

Southwest Airlines

Flying High with Low Costs

Southwest Airlines sent its first flights aloft in 1971. After almost 45 years, Southwest was so successful that the company was considered, in many ways, the crown jewel of the airline industry. The organization had achieved the longest continuous stretch of profitability in the history of the airline industry and was consistently ranked in the top 10 on Fortune's list of "Most Admired Companies," a list that spanned all industries. Southwest's executives liked to say that they strove toward a triple bottom-line of People, Planet, and Performance.

In 2015, Southwest was on strong financial ground, despite the fact that the prior 15 years had been some of the most difficult in aviation history. The airline industry had been hurt by the 9/11 terrorist attacks and the Great Recession of 2008–2009. Although 2009 had been a difficult year for the company, Southwest had still managed to eke out a positive net income of \$99 million. The company's performance improved in the subsequent years, with net income rising above \$400 million and revenues increasing from \$10.3 billion in 2009 to more than \$17 billion in 2012 (see **Exhibits 1 and 3**). Southwest achieved its strong financial performance in large part by having a high *load factor*, the airline industry's measure of the percentage of seats that are filled on an airline's flights. In 2010, Southwest hit the highest load factor in its history: 79.3 percent. Following its successful "Bags Fly Free" ad campaign, Southwest also saw its domestic market share increase by almost 2 percent. Southwest was known for high levels of both customer service and employee satisfaction. In 2013, Southwest not only rated as the top airline in a *Consumer Reports* survey of passengers¹ but also reigned at the top of the US Department of Transportation's customer satisfaction rankings. By 2015, with the benefit of lower fuel costs, it achieved record profits of \$4.1 billion. Overall, Southwest had an enviable record of performance.

The US Airline Industry

The airline industry is critical to the health of the US economy. Airlines provide 11 million jobs in the United States and are responsible for five cents of every dollar of the US gross domestic product (GDP). For every 100 airline jobs that exist, 388 more jobs are supported outside of the airline industry.²

A key turning point in airline history was the deregulation of the industry in 1978. Before deregulation, the Civil Aeronautics Board regulated all passenger fares, which meant the price was the same for each flight between two cities. The board also regulated industry entrances and exits; mergers and acquisitions; and even airlines' rates of return. Typically, any given market had only a few airlines, and price competition was essentially nonexistent.

Following deregulation, numerous new entrants moved into both established and unserved markets, and fare prices began to drop quickly. The average passenger fare in 1978 was about 8.49 cents per mile. In 2009, that price, adjusted for inflation, had decreased

EXHIBIT 1 Southwest Airlines Selected Financial & Operating Figures

Financial Data: (In Millions except per share)	2015	2013	2011
Total Operating Revenues:	19,820	17,699	15,658
Operating Expenses:			
Salaries, wages, and benefits	6,383	5,305	4,371
Fuel and oil	3,616	5,763	5,644
Maintenance materials and repairs	1,005	1,080	955
Aircraft rentals	238	361	308
Landing fees and other rentals	1,166	1,103	959
Depreciation and amortization	1,015	867	715
Other operating expenses	2,242	86	1,879
Total Operating Expenses:	15,704	16,421	14,965
Operating Income:	4,116	1,278	693
Net Income:	2,181	794	178
Net income per share, basic	3.30	1.06	0.23
Total assets at period-end	21,312	19,345	18,068
Long-term obligations at period-end	2,541	2,191	3,107
Stockholders' equity at period-end	7,358	7,336	6,877
Operating Data:			
Revenue passengers carried	118,171,211	108,075,976	103,973,759
Enplaned passengers	144,574,882	133,155,030	127,551,012
Revenue passenger miles (RPMs) (000s)	117,499,879	104,348,216	97,582,530
Available seat miles (ASMs) (000s)	140,501,409	130,344,072	120,578,736
Load factor (1)	83.6%	80.1%	80.9%
Average aircraft stage length (miles)	750	703	679
Trips flown	1,267,358	1,312,785	1,317,977
Average passenger fare	154.85	154.72	141.90
Passenger revenue yield per RPM	15.57¢	16.02¢	15.12¢
Operating revenue yield per ASM	13.98¢	13.58¢	12.99¢
Operating expenses per ASM	11.18¢	12.60¢	12.41¢
Fulltime equivalent Employees at period-end	49,583	44,831	45,392
Aircraft in service at period-end (2)	704	680	698

(1) Revenue passenger miles divided by available seat miles

(2) Includes leased aircraft

Source: Southwest Airlines Annual Reports

56 percent.³ As prices declined for passengers, however, more than 150 airlines went bankrupt, and eight of the 11 major airlines went bankrupt, merged, or closed.

The airline industry's profit margins are some of the lowest in the world (see **Exhibits 4** and **5**). Airlines paid considerable attention to reducing their operating costs, but their control over those costs was severely limited. In particular, labor costs represented the largest percentage of an airline's costs, but union agreements limited labor flexibility. The sizes of the crew and ground staff were typically proportional to the size of the aircraft they served.