SOUTHWEST AIRLINES
CASE STUDY

I. COMPANY OVERVIEW

Southwest Airlines Co. ("Southwest") is a major U.S. airline that primarily provides short haul, high-frequency, point-to-point, low-fare service. Southwest was incorporated in Texas and commenced operations on June 18, 1971 with three Boeing 737 aircraft serving three Texas cities—Dallas, Houston, and San Antonio. Today Southwest operates nearly 400 Boeing 737 aircraft to 59 U.S. cities. Southwest has the lowest operating cost structure in the domestic airline industry and consistently offers the lowest and simplest fares. Southwest also has one of the best overall customer service records. LUV is Southwest's NYSE symbol, selected to represent the company's home at Dallas Love Field, as well as the theme of Southwest's employee and customer relationships (Southwest Airlines Investor Relations statement at www.southwest.com. 10/10/04).

For fiscal 2003 Southwest Airlines achieved revenues totaling $5,937 million, an increase of 7.5% on 2002 revenues of $5,741 million. The company's business is divided into three distinct areas: Passengers, Freight, and Other, which respectively accounted for 96.7%, 1.6%, and 1.7% of 2003 revenues (www.datamonitor.com, 10/10/04).

II. CURRENT SITUATION

A. Current Performance

Overall, Southwest's performance in recent years has been outstanding. The company's ROI has been steadily increasing, and Southwest has consistently ranked first in market share in 80-90 percent of its top 100 city-pair routes. Its airline industry market share in 2000 was 9.4%. despite being in an industry that is characterized by "vulnerability to economic cycles and big swings in bottom-line performance," Southwest has been profitable every year since 1973. It posted a growth rate of 1.0% in 2000, up from .5% in 1999.

Operating expenses: Consolidated operating expenses for 2002 increased $181 million, or 3.7%, compared to the 5.5% increase in capacity. To a large extent, changes in operating expenses for airlines are driven by changes in available seat miles (ASMs). The following presents Southwest's operating expenses per ASM for 2002 and 2001 followed by explanations of these changes on a per-ASM basis:

	2002 (cents)	2001 (cents)	Change (cents)	Change (%)
Salaries, wages, benefits	2.89	2.84	.05	1.8
Fuel, oil	1.11	1.18	(.07)	(5.9)
Maintenance	.57	.61	(.04)	(6.6)
Agency Commissions	.08	.16	(.08)	(50.0)
Aircraft rentals	.27	.29	(.02)	(6.9)
Landing fees	.50	.48	.02	4.2
Depreciation	.52	.49	.03	6.1
Other	1.47	1.49	(.020)	(1.3)
TOTAL	7.41	7.54	(.13)	(1.7)

Overall, Southwest's competitive position in the airline industry is high. The company has strong market shares, effective management, and strong strategies.

B. Strategic Posture

The company's mission, objectives, strategies, and policies are clearly stated on Southwest's website. Southwest communicates this information throughout the organization and to its customers through the website, annual reports, advertisements, and their annual employee auctions.

> **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.
>
> **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.

It may be noted that the mission statement is purely service oriented, and sets no operational goals.

Southwest is optimistic about its current and future performance, as revealed the following Year in Review from the 2003 Annual Report:

> In 2003, Southwest posted a profit for the 31st consecutive year. The Company also extended its streak of consecutive quarterly profits to 51 periods in fourth quarter 2003. Both of these achievements are unsurpassed in the airline industry. For the third consecutive year, the airline industry as a whole suffered a net loss and many of the larger airlines underwent or continued massive efforts to restructure their business, gain wage concessions from their employees, and slash costs in efforts to avoid bankruptcy or emerge from bankruptcy. For the Company, although profitability levels have not returned to those achieved prior to the September 11, 2001, terrorist attacks, profits increased considerably versus 2002, even excluding the impact of government grants received in both years.
>
> Although the process has been gradual, revenue trends had shown improvement prior to the Iraq war, and have steadily improved since major hostilities in Iraq ended in May 2003. However, air traffic remains depressed compared to pre-September 11, 2001, levels, particularly business demand. Unit revenues continue to run below pre-September 11, 2001, levels by more than 10 percent and the percentage of Customers traveling on full-fares remains down from historical levels. The Company does not anticipate a complete recovery in revenues until the economy fully recovers and there is an upturn in business travel. The Company's business strategy did not waver in 2003. Southwest remained committed to providing predominantly shorthaul flights, high frequency service, low fares, point-to-point flying, and high-quality Customer Service, all while keeping costs low. The Company also continued to complement this strategy by adding longer haul flights, including transcontinental service.

