Operating Expenses	Total Operating Expenses
American Airlines										
1995	0.94¢	5.59¢	1.53¢	1.34¢	0.59¢	0.22¢	0.19¢	1.14¢	3.65¢	14.25¢
2000	1.16	5.77	2.04	1.90	0.48	0.23	0.18	0.58	3.30	14.48
2005	0.90	4.65	3.67	1.42	0.41	0.32	0.10	0.95	3.66	15.18
2010	0.88	5.18	4.57	1.92	0.47	0.35	0.13	1.23	3.68	17.53
2011	0.89	5.27	5.82	1.91	0.51	0.31	0.15	1.82	4.07	19.87
2012	0.86	5.17	6.10	1.87	0.43	0.30	0.12	1.91	3.70	19.61
2013	0.91	4.39	5.94	1.82	0.57	0.31	0.14	1.35	4.38	18.90
2014	1.01	4.63	5.56	1.92	0.66	0.31	0.07	1.56	4.46	19.18
2015	1.27	5.01	3.08	1.77	0.67	0.30	0.07	2.26	3.93	17.09
Delta Air Lines										
1995	1.27¢	4.97¢	1.70¢	1.16¢	0.71¢	0.30¢	0.18¢	0.43¢	4.07¢	13.53¢
2000	1.27	5.08	1.73	1.41	0.54	0.22	0.12	0.74	3.03	12.85
2005	0.93	4.31	3.68	1.10	0.38	0.22	0.16	0.84	6.01	16.69
2010	0.91	4.15	4.51	1.33	0.14	0.28	0.10	0.64	6.26	17.41
2011	0.95	4.27	5.77	1.41	0.15	0.28	0.13	0.54	7.09	19.65
2012	0.99	4.57	5.97	1.53	0.15	0.28	0.14	0.71	6.85	20.21
2013	1.11	4.82	5.42	1.58	0.13	0.28	0.13	0.68	6.61	19.65
2014	1.15	5.17	6.43	1.56	0.16	0.28	0.12	1.03	5.95	20.70
2015	1.19	5.55	3.45	1.47	0.18	0.27	0.12	1.38	5.08	17.50
Southwest Airlines										
1995	0.92¢	3.94¢	1.56¢	1.21¢	0.79¢	0.35¢	0.41¢	1.09¢	1.56¢	10.91¢
2000	0.86	4.22	1.95	1.22	0.48	0.31	0.35	1.42	0.96	10.91
2005	1.18	4.70	2.44	1.17	0.31	0.34	0.29	0.73	1.23	11.21
2010	1.37	4.97	4.63	1.47	0.28	0.46	0.26	0.83	1.32	14.23
2011	1.37	4.99	5.76	1.47	0.23	0.45	0.26	0.98	1.35	15.50
2012	1.57	5.66	6.70	1.86	0.42	0.51	0.26	1.29	1.72	18.43

(Continued)

	Total Salaries and Fringe Benefits		Costs incurred per revenue passenger mile (in cents)							
	Pilots and Copilots	All Employees	Fuel and Oil	Maintenance	Rentals	Landing Fees	Advertising	General and Administrative	Other Operating Expenses	Total Operating Expenses
2013	1.59	5.87	6.38	1.85	0.46	0.52	0.23	1.21	1.68	18.19
2014	1.46	5.64	5.23	1.58	0.35	0.47	0.20	1.22	1.49	16.17
2015	1.46	5.69	3.07	1.44	0.25	0.42	0.18	1.02	1.28	13.35
United Airlines										
1995	0.86¢	4.73¢	1.51¢	1.51¢	0.90¢	0.29¢	0.17¢	0.53¢	2.92¢	12.58¢
2000	1.15	5.75	1.98	1.84	0.73	0.28	0.21	0.76	3.09	14.65
2005	0.62	3.72	3.53	1.60	0.35	0.30	0.16	0.60	5.09	15.35
2010	0.67	4.34	4.46	1.86	0.32	0.38	0.06	1.31	5.24	17.96
2011	0.69	4.38	5.60	2.14	0.32	0.36	0.08	1.38	6.07	20.34
2012	0.74	4.71	5.97	1.72	0.44	0.35	0.09	1.57	5.84	20.69
2013	0.95	5.01	5.59	1.70	0.41	0.35	0.10	1.38	6.19	20.74
2014	1.09	5.11	5.31	1.68	0.38	0.38	0.10	1.37	6.07	20.41
2015	1.12	5.45	3.44	1.50	0.32	0.36	0.11	1.58	5.04	17.81

Note 1: Cost per revenue passenger mile for each of the cost categories in this exhibit is calculated by dividing the total costs for each cost category by the total number of revenue passenger miles flown, where a revenue passenger mile is equal to one paying passenger flown one mile. Costs incurred per revenue passenger mile thus represent the costs incurred per ticketed passenger per mile flown

Note 2: US Airways and America West started merging operations in September 2005, and joint reporting of their operating costs began in late 2007. Effective January 2010, data for Delta Air Lines include the combined operating costs of Delta and Northwest Airlines; the merger of these two companies became official in October 2008. United Airlines acquired Continental Airlines in 2010, and the two companies began joint reporting of operating expenses in 2012.

Note 3: America Airlines and US Airways merged in December 2013, but continued to operate under their separate names through 2014. Previously, US Airways had merged with America West in September 2005.

Note 4: Delta Air Lines and Northwest Airlines merged in October 2008; however, combined reporting did not begin until 2010.

Note 5: Southwest Airlines acquired AirTran in late 2010; starting in 2013 and continuing into 2014, AirTran flights were rebranded as Southwest Airlines flights. Southwest's first international flights began when some of AirTran's international flights were rebranded as Southwest flights in 2013.

Note 6: United Airlines acquired Continental Airlines in 2010, and the two companies began joint reporting of passenger traffic in 2012. Prior to 2012, traffic count data are only for United flights.

EXHIBIT 9 Southwest Airlines's Operating Expenses per Available Seat Mile, Various Years 1995–2015

	Costs (in cents) per available seat mile						
Expense Category	**2015**	**2014**	**2013**	**2010**	**2005**	**2000**	**1995**
Salaries, wages, bonuses, and benefits	4.54¢	4.14¢	3.86¢	3.76¢	3.27¢	2.81¢	2.40¢
Fuel and oil	2.57	4.04	4.42	3.68	1.58	1.34	1.01
Maintenance materials and repairs	0.72	0.75	0.83	0.76	0.52	0.63	0.60
Aircraft rentals	0.17	0.22	0.28	0.18	0.19	0.33	0.47
Landing fees and other rentals	0.83	0.85	0.85	0.82	0.53	0.44	0.44
Depreciation	0.72	0.72	0.66	0.64	0.55	0.47	0.43
Acquisition and integration	0.03	0.10	0.07	—	—	—	—
Other operating expenses	1.60	1.68	1.63	1.45	1.41	1.71	1.72
Total	**11.18¢**	**12.50¢**	**12.60¢**	**11.29¢**	**8.05¢**	**7.73¢**	**7.07¢**

Note: Figures in this exhibit differ from those for Southwest in Exhibit 8 because the cost figures in Exhibit 8 are based on *cost per passenger revenue mile,* whereas the cost figures in this exhibit are based on *cost per available seat mile.* Costs per revenue passenger mile represent the costs per ticketed passenger per mile flown, whereas costs per available seat mile are the *costs per seat per mile flown (irrespective of whether the seat was occupied or not).*

Sources: Company 10-K reports and annual reports, various years.

baggage, flight attendants were encouraged to be engaging, converse and joke with passengers, and go about their tasks in ways that made passengers smile. On some flights, attendants sang announcements to passengers on takeoff and landing. On one flight while passengers were boarding, an attendant with bunny ears popped out of an overhead bin exclaiming "Surprise!" The repertoires to amuse passengers varied from flight crew to flight crew.

During their tenure, both Herb Kelleher and Colleen Barrett had made a point of sending congratulatory notes to employees when the company received letters from customers complimenting particular Southwest employees; complaint letters were seen as learning opportunities for employees and reasons to consider making adjustments. Employees were provided the following policy guidance regarding how far to go in trying to please customers:

> No Employee will ever be punished for using good judgment and good old common sense when trying to accommodate a Customer—no matter what our rules are.[16]
>
> When you empower People to make a positive difference everyday, you allow them to decide. Most guidelines are written to be broken as long as the Employee is leaning toward the Customer. We follow the Golden Rule and try to do the right thing and think about our Customer.[17]

Southwest executives believed that conveying a friendly, fun-loving spirit to customers was the key to competitive advantage. As one Southwest manager put it, "Our fares can be matched; our airplanes and routes can be copied. But we pride ourselves on our customer service."[18]

Southwest's emphasis on point-to-point flights enabled many passengers to fly nonstop to their destinations, thereby cutting total trip time and avoiding not only the added built-in travel time to make connections but also the oft-encountered delays associated with connecting flights (late incoming flights, potential equipment failures requiring repairs at the gate, and late departures). In recent years, about 72 percent of Southwest's passengers flew nonstop to their destination—nonstop travel was a major contributor to providing customers with a top-notch travel experience.

In 2007, Southwest invested in an "extreme gate makeover" to improve the airport experience of customers. The makeover included adding (1) a business-focused area with padded seats, tables with power outlets, power stations with stools, and a large screen TV with news programming; and (2) a family-focused area with smaller tables and chairs, power stations for charging electrical devices, and kid-friendly TV programming. Later, Southwest added free wireless Internet service for passengers waiting in its gate areas.

In 2013–2014, Southwest began offering in-flight satellite-based Internet service on all of its 737-700 and 737-800 aircraft, representing over 75 percent of Southwest's fleet. Southwest's arrangement with its Internet service provider enabled the company to control the pricing of in-flight Internet service (which in 2014 was $8 a day per device, including stops and connections). The addition of in-flight Internet service, coupled with the free wireless service available in all of Southwest's gate areas, meant that passengers traveling on a Southwest airplane equipped with satellite Internet service had gate-to-gate connectivity for small portable electronic devices—in early 2016, Southwest was the only carrier currently offering gate-to-gate connectivity on 80 percent of its total aircraft fleet.

In 2013, Southwest joined with DISH Network to give customers free access to 17 live channels and 75 on-demand recorded episodes from various TV series at no additional charge. This promotion was later extended through the end of 2014. Shortly thereafter, Southwest added a selection of movies-on-demand (currently priced at $5 per movie) to its entertainment offerings and, in December 2013, became the first airline to offer a messaging-only option for $2 a day per device, including all stops and connections. Passengers did not have to purchase in-flight Internet service to access television offerings, movies-on-demand, or the messaging-only service.

In 2013, Southwest introduced a completely redesigned Southwest mobile website and app for iPhone and Android that had more features and functionality. The app enabled passengers to begin using mobile boarding passes.

Strategic Plan Initiatives, 2013–2016

Integrating Southwest's and AirTran's Operations The process of integrating AirTran into Southwest's operation began in 2013 and was completed by year-end 2014, with the last AirTran flight operating on December 28, 2014. Important integration accomplishments included:

- Transitioning of AirTran's Atlanta hub into a point-to-point operation to capture the efficiencies related to the scheduling of aircraft, flight crews, and ground staff.
- In addition to converting AirTran's flight schedules into a point-to-point operation, Southwest had merged and optimized the combined Southwest–AirTran flight schedules.
- Southwest had established a Southwest presence in all AirTran cities not currently served by Southwest and rebranded all AirTran operations and activities as Southwest.
- Conversion of AirTran's Boeing 737-700 aircraft to the Southwest fleet.
- AirTran's flight attendants had transitioned from the Association of Flight Attendants–CWA ("AFA") to the Transportation Workers of America union representing Southwest's flight attendants.

Southwest's Fleet Modernization Initiative Southwest had multiple efforts underway to modernize its aircraft fleet. One effort, referred to by Southwest as *Evolve—The New Southwest Experience,* entailed retrofitting and refreshing the cabin interior of its fleet of 471 Boeing 737-700 planes. The goal of the Evolve program was to enhance customer comfort, personal space, and the overall travel experience while improving fleet efficiency and being environmentally responsible. The cabin refresh featured recyclable carpet, a brighter color scheme, and more durable, eco-friendly, and comfortable seats that weighed less than the prior seats. By maximizing the space inside the plane, Evolve allowed for six additional seats on each retrofitted aircraft, along with more climate-friendly and cost-effective materials. Southwest retrofitted 78 of its 737-300 aircraft with Evolve in 2013. In addition, the new 737-800 aircraft entering the company's fleet had the Evolve interior. The 17 AirTran 737-700 aircraft that were transferred to Southwest's fleet at year-end-2013 were refreshed with the new Evolve interior, and the remaining 35 AirTran 737-700 aircraft were refreshed with the Evolve interior when they became part of the Southwest fleet in the second half of 2014.

Furthermore, Southwest had divested AirTran's fleet of Boeing 717-200 aircraft. It had negotiated an agreement with Delta Air Lines, Inc. and Boeing Capital Corp. to lease or sublease AirTran's 88 Boeing 717-200 aircraft to Delta. Deliveries to

Delta began in September 2013. The company did not want to keep Boeing 717-200 planes in its aircraft fleet because of the added maintenance and repair costs associated with having a second type of plane in its fleet. Moreover, replacing the Boeing 717 aircraft capacity with Boeing 737 capacity provided incremental revenue opportunities with more seats per aircraft, while costing approximately the same amount to fly on a per-trip basis as the smaller Boeing 717 aircraft.