III. CORPORATE GOVERNANCE

A. Board of Directors

There are 12 members on the Southwest Airlines board of directors. Two are current officers of the Company (Gary C. Kelly and Colleen C. Barrett), and another, Herbert D. Kelleher, is the Company's semi-retired founder and CEO. The board of directors are:

Colleen C. Barrett
President and Corporate Secretary, Southwest Airlines

Louis Caldera
President, University of New Mexico

C. Webb Crockett
Attorney at Law, Fennemore Craig, Phoenix, AZ

William H. Cunningham, PhdD
Professor of Marketing, University of Texas School of Business

Travis C. Johnson
Attorney at Law, El Paso, TX

Herbert D. Kelleher
Chairman, Founder, and former CEO, Southwest Airlines

Rollin W. King
Retired, Dallas, TX

Nancy Loeffler
Longtime advocate of volunteerism, San Antonio, TX

John T. Montford
Senior Vice President, SBC Telecommunications, Inc.

June M. Morris
Founder ad former CEO, Morris Air Corp.

Gary C. Kelly
Vice Chairman and CEO, Southwest Airlines

According to an SEC filing of April 16, 2001, the only individual on the board of trustees who held significant shares of Southwest stock was Herbert C. Kelleher, who at that time owned 11,228,123 shares of common stock or 1.5% of the total shares outstanding. The executive officers and directors as a group (19 persons) owned 17,442,660 shares or 2.3% of the total.

Southwest Airlines stock is publicly traded under the symbol LUV. As of September 10, 2004, Value Line reported 786,k426,363 shares of common stock outstanding. There is no preferred stock.

B. Top Management

Two of the board members are also officers in the company: CEO Gary Kelly and President Colleen C. Barrett. Herbert D. Kelleher, of course, is the longtime public face of Southwest Airlines. He founded the carrier in 1971, became chairman, president, and CEO, and there was inevitably public discussion regarding the lack of succession plans at Southwest. However, some commentators felt this was not going to be a problem. "One of Kelleher's signal achievements was to entrench Southwest's low-cost, short-haul formula so thoroughly that many believe it could survive under anyone's command," commented Wendy Zellner in *Business Week* (8/16/99). "Former Southwest CEO Howard D. Putnam, who left in '81, recalls the words of Lamar Muse, the company's first chief: 'Only an idiot could screw up Southwest Airlines.' Maybe. But a great company can surely lose its way under weak leaders."

In the April 2, 201 issue of *Business Week*, Zellner had the opportunity to answer her own question. On March 19, 2001, Southwest announced that Kelleher was going to continue as chairman, and on June 19 of that year James F. Parker, general counsel, would take over as CEO while Colleen Barrett, executive vice-president, would assume the role of president. As Zellner commented, “It ain’t broke. Kelleher’s battle plan has stood the test of time and competition. In a consolidating industry plagued by labor strife and disgruntled passengers, Kelleher’s low-cost model of point-to-point flights looks stronger than ever. Who better to keep it gong than Kelleher’s closet confidants?”

In July 2004, following 53 straight quarter in which the airline showed a profit, Jim Parker abruptly resigned. Although the company was profitable, his tenure had been marred by a lengthy negotiation with the flight attendants’ union, which was only resolved by the personal intervention of Herb Kelleher. According to *Business Travel World* (August 2004), “Parker, an employment lawyer before he joined Southwest in 1986, was forced to pull out of contract talks with the airline’s flight attendants earlier this year. It appears that the talks had become highly acrimonious and personal in nature and, like many a CEO before him, Parker was forced eventually to walk because he had lost the trust of staff. Parker also never seemed entirely comfortable with taking over three years ago from the legendary Herb Kelleher, who founded the airline and created its business model for a sustainable low-cost carrier. ‘It was just time to let someone else have a turn,’ was Parker’s farewell comment.”