Incorporating Larger Boeing Aircraft into Southwest's Fleet Starting in 2012, Southwest began a long-term initiative to replace older Southwest aircraft with a new generation of Boeing aircraft that had greater seating capacity, a quieter interior, LED reading and ceiling lighting, improved security features, reduced maintenance requirements, increased fuel efficiency, and the capability to fly longer distances without refueling. Of the 704 active aircraft in Southwest's fleet at year-end 2015, the company had plans to remove 122 Boeing 737-300 aircraft (with 143 seats and an average age of 20 years) and 15 Boeing 737-500 aircraft (with 122 seats and an average age of 22 years) from its fleet over the next five years and replace them with new Boeing 737-700s (143 seats), 737-800s (175 seats), and 737-MAX aircraft (up to 189 seats). While Southwest had added 54 new Boeing 737-700 and 737-800 planes to its fleet in 2012–2013 and 52 Boeing 737-800 aircraft delivered in 2014–2015, 56 Boeing 737-700 aircraft were scheduled to be delivered in 2016–2018 (with options to take delivery on an additional 36 planes) and 200 737-MAX aircraft to be delivered during 2017–2024 (with options to take delivery on an additional 83 planes—Southwest was Boeing's launch customer for the 737-MAX. Plans called for some of the new aircraft to be leased from third parties rather than being purchased—of the company's current fleet of 704 aircraft, 581 were owned and 123 were leased.

Southwest expected that the new Boeing 737-800 and 737-MAX aircraft would significantly enhance the company's capabilities to (1) more economically fly long-haul routes (the number of short-haul flights throughout the domestic airline industry had been declining since 2000); (2) improve scheduling flexibility and more economically serve high-demand, gate-restricted, slot-controlled airports by adding seats to such destinations without increasing the number of flights; and (3) boost overall fuel efficiency to reduce overall costs. Additionally, the aircraft would enable Southwest to profitably expand its operations to new, more distant destinations (including extended routes over water) such as Hawaii, Alaska, Canada, Mexico, and the Caribbean. Southwest management expected that the new Boeing 737-MAX planes would have the lowest operating costs of any single-aisle commercial airplane on the market.

Launching International Service and a New Reservation System In January 2014, Southwest launched an international reservation system separate from its domestic reservation system (but linked to and accessible from www.southwest.com) and began selling tickets for its inaugural international daily nonstop service on Southwest aircraft beginning July 1, 2014, to Jamaica (Montego Bay), the Bahamas (Nassau), and Aruba (Oranjestad). The company added service to new Latin American destinations in 2015, including San Jose, Costa Rica; Puerto Vallarta, Mexico; Belize City, Belize; and Liberia, Costa Rica. The company expected to add flights to additional near-international locations in 2016 after the opening of a five-gate international terminal and customs facility and Hobby Airport in October 2015. Southwest also operated international flights from Fort Lauderdale, Florida.

Growing Southwest's Rapid Rewards Frequent Flyer Program Southwest's current Rapid Rewards frequent flyer program, launched in March 2011, linked free travel awards to the number of points members earned purchasing tickets to fly Southwest (the previous version of the Rapid Rewards program had tied free travel awards to the number of flight segments flown during a 24-month period). The amount of points earned was based on the fare and fare class purchased, with higher fare products (like Business Select) earning more points than lower fare products (like Wanna Get Away). Likewise, the amount of points required to be redeemed for a flight was based on the fare and fare class purchased. Rapid Rewards members could also earn points through qualifying purchases with Southwest's Rapid Rewards Partners (which included car rental agencies, hotels, restaurants, and retail locations), and they could purchase points. Members who opted to obtain a Southwest co-branded Chase® Visa credit card, which had an annual fee of $99, earned 2 points for every dollar spent on purchases of Southwest tickets and on purchases with Southwest's car rental and hotel partners, and they earned 1 point on every dollar spent everywhere else. Holders of Southwest's co-branded Chase Visa credit card could redeem credit card points for items other than travel on Southwest, including international flights on other airlines, cruises, hotel stays, rental cars, gift cards, event tickets, and more. The most active members of Southwest's Rapid Rewards program qualified for priority check-in and security lane access (where available), standby priority, free in-flight Wi-Fi, and—provided they flew 100 qualifying flights or earned 110,000 qualifying points in a calendar year—automatically received a Companion Pass, which provided for unlimited free roundtrip travel for one year to any destination available on Southwest for a designated companion of the qualifying Rapid Rewards Member.

Rapid Rewards members could redeem their points for every available seat, every day, on every flight, with no blackout dates. Points did not expire so long as the Rapid Rewards Member had points-earning activity during the most recent 24 months.

In 2016, the current Rapid Rewards program had exceeded management's expectations with respect to the number of frequent flyer members added, the amount spent per member on airfare, the number of flights taken by members, the number of Southwest's co-branded Chase Visa credit card holders added, the number of points sold to business partners, and the number of frequent flyer points purchased by program members.

Southwest had enabled the members of AirTran's A+ Rewards frequent flyer program to transfer their loyalty rewards to Southwest Rapid Rewards. In 2015, the members of the Southwest Rapid Rewards frequent flyer program redeemed approximately 7.3 million flight awards, accounting for approximately 12.0 percent of revenue passenger miles flown. This was significantly higher than the 2012 redemptions of approximately 4.5 million flight awards (accounting for approximately 9.0 percent of revenue passenger miles flown) and the 2011 redemptions of approximately 3.7 million flight awards (accounting for approximately 8.6 percent of revenue passenger miles flown).

Southwest's Growth Strategy

Southwest's strategy to grow its business consisted of (1) adding more daily flights to the cities/airports it currently served and (2) adding new cities/airports to its route schedule.

It was normal for customer traffic to grow at the airports Southwest served. Hence, opportunities were always emerging for Southwest to capture additional revenues by adding more flights at the airports already being served. Sometimes these opportunities entailed adding more flights to one or more of the same destinations and sometimes the opportunities entailed adding flights to a broader selection of Southwest destinations, depending on the mix of final destinations the customers departing from a particular airport were flying to.

To spur growth beyond that afforded by adding more daily flights to cities/airports currently being served, it had long been Southwest's practice to add one or more new cities/airports to its route schedule annually. In selecting new cities, Southwest looked for city pairs that could generate substantial amounts of both business and leisure traffic. Management believed that having numerous flights flying the same routes appealed to business travelers looking for convenient flight times and the ability to catch a later flight if they unexpectedly ran late. As a general rule, Southwest did not initiate service to a city/airport unless it envisioned the potential for originating at least 8 flights a day there and saw opportunities to add more flights over time—in Denver, for example, Southwest had boosted the number of daily departures from 13 in January 2006 (the month in which service to and from Denver was initiated) to 79 daily departures in 2008, 129 daily departures in May 2010, and 184 daily departures in 2016.

On a number of occasions, when rival airlines had cut back flights to cities that Southwest served, Southwest had quickly moved in with more flights of its own, believing its lower fares would attract more passengers. When Midway Airlines ceased operations in November 1990, Southwest moved in overnight and quickly instituted flights to Chicago's Midway Airport. Southwest was a first-mover in adding flights on routes where rivals cut their offerings following 9/11. When American Airlines closed its hubs in Nashville and San Jose, Southwest immediately increased the number of its flights into and out of both locations. When US Airways trimmed its flight schedule for Philadelphia and Pittsburgh, Southwest promptly boosted its flights into and out of those airports. Southwest initiated service to Denver when United, beset with financial difficulties, cut back operations at its big Denver hub. In 2016, it was clear that Southwest intended to pick up the pace in adding service to more locations, particularly larger metropolitan airports, places like Hawaii and Alaska, and international destinations.

Marketing, Advertising, and Promotion Strategies

Southwest was continually on the lookout for novel ways to tell its story, make its distinctive persona come alive, and strike a chord in the minds of air travelers. Many of its print ads and billboards were deliberately unconventional and attention-getting so as to create and reinforce the company's maverick, fun-loving, and combative image. The company launched its TransFAREncy campaign in 2015 that focused on its easy-to-understand pricing that did not include hidden fees for checked bags, preferred seating, or flight changes. The other three largest U.S.-based airlines typically included upcharges for baggage or seat selection either immediately prior to online fare payment or upon airport check-in. In addition, American, Delta, and United all issued either nonrefundable tickets or tickets that included hefty change fees that could exceed the cost of a new ticket.

Previous campaigns had promoted the company's performance as "The Low-Fare Airline" and "The All-Time On-Time Airline," and its Triple Crown awards. One of the company's billboard campaigns touted the frequency of the company's flights with such phrases as "Austin Auften," "Phoenix Phrequently," and "L.A. A.S.A.P." Each holiday season since 1985 Southwest had run a "Christmas card" ad on TV featuring children and their families from the Ronald McDonald Houses and Southwest employees. Fresh advertising campaigns were launched periodically—Exhibit 10 shows four representative ads.

Southwest tended to advertise far more heavily than any other U.S. carrier. Passenger traffic at Southwest subsequently rose while passenger volumes went in the opposite direction at Southwest's largest competitors—all of which had recently introduced or increased fees for checked baggage.

The company periodically launched national and local advertising and promotional campaigns to highlight what management believed were important points of differentiation between Southwest and rival airlines. These differentiating features included:

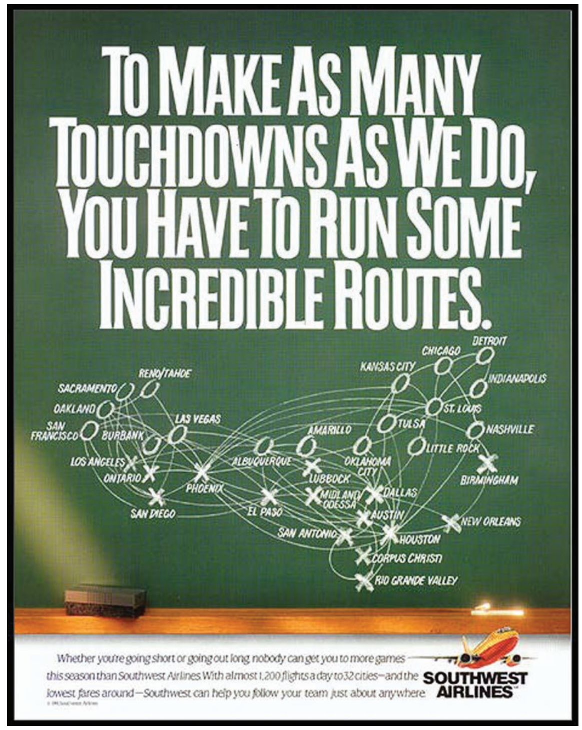
- Being the only major U.S. airline not to charge additional fees for first and second checked bags—moreover, Southwest allowed each ticketed customer to check one stroller and one car seat free of charge, in addition to the two free checked bags.
- Being the only major U.S. airline not to impose a fee for customers to change their travel schedules. Nor did Southwest impose additional fees for items such as seat selection, fuel surcharges, snacks, curb-side check-in, and telephone reservations.
- Offering a wide range of in-flight entertainment options and conveniences for passengers (in-flight Internet service, access to 17 live channels and episodes of 75 different television series, movies-on-demand, and messaging).

Southwest management believed these differentiating features—along with its low fares, network size, numerous nonstop flights, friendly customer service, and Rapid Rewards program—had been instrumental in helping grow passenger traffic on Southwest flights, build market share, and increase revenues. The company's advertising and promotional expenditures totaled $218 million in 2015, $207 million in 2014, and $208 million in 2015; these expenditures were included in "other operating expenses" in Exhibit 9.

SOUTHWEST'S PEOPLE MANAGEMENT PRACTICES AND CULTURE

Whereas the litany at many companies was that customers come first, at Southwest the operative principle was that "employees come first and customers come second." The high strategic priority placed on employees reflected management's belief that delivering superior service required employees who not only were passionate about their jobs but who also knew the company was genuinely concerned for their well-being and committed to providing them with job security. Southwest's thesis was simple: Keep employees happy—then they will keep customers happy.

EXHIBIT 10 Four Samples of Southwest's Ads



© Southwest Airlines

Since becoming the company's CEO, Gary Kelly had continuously echoed the views of his predecessors: "Our People are our single greatest strength and our most enduring long term competitive advantage."[19]

The company changed the personnel department's name to the People Department in 1989. Later, it was renamed the People and Leadership Development Department.

Recruiting, Screening, and Hiring

Southwest hired employees for attitude and trained for skills. Herb Kelleher explained:[20]

> We can train people to do things where skills are concerned. But there is one capability we do not have and that is to change a person's attitude. So we prefer an unskilled person with a good attitude . . . [to] a highly skilled person with a bad attitude.

Management believed that delivering superior service came from having employees who genuinely believed that customers were important and that treating them warmly and courteously was the right thing to do, not from training employees to *act* like customers are important. The belief at Southwest was that superior, hospitable service and a fun-loving spirit flowed from the heart and soul of employees who themselves were fun-loving and spirited, who liked their jobs and the company they worked for, and who were also confident and empowered to do their jobs as they saw fit (rather than being governed by strict rules and procedures).

Southwest recruited employees by means of newspaper ads, career fairs and Internet job listings; a number of candidates applied because of Southwest's reputation as one of the best companies to work for in America and because they were impressed by their experiences as a customer on Southwest flights. Recruitment ads were designed to capture the attention of people thought to possess Southwest's "personality profile." For instance, one ad showed Herb Kelleher impersonating Elvis Presley and had the message:[21]

> Work In A Place Where Elvis Has Been Spotted. The qualifications? It helps to be outgoing. Maybe even a bit off center. And be prepared to stay for a while. After all, we have the lowest employee turnover rate in the industry. If this sounds good to you, just phone our jobline or send your resume. Attention Elvis.