Parker was succeeded as CEO by Gary C. Kelly, an 18-year Southwest veteran who was promoted from CFO. Kelly’s most notable accomplishment prior to his appointment was his successful fuel-hedging strategy, which has insulated Southwest from a major source of cost increases. He was also involved with Southwest’s other cost-containment strategies including its emphasis on passenger-friendly technology. Laura Wright, the company’s vice-president for finance and treasurer and a colleague in Kelly’s programs, replaced him as CFO.

<u>The executive officers</u> of Southwest Airlines are elected annually at the first meeting of Southwest’s board of directors following the annual meeting of shareholders or appointed by the CEO pursuant to board authorization. Each of the executive officers has worked for Southwest Airlines for more than the past five years (list as of January 1, 2004, reprinted from Southwest Airlines 2003 Annual Report):

NAME	POSITION	AGE
Herbert D. Kelleher	Chairman of the Board	72
James F. Parker*	Vice Chairman and Chief Executive Officer	57
Colleen C. Barrett	Director, President and Chief Operating Officer	59
Donna D. Conover	Executive Vice President—Customer Service	50
Gary C. Kelly	Executive Vice President and Chief Financial Officer	48
James C. Wimberly	Executive Vice President—Chief Operations Officer	50
Joyce C. Rogge	Senior Vice President—Marketing	46
Ron Ricks	Vice President—Governmental Affairs	54
Dave Ridley	Vice President—Ground Operations	50

*resigned July, 2004

The Executive Planning Committee includes all officers of the Senior Vice President level and above. Members of the Executive Planning Committee are the following (www.Southwest.com, 10/10/04):

Gary C. Kelly, Vice Chairman and CEO
Colleen C. Barrett, President and Corporate Secretary
Donna D. Conover, Executive Vice President Customer Operations
James B. Wimberly, Executive Vice President Aircraft Operations
Ginger Hardage, Senior Vice President Corporate Communications
Robert E. Jordan, Senior Vice President Enterprise Spend Management
Tom Nealon, Senior Vice President Technology and Chief Information Officer
Ron Ricks, Senior Vice President Law, Airports and Public Affairs
Dave Ridley, Senior Vice President People and Leadership Development
Joyce C. Rogge, Senior Vice President Marketing
Michael G. Van de Ven, Senior Vice President Planning
Laura H. Wright, Senior Vice President Finance and CFO

IV. EXTERNAL ENVIRONMENT, OPPORTUNITIES AND THREATS

A. Competitive Environment: Southwest's direct competitors are the seven major low-cost carriers operating domestically. The following chart indicates Southwest's strong profit position in the most reported quarter (Q2 2004) (U.S. Department of Transportation, www.dot.gov).

Table 3: Quarterly Domestic Operating profit/loss margin (in percent)
Low-Cost Carriers
Ranked by 2nd Quarter 2004 Margin
(Operating Profit/Loss as Percent of Total Operating Revenue)
Source: Form 41, Schedule P1.2

2Q 2004 RANK	LOW-COST CARRIERS	Q2 2003 (%)	Q3 2003 (%)	Q4 2003 (%)	Q1 2004 (%)	Q2 2004 (%)	Q2 Operating Profit/Loss $(Millions)
1	JetBlue	18.7	19.7	13.4	11.3	14.1	45.1
2	Southwest	9.3	11.9	7.3	3.1	11.5	196.8
3	AirTran	13.1	11.1	8.7	4.3	11.3	31.0
4	America West	2.4	8.0	1.0	2.0	2.6	16.2
5	Spirit	6.8	1.7	-2.9	1.9	-3.0	-3.8
6	Frontier	4.3	13.5	7.7	-4.0	-3.8	-7.3
7	ATA	5.6	7.9	-6.5	-114.8	9.1	-26.0
	TOTAL	8.4	11.2	5.3	1.8	7.2	252.0