Colleen Barrett elaborated on what the company looked for (see Exhibit 11) in screening candidates for job openings:[22]

> We hire People to live the Southwest Way. They must possess a Warrior Spirit, lead with a Servant's Heart, and have a Fun-LUVing attitude. We hire People who fight to win, work hard, are dedicated, and have a passion for Customer Service. We won't hire People if something about their behavior won't be a Cultural fit. We hire the best. When our new hires walk through the door, our message to them is you are starting the flight of your life.

All job applications were processed through the People and Leadership Development Department.

EXHIBIT 11 Personal Traits, Attitudes, and Behaviors That Southwest Wanted Employees to Possess and Display

Living the Southwest Way		
Warrior Spirit	**Servant's Heart**	**Fun-LUVing Attitude**
• Work hard	• Follow The Golden Rule	• Have FUN
• Desire to be the best	• Adhere to the Basic Principles	• Don't take yourself too seriously
• Be courageous	• Treat others with respect	• Maintain perspective (balance)
• Display a sense of urgency	• Put others first	• Celebrate successes
• Persevere	• Be egalitarian	• Enjoy your work
• Innovate	• Demonstrate proactive Customer Service	• Be a passionate team player
	• Embrace the SWA Family	

Source: **www.southwest.com** (accessed August 18, 2010).

Screening Candidates In hiring for jobs that involved personal contact with passengers, the company looked for people-oriented applicants who were extroverted and had a good sense of humor. It tried to identify candidates with a knack for reading people's emotions and responding in a genuinely caring, empathetic manner. Southwest wanted employees to deliver the kind of service that showed they truly enjoyed meeting people, being around passengers, and doing their job, as opposed to delivering the kind of service that came across as being forced or taught. Kelleher elaborated: "We are interested in people who externalize, who focus on other people, who are motivated to help other people. We are not interested in navel gazers."[23] In addition to a "whistle while you work" attitude, Southwest was drawn to candidates who it thought would be likely to exercise initiative, work harmoniously with fellow employees, and be community-spirited.

Southwest did not use personality tests to screen job applicants nor did it ask them what they would or should do in certain hypothetical situations. Rather, the hiring staff at Southwest analyzed each job category to determine the specific behaviors, knowledge, and motivations that job holders needed and then tried to find candidates with the desired traits—a process called targeted selection. A trait common to all job categories was teamwork; a trait deemed critical for pilots and flight attendants was judgment. In exploring an applicant's aptitude for teamwork, interviewers often asked applicants to tell them about a time in a prior job when they went out of their way to help a co-worker or to explain how they had handled conflict with a co-worker. Another frequent question was: "What was your most embarrassing moment?" The thesis here was that having applicants talk about their past behaviors provided good clues about their future behaviors.

To test for unselfishness, Southwest interviewing teams typically gave a group of potential employees ample time to prepare five-minute presentations about themselves; during the presentations in an informal conversational setting, interviewers watched the audience to see who was absorbed in polishing their presentations and who was listening attentively, enjoying the stories being told, and applauding the efforts of the presenters. Those who were emotionally engaged in hearing the presenters and giving encouragement were deemed more apt to be team players than those who were focused on looking good themselves. All applicants for flight attendant positions were put through such a presentation exercise before an interview panel consisting of customers, experienced flight attendants, and members of the People and Leadership Department. Flight attendant candidates who got through the group presentation interviews then had to complete a three-on-one interview conducted by a recruiter, a supervisor from the hiring section of the People and Leadership Department, and a Southwest flight attendant; following this interview, the three-person panel tried to reach a consensus on whether to recommend or drop the candidate.

Training

Apart from the FAA-mandated training for certain employees, training activities at Southwest were designed and conducted by Southwest Airlines University (formerly the University for People). The curriculum included courses for new recruits, employees, and managers. Learning was viewed as a never-ending process for all company personnel; the expectation was that each employee should be an "intentional learner," looking to grow and develop not just from occasional classes taken at Southwest Airlines University but also from their everyday on-the-job experiences.

Southwest Airlines University conducted a variety of courses offered to maintenance personnel and other employees to meet the safety and security training requirements of the Federal Aviation Administration, the U.S. Department of Transportation, the Occupational Safety and Health Administration, and other government agencies. And there were courses on written communications, public speaking, stress management, career development, performance appraisal, decision making, leadership, customer service, corporate culture, environmental stewardship and sustainability, and employee relations to help employees advance their careers.

Leadership development courses that focused on developing people, team-building, strategic thinking, and being a change leader were keystone offerings. New supervisors attended a four-week course "Leadership Southwest Style" that emphasized coaching, empowering, and encouraging, rather than supervising or enforcing rules and regulations. New managers attended a two-and-a-half-day course on "Next-Level leadership." There were courses for employees wanting to explore whether a management career was for them and courses for high-potential employees wanting to pursue a long-term career at Southwest. From time to time, supervisors and executives attended courses on corporate culture, intended to help instill, ingrain, and nurture such cultural themes as teamwork, trust, harmony, and diversity. All employees who came into contact with customers, including pilots, received customer care training. Altogether, Southwest employees spent over 1.7 million hours in training sessions of one kind or another in 2015:[24]

Job Category	Amount of Training
Maintenance and support personnel	148,300 hours
Customer support and services personnel	214,700 hours
Flight attendants	241,700 hours
Pilots	476,300 hours
Ground operations personnel	656,400 hours

The OnBoarding Program for Newly Hired Employees Southwest had a program called OnBoarding "to welcome New Hires into the Southwest Family" and provide information and assistance from the time they were selected until the end of their first year. All new hires attended a full-day orientation course that covered the company's history, an overview of the airline industry and the competitive challenges that Southwest faced, an introduction to Southwest's culture and management practices, the expectations of employees, and demonstrations on "Living the Southwest Way." The culture introduction included a video called the *Southwest Shuffle* that featured hundreds of Southwest employees rapping about the fun they had on their jobs (at many Southwest gatherings, it was common for a group of employees to do the Southwest Shuffle, with the remaining attendees cheering and clapping). All new hires also received safety training. Anytime during their first 30 days, new employees were expected to access an interactive online tool—OnBoarding Online Orientation—to learn more about the company. During their first year of employment, new hires were invited to attend a "LUV@First Bite Luncheon" in the city where they worked; these luncheons were held on the same day as Leadership's Messages to the Field; at these luncheons, there were opportunities to network with other new hires and talk with senior leaders.

An additional element of the OnBoarding program involved assigning each new employee to an existing Southwest employee who had volunteered to sponsor a new hire and be of assistance in acclimating the new employee to the job and Living the Southwest Way; each volunteer sponsor received training from Southwest's OnBoarding Team in what was expected of a sponsor. Much of the indoctrination of new employees into the company's culture was done by the volunteer sponsor, co-workers, and the new employee's supervisor. Southwest made active use of a one-year probationary employment period to help ensure that new employees fit in with its culture and adequately embraced the company's cultural values.