For comparison purposes, the following is the Q2 2004 profitability of the seven major network carriers (www. dot.gov):

Table 2: Quarterly Domestic Operating profit/loss margin (in percent)
Network Carriers
Ranked by 2ndQuarter 2004 Margin
(Operating Profit/Loss as Percent of Total Operating Revenue)
Source: Form 41; Schedule P1.2

Q2 204 RANK	NETWORK CARRIERS	Q2 203 (%)	Q3 2003 (%)	Q4 2003 (%)	Q1 2004 (%)	Q2 2004 (%)	Q2 Operating Profit/Loss\ $(Millions)
1	Northwest	0.2	5.4	-0.2	-3.9	4.3	84.3
2	US Airways	-7.1	-5.7	-4.8	-11.0	2.0	31.9
3	Alaska	1.6	10.6	-4.2	-11.2	1.1	5.5
4	Continental	8.8	-4.3	-8.5	-9.9	-4.3	-59.8
5	American	-13.9	-6.3	-13.8	-8.3	-4.6	-145.3
6	United	-12.1	0.0	-8.9	-12.2	-4.7	-125.9
7	Delta	-6.9	-6.0	-6.7	-13.1	-6.2	-198.0
	TOTAL	-6.7	-2.7	-7.8	-9.9	-2.8	-407.3

In today's airline industry business environment, the low-cost carriers as a group are far more profitable than the major network carriers, and also perform better than the regionals (www.dot.gov):

Table 1: Quarterly Domestic Operating Profit/Loss margin (in percent)
Passenger Airlines by Group
Ranked by Q2 2004 Margin
(Operating Profit/Loss as Percent of Total Operating Revenue)
Source: Form 41, Schedule P1.2

Q2 2004 RANK	TYPE	Q2 2003 (%)	Q3 2003 (%)	Q4 2003 (%)	Q1 2004 (%)	Q2 2004 (%)	Q2 Operating Profit/Loss $(Millions)
1	Regionals	14.2	15.3	14.1	11.3	9.0	164.4
2	Low-Cost	8.4	11.2	5.3	1.8	7.2	252.0
3	Network	-6.7	-2.7	-7.8	-9.9	-2.8	-407.3
	TOTAL	-2.1	1.4	-3.5	-5.8	0.1	9.1

Southwest's Domestic Unit Revenues are strong, and Southwest currently ranks #3 for operating revenue per available seat mile among the seven major low-cost carrier:

Table 7. Airline Domestic Unit Revenue (Cents per Mile)
Low-Cost Carriers
Ranked by Q2 Domestic Unit Revenue
(Domestic Operating Revenue Per Available Seat Mile)
Source: Form 41; Schedule P1.2 T100; T-2 Data

Q2 2004 Rank	Low-Cost Carriers	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Q2 2004	Q2 Operating Revenue $(Millions)
1	AirTran	9.46	9.08	8.87	8.61	9.53	275.0
2	Frontier	8.66	9.79	9.18	9.53	9.45	192.4
3	Southwest	8.45	8.52	8.28	8.06	9.13	1.716.2
4	America West	8.13	8.29	7.90	7.79	8.50	622.4
5	Spirit	7.84	7.73	7.81	8.11	7.92	126.0
6	JetBlue	7.48	7.37	7.00	6.84	6.91	319.7
7	ATA	6.80	6.86	6.06	5.93	6.41	287.1
	TOTAL	8.18	8.25	7.91	7.76	8.48	3.358.9

Southwest's costs are not the lowest of the low-cost segment:

Table 11. Airline Domestic Unit Costs (Cents per Mile)
Low-Cost Carriers
Ranked by Q2 Domestic Unit Costs
(Domestic Operating Expenses per Available Seat Mile)
Source: Form 41; Schedule P1.2 T100; T2 Data

Q2 2004 Rank	Low-Cost Carriers	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Q2 2004	Q2 Operating Expenses $(Millions)
1	Frontier	8.28	8.47	8.60	10.24	9.80	199.7
2	AirTran	8.22	8.07	8.10	8.24	8.45	243.9
3	America West	7.94	7.62	7.82	7.63	8.28	606.2
4	Spirit	7.31	7.60	8.04	7.95	8.15	313.1
5	Southwest	7.67	7.50	7.67	7.81	8.08	1,519.5
6	ATA	6.42	6.32	6.46	6.81	6.99	313.1
7	JetBlue	6.08	5.92	6.07	6.06	5.93	274.6
	TOTAL	7.49	7.33	7.49	7.63	7.87	3,286.9

Mirroring their performance in profit margins, the low-cost carriers also perform strongly as a group in the area of domestic operating expenses per available seat mile (ASM):

Table 9. Airline Domestic Unit Costs (Cents per Mile)
Passenger Airlines by Group
Ranked by Q2 Domestic Unit Costs
(Domestic Operating Expenses per Available Seat Mile in Cents)
Source: Form 41; Schedule p1.2. T100; T2 Data.

Q2 2004 RANK	TYPE	Q2 2003 (%)	Q3 2003 (%)	Q4 2003 (%)	Q1 2004 (%)	Q2 2004 (%)	Q2 Operating Profit/Loss $(Millions)
1	Regionals	13.54	12.99	12.94	13.61	13.53	1,651.7
2	Network	12.15	11.70	12.32	12.55	12.40	14,951.1
3	Low-Cost	7.49	7.33	7.49	7.62	7.87	3,286.9
	TOTAL	11.15	11.22	11.22	11.44	11.40	19,889.7

B. Opportunities

Low-cost position. Southwest's greatest opportunity is directly related to its greatest strength: to continue to develop its low-cost position in the airline industry.

Southwest must maintain an emphasis on low-cost flying, and brand association that has served it well so far. After September 11, customer numbers dwindled due to consumer fears over flying. One way the Company hopes to regain the trust of the public is through lower airfare. In 2002, no fare was more than $399. However, in August 2002, the company reduced fares even further, lowering last-minute fares while maintaining the full schedule of frequent flights in order to further stimulate travel. As of 2003 Southwest was offering fares as low as $39. The company must keep prices as low as possible in order to stimulate demands, and look to redistribute expenses through other areas.

Continue streamlining and automation. Continual streamlining and automation is necessary in order to both aid in cost-cutting and maintain the competitive advantage on which the company brand is based. Southwest has expanded ticket counters and security checkpoints and has increased its airport workforce. The boarding process has been streamlined through replacing the traditional plastic boarding card system with an automated one, and the carrier is in the process of rolling out new self check-in technology. This should result in a reduction of boarding times, and contrast sharply with those carriers that still have extensive queueing.

Expand geographically. The market share Southwest holds has grown substantially, particularly since 9/11. Fifty percent of the core market is under control of Southwest and this is expanding. With the increase in the number of cities and networks to which it is linked, Southwest could begin to target large city markets and with such a strong brand name, both marketing and PR costs will reduce. Furthermore, the timing appears perfect, if it wishes to capitalize on the pressure currently endured by many of the established carriers.

Merger or acquisition. Southwest could strengthen its position through an alliance. Many competitors have reduced share price due to poor financials. Southwest could exploit this through a merger or a favorable acquisition. This could provide an easier route into the major hubs and remove many of the challenges associated with entering new markets.

C. Threats

Cost of operations. Significant costs of operations include rising labor costs (which produced a damaging round of negotiations with the flight attendants' union) and rising fuel costs, which cannot be avoided forever through hedging. In addition to the difficult revenue environment for commercial airlines, Southwest is faced with increased war risk insurance and passenger security laws and directives. In response to the attacks of September 11, the airline industry worked with Congress, the DOT, the FAA, and law enforcement agencies to enhance security. Potential costs, such as security onboard aircraft and anti-weapons systems will increase expenses to the airlines. Since Southwest relies on a low-fare business model, it may be less able to pass along increased security costs to passengers.