Promotion

Approximately 80 to 90 percent of Southwest's supervisory positions were filled internally, reflecting management's belief that people who had "been there and done that" would be more likely to appreciate and understand the demands that people under them were experiencing and, also, more likely to enjoy the respect of their peers and higher-level managers. Employees could either apply for supervisory positions or be recommended by their present supervisor.

Employees being considered for managerial positions of large operations (Up and Coming Leaders) received training in every department of the company over a six-month period in which they continued to perform their current job. At the end of the six-month period, candidates were provided with 360-degree feedback from department heads, peers, and subordinates; personnel in the People and Leadership Department analyzed the feedback in deciding on the specific assignment of each candidate.[25]

Compensation and Benefits

Southwest's pay scales and fringe benefits were quite attractive compared to other major U.S. airlines (see Exhibit 12). Southwest's average pay for pilots in 2013 was anywhere from 31 to 92 percent higher than the average pay for pilots at American Airlines, Delta Air Lines, and United Airlines; the average pay for Southwest's flight attendants ranged from as little as 12 percent higher to as much as 38 percent higher than these same rivals. Its benefit package was the best of any domestic airline in 2013.

In 2016, in addition to vacation, paid holidays, and sick leave, Southwest offered full-time and

EXHIBIT 12 Employee Compensation and Benefits at Selected U.S. Airlines, 2005, 2009, and 2013

	Southwest Airlines	American Airlines	Delta Air Lines	United Airlines
Average pilot wage/salary				
2005	**$157,420**	$137,734	$155,532	$114,789
2009	**176,225**	137,482	137,948	125,465
2013	**229,290**	144,266	174,196	153,786
Averageflightattendantwage/salary				
2005	**$ 42,045**	$ 46,191	$ 40,037	$ 35,450
2009	**46,839**	50,933	39,161	40,559
2013	**61,277**	52,000	45,945	47,588
All-employeeaveragewage/salary				
2005	**$ 62,122**	$ 57,889	$ 57,460	$ 49,863
2009	**75,624**	62,961	56,030	58,239
2013	**81,675**	68,269	72,960	68,056
Averagebenefitsperemployee				
2005	**$ 26,075**	$ 24,460	$ 39,379	$ 20,980
2009	**23,820**	30,516	28,279	22,749
2013	**34,573**	27,028	32,638	32,222

Note: Data after 2013 was not available.

Sources: **www.airlinepilotcentral.com**; **www.airlinefinancials.com** (both accessed May 22, 2013).

part-time Southwest and AirTran employees a benefits package that included:

- A 401(k) retirement savings plan
- A profit-sharing plan
- Medical and prescription coverage
- Mental health chemical dependency coverage
- Vision coverage
- Dental coverage
- Adoption assistance
- Mental health assistance
- Life insurance
- Accidental death and dismemberment insurance
- Long-term disability insurance
- Dependent life insurance
- Dependent care flexible spending account
- Health care flexible spending account
- Employee stock purchase plan
- Wellness program
- Flight privileges
- Health care for committed partners
- Early retiree health care

Company contributions to employee 410(k) and profit-sharing plans totaled $1.74 billion during 2009–2013. In 2013, Southwest's contribution to the profit-sharing plan represented about 6 percent of each eligible employee's compensation. Employees participating in stock purchases via payroll deduction bought 1.7 million shares in 2011, 2.2 million shares in 2012, and 1.5 million shares in 2013 at prices equal to 90 percent of the market value at the end of each monthly purchase period.

Employee Relations

About 83 percent of Southwest's 45,000 employees belonged to a union. An in-house union—the

Southwest Airline Pilots Association (SWAPA)—represented the company's pilots. The Teamsters Union represented Southwest's stock clerks and flight simulator technicians; a local of the Transportation Workers of America represented flight attendants; another local of the Transportation Workers of America represented baggage handlers, ground crews, and provisioning employees; the International Association of Machinists and Aerospace Workers represented customer service and reservation employees, and the Aircraft Mechanics Fraternal Association represented the company's mechanics.

Management encouraged union members and negotiators to research their pressing issues and to conduct employee surveys before each contract negotiation. Southwest's contracts with the unions representing its employees were relatively free of restrictive work rules and narrow job classifications that might impede worker productivity. All of the contracts allowed any qualified employee to perform any function—thus pilots, ticket agents, and gate personnel could help load and unload baggage when needed and flight attendants could pick up trash and make flight cabins more presentable for passengers boarding the next flight.

Except for one brief strike by machinists in the early 1980s and some unusually difficult negotiations in 2000–2001, Southwest's relationships with the unions representing its employee groups had been harmonious and nonadversarial for the most part. However, the company was engaged in difficult contract negotiations with its pilots in 2016.

Contract Negotiations with the Southwest Airlines Pilots' Association

Contract negotiations between Southwest Airlines management and SWAPA involved a number of issues, including pay. In 2015, the contracted hourly rate of pay for a Boeing 737 captain at Southwest Airlines was $216 with 78 guaranteed hours per month. The hourly rate of pay for an American 737 captain was $235 with 73 guaranteed hours, while Delta 737 captains were paid $217 per hour for 65 guaranteed hours and captains of United Airlines Boeing 737s were paid $236 per hour for 70 guaranteed hours per month.

In mid-2016, SWAPA and its member pilots were concerned with an hourly rate of pay that was the lowest among major carriers and had been unchanged since 2011. Pilots were also seeking improvements to work rules and flying schedules and a separate wage rate for larger 737-MAX aircraft. It was typical in the airline industry for pilot hourly rates of pay to increase with the size of the aircraft. Southwest's pilots were concerned that the company had made a firm order for 200 Boeing 737-MAX aircraft and had options on an additional 191 planes for delivery between 2017 and 2027, but had not negotiated a wage rate with pilots who would fly the larger planes. The SWAPA and management had sent a tentative agreement to membership for a vote in September 2015, but the terms were rejected by Southwest's pilots in November 2015. The SWAPA filed suit against Southwest Airlines in May 2016 concerning the lack of a contract with pilots to fly the 737-MAX planes scheduled for delivery in 2017.

The No-Layoff Policy

Southwest Airlines had never laid off or furloughed any of its employees since the company began operations in 1971. The company's no-layoff policy was seen as integral to how the company treated its employees and management efforts to sustain and nurture the culture. According to Kelleher,[26]

> Nothing kills your company's culture like layoffs. Nobody has ever been furloughed here, and that is unprecedented in the airline industry. It's been a huge strength of ours. It's certainly helped negotiate our union contracts. . . . We could have furloughed at various times and been more profitable, but I always thought that was shortsighted. You want to show your people you value them and you're not going to hurt them just to get a little more money in the short term. Not furloughing people breeds loyalty. It breeds a sense of security. It breeds a sense of trust.

Southwest had built up considerable goodwill with its employees and unions over the years by avoiding layoffs. Both senior management and Southwest employees regarded the three recent buyout offers as a better approach to workforce reduction than involuntary layoffs.