Post-9/11 commercial airline environment. A major threat comes from the unstable airline industry as the result of the 9/11 attacks. Immediately after the terrorist attacks, and in the face of falling demand for air service, most major carriers announced significant service reduction, grounded aircraft, and reduced employee levels. These events negatively impacted industry profits. Despite the absence of subsequent attacks, the political environment remains unstable, throwing into question the airlines' ability to make long-range strategic plans.

Following 9/11, Southwest was able to offset losses through lower jet fuel prices and internal cost reduction initiatives. However, there can be no assurance that Southwest will be able to continue to offset future cost increases resulting from the changing commercial airline environment.

Varied competitive factors. Another threat derives from the Company being subject to varying degrees of competition from surface transportation in its short-haul markets, particularly the private automobile. The short-haul air services that compete with surface transportation regard price as a competitive factor for customers. Similarly, frequency and convenience of scheduling, facilities, transportation safety and security procedures, and customer service may be of equal or greater importance to many passengers. These can limit the number of customers who choose Southwest.

Threats recognized by Southwest in the Company's 2003 Annual Report:

• Items directly linked to the September 11, 2001 terrorist attacks, such as the adverse impact of new airline and airport security directives on the Company's costs and customer demand for travel, changes in the Transportation Security Administration's scope for managing U.S. airport security, the availability and cost of war-risk and other aviation insurance, including the federal government's provision of third party war-risk coverage, and the possibility of additional incidents that could cause the public to question the safety and/or efficiency of air travel.

• War or other military actions by the U.S. or others.

• Competitive factors, such as fare sales and capacity decisions by the Company and its competitors, changes in competitors' flight schedules, mergers and acquisitions, codesharing programs, and airline bankruptcies.

• General economic conditions, which could adversely affect the demand for travel in general and consumer ticket purchasing habits, as well as decisions by major freight customers on how they allocate freight deliveries among different types of carriers.

• Factors that could affect the Company's ability to control its costs, such as the results of employee labor contract negotiations, employee hiring and retention rates, costs for health care, the largely unpredictable prices of jet fuel, crude oil, and heating oil, the continued effectiveness of the Company's fuel hedges, changes in the Company's overall fuel hedging strategy, capacity decisions by the Company and its competitors, unscheduled required airframe or engine repairs and regulatory requirements, changes in commission policy, availability of capital markets, future financing decisions made by the Company, and reliance on single suppliers for both the Company's aircraft and its aircraft engines.

• Disruptions to operations due to adverse weather conditions and air traffic control-related constraints.

V. INTERNAL ENVIRONMENT, STRENGTHS AND WEAKNESSES

A. Strengths

Sensible expansion policy. Southwest has developed a very sensible strategy for expansion, paying particular attention not to strain the balance sheet. It has also achieved a national presence through flights to 59 airports in 58 cities. Southwest has been able to become a national airline by strategic expansion to airports where there is less competition. For example, it opened a major operation at Baltimore-Washington International and therefore avoided the presence of other major airlines at Reagan National and Dulles. The continued growth of the Company is testament to the strategic direction taken by management, particularly considering the difficult business environment.

Business model. Due to a change in passenger profile, business class and first class seats have suffered declining demand. Many companies have been forced to introduce low-cost fare options. Since Southwest has been an industry leader and "ahead of the curve" in providing low cost, standardized travel options, it has no need to change strategy, thus saving on restructuring costs. The Company also benefits from its long establishment in the low-cost airline market, allowing the Company to capitalize on significant customer awareness of the brand.

Southwest has a highly efficient operation. The Company was first to introduce to the airline industry the ten-minute turnaround (between arrival at the gate and departure). This has subsequently increased demand for short flight routes.

Strong financials. Southwest has the strongest market capitalization and balance sheet of all rivals in the sector. A market capitalization of $14,022 million accounts for twice the market capitalization of the five largest rivals put together. In the current volatile market, it should allow Southwest to overcome short-term downturns in demand more successfully than the other main carriers. The continued ability of Southwest to produce positive results highlights it among rivals. 2003 saw quarter-over-quarter increases in income, representing 51 consecutive quarterly profit rises. Revenues for the full year 2003, which were $5,937 million, increased 7.5% against 2002 revenues (www.datamonitor.com September 2004).

B. Weaknesses

Little room for strategic development. The main weakness of the Company results from operating in a highly competitive market, one that is increasingly susceptible to a volatile political environment. The airline industry is highly competitive as to fares, frequent flier benefits, routes, and service. Some carriers competing with Southwest have larger fleets and a more established brand name. Many carry passengers from the major hubs in the U.S., holding long-standing relationships with key airports. To enter these markets, the corporate strategy of Southwest will have to be adjusted.

No established alliances. Certain major U.S. airlines have established marketing alliances with each other, including Northwest Airlines/Continental Airlines, American Airlines/Alaska Airlines, and Continental Airlines/America West Airlines. In 2001, AMR Corp., parent of American Airlines, completed its acquisition of the assets of Trans World Airlines. This puts enormous strain on the Company to maintain its position in the industry while running a smaller fleet.

Fully valued share price. Despite Southwest holding the strongest financial position in te airline industry, the stock of the Company is considered fully valued, particularly in the short term. This will disconcert the investor searching for quick gains resulting in the potential loss of capital to its competitors. The strong financial position will apply pressure to the strategic direction of the Company, forcing the directors of Southwest to consciously pursue the same level of growth if they are to maintain investor confidence.

C. Corporate Resources

Marketing. Southwest is a low-cost carrier. They provide themselves on cost efficiencies, which enable them to offer good service at lower prices to the customer than their competitors. Their marketing strategy was to convey the message that what Southwest had to offer was of value. Southwest markets itself as the only major short-hop, low-fare, point-to-point carrier in the U.S. airline industry. Their marketing style is known for being unconventional, unique, unpredictable, and attention-getting in order to create and reinforce the Company's maverick and fun-loving, combative image. They continually look for ways to make their distinctive image come alive and strike a spark in the minds of the consumer.

Finance. In the year 2000, Southwest reported its 28th consecutive year of profitability as well as its ninth consecutive year of increased profits. In many years, Southwest was reporting profits while many other airline companies were reporting losses. Southwest is able to maintain and increase their profit margin by keeping costs low, being highly efficient, and creatively cutting costs.

Operations and logistics. One of Southwest's most important strategies is keeping its costs low and moving customers in above-average times. In an effort to move customers along quickly, Southwest tries to avoid congested airports. Southwest also encourages passengers to make reservations and ticket purchases through their website.

Southwest operates a system of point-to-point routes as opposed to the hub-and-spoke routes of most carriers. Assigned seating is not used. From 1991 to 2001, Southwest received five consecutive Triple Crown awards, which recognize the airline with the best on-time record, best baggage-handling, and fewest customer service complaints.

By serving smaller airports near major metropolitan areas and in medium-sized cities, Southwest is able to produce better-than-average on-time performance, as well as reducing fuel costs of idle planes waiting for clearance to land. Serving smaller airports also lowers landing fees and terminal gate costs.

Human resource management. Southwest's operative principal is "employees come first and customers come second." Southwest employees are "hired for attitude and trained for skill." The Company's strategy is that it can train people to do the tasks and hold the skills that are required, but a person's attitude is not something that can be changed.

The hiring process involves an interviewing approach called "Target Selection," which aims at matching people's traits (or target dimensions) for performing a specific job successfully. New hires are trained at Southwest University for People. Managers trained in this program take leadership courses that emphasize a management style based on coaching and encouraging rather than supervising or enforcing rules. The Company has the lowest turnover rate in the industry, which may be partly due to the fact that 80% to 90% of supervisory positions are filled internally.

Information systems. Southwest pursues aggressive IS objectives to make the reservation process more efficient. Southwest provides an easy-to-use online reservation system, sends emails to customers advertising special fares, and provides extensive training to IS managers.