Operation Kick Tail

In 2007, Southwest management launched an internal initiative called Operation Kick Tail, a multiyear call to action for employees to focus even more attention on providing high-quality customer service, maintaining low costs, and nurturing the Southwest culture. One component of this initiative involved giving a Kick Tail Award to employees when they did something exemplary to make a positive difference in a customer's travel experience or in the life of a co-worker or otherwise stood out in exhibiting the values in Living the Southwest Way (Exhibit 11).

Gary Kelly saw this aspect of Operation Kick Tail as a way to foster the employee attitudes and commitment needed to provide "Positively Outrageous Customer Service;" he explained:

> One of Southwest's rituals is finding and developing People who are "built to serve." That allows us to provide a personal, warm level of service that is unmatched in the airline industry.

Southwest management viewed the Operation Kick Tail initiative as a means to better engage and incentivize employees to strengthen their display of the traits in Living the Southwest Way (and achieve a competitive edge keyed to superior customer service).

Management Style

At Southwest, management strived to do things in a manner that would make Southwest employees proud of the company they worked for and its workforce practices. Managers were expected to spend at least one-third of their time out of the office, walking around the facilities under their supervision, observing firsthand what was going on, listening to employees and being responsive to their concerns. A former director of people development at Southwest told of a conversation he had with one of Southwest's terminal managers:[27]

> While I was out in the field visiting one of our stations, one of our managers mentioned to me that he wanted to put up a suggestion box. I responded by saying that, Sure—why don't you put up a suggestion box right here on this wall and then admit you are a failure as a manager?" Our theory is, if you have to put up a box so people can write down their ideas and toss them in, it means you are not doing what you are supposed to be doing. You are supposed to be setting your people up to be winners. To do that, you should be there listening to them and available to them in person, not via a suggestion box. For the most part, I think we have a very good sense of this at Southwest. I think that most people employed here know that they can call any one of our vice presidents on the telephone and get heard, almost immediately.
>
> The suggestion box gives managers an out; it relinquishes their responsibility to be accessible to their people, and that's when we have gotten in trouble at Southwest—when we can no longer be responsive to our flight attendants or customer service agents, when they can't gain access to somebody who can give them resources and answers.

Company executives were very approachable, insisting on being called by their first names. At new employee orientations, people were told, "We do not call the company chairman and CEO Mr. Kelly, we call him Gary." Managers and executives had an open door policy, actively listening to employee concerns, opinions, and suggestions for reducing costs and improving efficiency.

Employee-led initiatives were common. Southwest's pilots had been instrumental in developing new protocols for takeoffs and landings that conserved fuel. Another frontline employee had suggested not putting the company logos on trash bags, saving an estimated $250,000 annually. Rather than buy 800 computers for a new reservations center in Albuquerque, company employees determined that they could buy the parts and assemble the PCs themselves for half the price of a new PC, saving the company $1 million. It was Southwest clerks that came up with the idea of doing away with paper tickets and shifting to e-tickets.

There were only four layers of management between a frontline supervisor and the CEO. Southwest's employees enjoyed substantial authority and decision-making power. According to Kelleher:[28]

> We've tried to create an environment where people are able to, in effect, bypass even the fairly lean structures that we have so that they don't have to convene a meeting of the sages in order to get something done. In many cases, they can just go ahead and do it on their own. They can take individual responsibility for it and know they will not be crucified if it doesn't work out. Our leanness requires people to be comfortable in making their own decisions and undertaking their own efforts.

From time to time, there were candid meetings of frontline employees and managers where operating problems and issues between and among workers and departments were acknowledged, openly discussed, and resolved.[29] Informal problem avoidance and rapid problem resolution were seen as managerial virtues.

Southwest's Two Big Core Values—LUV and Fun

Two core values—LUV and fun—permeated the work environment at Southwest. LUV was much more than the company's ticker symbol and a recurring theme in Southwest's advertising campaigns.

Over the years, LUV grew into Southwest's codeword for treating individuals—fellow employees and customers—with dignity and respect and demonstrating a caring, loving attitude. LUV and red hearts commonly appeared on banners and posters at company facilities, as reminders of the compassion that was expected toward customers and other employees. Practicing the Golden Rule, internally and externally, was expected of all employees. Employees who struggled to live up to these expectations were subjected to considerable peer pressure and usually were asked to seek employment elsewhere if they did not soon leave on their own volition.

Fun at Southwest was exactly what the word implies and it occurred throughout the company in the form of the generally entertaining behavior of employees in performing their jobs, the ongoing pranks and jokes, and frequent company-sponsored parties and celebrations (which typically included the Southwest Shuffle). On holidays, employees were encouraged to dress in costumes. There were charity benefit games, chili cook-offs, Halloween parties, new Ronald McDonald House dedications, and other special events of one kind or another at one location or another almost every week. According to one manager, "We're kind of a big family here, and family members have fun together."

Culture-Building Efforts

Southwest executives believed that the company's growth was primarily a function of the rate at which it could hire and train people to fit into its culture and consistently display the traits and behaviors set forth in Living the Southwest Way. Kelly said, "some things at Southwest won't change. We will continue to expect our people to live what we describe as the 'Southwest Way,' which is to have a Warrior Spirit, Servant's Heart, and Fun-Loving Attitude. Those three things have defined our culture for 36 years."[30]

The Corporate Culture Committee Southwest formed a Corporate Culture Committee in 1990 to promote "Positively Outrageous Service" and devise tributes, contests, and celebrations intended to nurture and perpetuate the Southwest Spirit and Living the Southwest Way. The committee was composed of 100 employees who had demonstrated their commitment to Southwest's mission and values and zeal in exhibiting the Southwest Spirit and Living the Southwest Way. Members came from a cross-section of departments and locations and functioned as cultural ambassadors, missionaries, and storytellers during their two-year term.

The Corporate Culture Committee had four all-day meetings annually; ad hoc subcommittees formed throughout the year met more frequently. Over the years, the committee had sponsored and supported hundreds of ways to promote and ingrain the traits and behaviors embedded in Living the Southwest Way—examples included promoting the use of red hearts and LUV to embody the spirit of Southwest employees caring about each other and Southwest's customers, showing up at a facility to serve pizza or ice cream to employees or to remodel and decorate an employee break room. Kelleher indicated, "We're not big on Committees at Southwest, but of the committees we do have, the Culture Committee is the most important."[31]

In addition, there was a Culture Services Team in Southwest's executive office dedicated solely to ensuring that the culture of Southwest Airlines remained alive and well; the team's duties included coordinating the yearly Messages to the Field, planning Spirit Parties at various locations, writing commendations and congratulatory notes to employees exhibiting outstanding performances, organizing the company's Annual Awards Banquet, and supporting the Corporate Culture Committee. Each major department and geographic operating unit had a Local Culture Committee charged with organizing culture-building activities and nurturing the Southwest Spirit within their unit. More recently, the company had created a new position in each of its major operating departments and largest geographic locations called Culture Ambassador; the primary function of cultural ambassadors was to nurture the Southwest Spirit by helping ensure that the Local Culture Committee had the resources needed to foster the culture at each of their locations, planning and coordinating departmental celebrations and employee appreciation events, and acting as a liaison between the local office and the corporate office on culture-related matters.