VI. ANALYSIS OF STRATEGIC FACTORS (SWOT)

A. Situational Analysis

Strengths

- Low operating costs
- Service innovation
- Technological expertise
- Integrated marketing campaign
- Product innovation
- Age of equipment
- Ability to continuously refine service
- Intellectual capital
- Financial position
- No-frills service fills market niche
- Image
- Safety record
- Customer service

Weaknesses

- Product breadth and depth
- Multi-country coverage
- No baggage transfer outside Southwest system
- Lack of intra-airline services and alliances

Opportunities

- Growth opportunities for smaller urban airport destinations
- Societal values in the changing economy
- Rebound opportunity as a result of 9/11 decline in market size
- Vertical integration
- Extent of rival's horizontal integration
- Long-term industry growth

Threats

- Costs: Aviation fuel, labor
- Terrorist attack on an aircraft
- Weather
- General economic downturn
- Legislative and regulatory constrictions
- Communications technology and e-commerce
- Number of rivals and their relative size.
- Network airlines subsidiaries that replicate Southwest business model
- Rival distribution channels
- Extent to which rivals use economy of scale
- Industry profitability in relation to the changing economy
- Declining consumer confidence
- Diminishing pool of qualified employees

B. Review of Mission and Objectives

- To provide a low-cost/low-price/no-frills, reliable, friendly service with "more value for less money" mode of transportation for consumers traveling short distances for business and/or leisure.

C. Short-Term Strategic Objectives

Two Years:
- To increase market share by 5%
- Purchase two new planes
- Increase aircraft utilization by 3%
- Add one or two new cities to each route system in any one given year
- Work on improving one-time performance by 5% within one year
- To become the best-ranking airline for Involuntary denied boarding

Three Years:
- Southwest will decrease its downtime for repair of planes by 2%
- Continue to be the most admired airline in America
- Improve technological know-how by 5%
- Introduce new innovative products or services by 5%
- Increase the number of cities added to routes each year to four cities

Five Years:
- Continue to increase product quality by 5%
- Continue to develop new product lines by 5%
- Keep improving Internet capabilities and e-commerce by 5%
- Continue to rank #1 for the next five years in customer satisfaction

D. Long-Term Strategic Objectives (5-10 Years)

• Reduce employee turnover
• Increase Southwest's 65% share of passenger traffic in its biggest 100 cities by 10%
• Improve their design-to-market time by 5%
• Increase product quality by 10%
• Decrease operating costs by 5%
• Increase Internet sales by 90%
• Decrease flight times by 3%
• To still be the most admired airline in America in 2010
• Introduce new systems to decrease time required to create optimal crew schedules by 5%
• Decrease the number of customer complaints per 100,000 passengers by 2%
• Increase number of aircraft in fleet by 5%
• Continue to effectively hedge fuel prices

VII. STRATEGIC ATLTERNATIVES AND RECOMMENDED STRATEGY

1. Introduce structured continuous learning programs that will be used to retain current employees.

2. Adapt services and specials to cater to the population based on their demographics in order to increase market share.

3. Pursue market growth opportunity created when the market declined after 9/11.

4. Defer delivery of new aircraft.

5. Create a "shared services" ground crew pilot program with competitors.

6. Create a promotional campaign of a "buy one, get one free" ticket offer on one-way ticket purchases for off-peak flights.

7. Aggressively pursue Internet marketing opportunities.

8. Improve turnaround times.

9. Continue to successfully hedge fuel prices.

10. Improve employee-management relations to avoid disruptive contract negotiations.

VIII. IMPLEMENTATION

Short-term goals: Many of the marketing strategies can be implemented immediately at the department level

Mid-term goals: Programs to improve operational efficiency and improve employee retention can be implemented within one year.

Long-term goals: Strategic goals such as market expansion (perhaps overseas), acquisitions and mergers, and aircraft delivery schedules must be planned in the context of a five- or ten-year plan at the highest levels of management.

Through consistent focus on operational efficiency and cost control, progressive human resources management, upbeat marketing, service to underserved markets, and a dedication to quality at every level, Southwest Airlines is poised to remain profitable and dynamic.