Efforts to Nurture and Sustain the Southwest Culture Apart from the efforts of the Corporate Culture Committee, the Local Culture Committees, and the cultural ambassadors, Southwest management sought to reinforce the company's core values and culture via a series of employee recognition programs to single out and praise employees for their outstanding contributions to customer service, operational excellence, cost-efficiency, and display of the Southwest Spirit. In addition to Kick Tail awards, there were "Heroes of the Heart" awards, *Spirit* magazine Star of the Month awards, President's Awards, and LUV Reports whereby one or more employees could recognize other employees for an outstanding performance or contribution.

Other culture-supportive activities included a CoHearts mentoring program, a Day in the Field program where employees spent time working in another area of the company's operations, a Helping Hands program where volunteers from around the system traveled to work two weekend shifts at other Southwest facilities that were temporarily shorthanded or experiencing heavy workloads, and periodic Culture Exchange meetings to celebrate the Southwest Spirit and company milestones. Almost every event at Southwest was videotaped, which provided footage for creating such multipurpose videos as *Keepin' the Spirit Alive* that could be shown at company events all over the system and used in training courses. The concepts of LUV and fun were spotlighted in all of the company's training manuals and videos.

Southwest's monthly employee newsletter often spotlighted the experiences and deeds of particular employees, reprinted letters of praise from customers, and reported company celebrations of milestones. A quarterly news video, *As the Plane Turns,* was sent to all facilities to keep employees up to date on company happenings, provide clips of special events, and share messages from customers, employees, and executives. The company had published a book for employees describing "outrageous" acts of service.

In 2012, Southwest launched the SWAG (Southwest Airlines Gratitude) initiative, which included a software tool that enabled each employee to set up a profile that listed all the recognitions and awards he or she received. This tool also allowed the employee to send commendations to other employees recognizing their hardworking efforts and/or exemplary performance. Employees who won Kick Tail, Heroes of the Heart, Star of the Month, and President's Awards were credited with SWAG points that could be redeemed in the company's SWAG Shop, which contained thousands of items and enabled employees to reward themselves however they found most meaningful.

Employee Productivity

Management was convinced the company's strategy, culture, esprit de corps, and people management practices fostered high labor productivity and contributed to Southwest having low labor costs in comparison to the labor costs at its principal domestic rivals (Exhibit 9). When a Southwest flight pulled up to the gate, ground crews, gate personnel, and flight attendants hustled to perform all the tasks requisite to turn the plane quickly—employees took pride in doing their part to achieve good on-time performance. Southwest's turnaround times were in the 25- to 30-minute range, versus an industry average of around 45 minutes. In 2015, just as had been the case for many years, Southwest's labor productivity compared quite favorably with its chief domestic competitors:

	Productivity Measure	
	Passengers Enplaned per Employee, 2015	Employees per Plane, 2015
Southwest Airlines	**2,869**	**72**
American Airlines	1,147	109
Delta Air Lines	1,633	104
United Airlines	1,129	116

Source: Bureau of Transportation Statistics, various data tables.

Southwest Airlines's Competitive Standing in 2016

Under Herb Kelleher, instituting practices, procedures, and support systems that promoted operating excellence had become a tradition and a source of company pride. Much time and effort over the years had gone into finding the most effective ways to do aircraft maintenance, to operate safely, to make baggage handling more efficient and baggage transfers more accurate, and to improve the percentage of on-time arrivals and departures. Believing that air travelers were more likely to fly Southwest if its flights were reliable and on-time, Southwest's managers constantly monitored on-time arrivals and departures, making inquiries when many flights ran behind and searching for ways to improve on-time performance. One initiative to help minimize weather and operational delays involved the development of a state-of-the-art flight dispatch system.

Southwest's current CEO, Gary Kelly, had followed Kelleher's lead in pushing for operating excellence. One of Kelly's strategic objectives for Southwest was "to be the safest, most efficient, and most reliable airline in the world." Southwest managers and employees in all positions and ranks were proactive in offering suggestions for improving Southwest's practices and procedures; those with merit were quickly implemented. Southwest was considered to have one of the most competent and thorough aircraft maintenance programs in the commercial airline industry and, in 2016 was widely regarded as the best operator among U.S. airlines. Exhibit 13 presents data comparing Southwest against its four domestic rivals on four measures of operating performance.

EXHIBIT 13 Comparative Statistics on On-Time Flights, Mishandled Baggage, Boarding Denials Due to Oversold Flights, and Passenger Complaints for Major U.S. Airlines, 2000, 2005, 2010, 2013, 2015–2016

Percentage of Scheduled Flights Arriving within 15 Minutes of the Scheduled Time (during the previous 12 months ending in May of each year)						
Airline	**2000**	**2005**	**2010**	**2013**	**2015**	**2016**
American Airlines	75.8%	78.0%	79.6%	77.6%	76.3%	81.7%
Delta Air Lines	78.3	76.4	77.4	84.5	85.2	87.2
Southwest Airlines	**78.7**	**79.9**	**79.5**	**76.7**	**76.8**	**81.1**
United Airlines	71.6	79.8	85.2	79.3	76.3	80.9
Mishandled Baggage Reports per 1,000 Passengers (in May of each year)						
Airline	**2000**	**2005**	**2010**	**2013**	**2015**	**2016**
American Airlines	5.44	4.58	4.36	3.02	4.38	3.08
Delta Air Lines	3.64	6.21	4.90	2.15	1.82	1.56
Southwest Airlines	**4.14**	**3.46**	**4.97**	**3.72**	**3.20**	**2.77**
United Airlines	6.71	4.00	4.13	3.47	2.85	2.29
Involuntary Denied Boardings per 10,000 Passengers Due to Oversold Flights (January through March of each year)						
Airline	**2000**	**2005**	**2010**	**2013**	**2015**	**2016**
American Airlines	0.59	0.72	0.75	0.36	0.79	0.84
Delta Air Lines	0.44	1.06	0.29	0.52	0.22	0.10
Southwest Airlines	**1.70**	**0.74**	**0.76**	**0.66**	**1.04**	**0.91**
United Airlines	1.61	0.42	1.00	1.37	1.00	0.49
Complaints per 100,000 Passengers Boarded (in May of each year)						
Airline	**2000**	**2005**	**2010**	**2013**	**2015**	**2016**
American Airlines	2.77	1.01	1.08	1.99	3.32	1.99
Delta Air Lines	1.60	0.91	1.21	0.53	0.56	0.45
Southwest Airlines	**0.41**	**0.17**	**0.29**	**0.36**	**0.40**	**0.29**
United Airlines	5.07	0.87	1.47	1.89	2.32	1.99

Sources: Office of Aviation Enforcement and Proceedings, Air Travel Consumer Report, various years.

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[6] Ibid., pp. 246–247.
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