



TRABAJO DE FIN DE GRADO

Antecedentes organizativos en el modelo de negocio Low-Cost: El Efecto Southwest

Managerial practices in the Low-Cost business model: The Southwest Effect

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Abstract

When Air Southwest was founded on March 15, 1967 (Texas, USA), very few people could think that this small company that provided service within the state of Texas could become the airline giant (8th airline company in revenue (FORBES 2000 world's biggest public companies)) that changed the aviation industry with its management practices. Today, more than forty years since its creation, we can find that its influence is growing bigger and bigger, to an extent that we can talk about the Southwest Effect.

When Southwest enters a new market, there is a decrease in airfares and increase in air travel. Industry insiders call this The Southwest Effect, and it has become an exceptional factor in the United States of America, not just in the aviation industry but also in the culture and daily life of the citizens. Southwest alone, by changing its experience and specially its prices, has changed the whole industry of aviation, converting an industry that was extremely expensive into one that has brought the world together.

To study this effect and understand Southwest success, first we have to take a look through the company's and the aviation industry's history, as well as several factors that include the company's culture, organization and finances. This report will study the true reasons behind the company's success, and the likeability of copying its business model.

Resumen

Cuando Aerolíneas Southwest comenzó el 15 de Marzo de 1967 en Texas, USA, poca gente podía imaginar que ésta pequeña compañía que ofrecía servicios dentro del estado de Texas podría convertirse en el gigante de las aerolíneas que cambió la industria de la aviación con sus prácticas de gestión. Hoy, más de cuarenta años después de su creación, podemos encontrar que su influencia no ha cesado de crecer, hasta un punto que podemos hablar del Efecto Southwest.

Cuando Southwest entra en un nuevo mercado, hay un descenso automático en los precios de los vuelos, y un incremento en la frecuencia de viajes aéreos. Expertos de la industria llaman a esto el Efecto Southwest, y se ha convertido en un factor excepcional, no solo dentro de la industria de la aviación, sino también en la cultura y vida diaria de los ciudadanos americanos. Southwest ha conseguido cambiar su experiencia de viaje y los precios de los vuelos, y esto ha producido un cambio en toda la industria de la aviación,

convirtiéndolo un servicio caro y poco funcional en un servicio que ha conectado al mundo entero.

Para estudiar éste efecto, y entender las razones del éxito de Southwest Airlines, primero debemos estudiar la historia de la compañía y de la industria de la aviación, así como diversos factores entre los que se incluyen el diseño organizacional, la cultura y sus finanzas. Éste estudio pretende descubrir las auténticas razones detrás del éxito de Southwest, así como la probabilidad de que dicho modelo de negocio sea emulado en otros mercados.

Introduction

The main objective of this study has been the development of the concept of Simple Management.

It is a combined study of the managerial practices in the aviation industry, especially within the Low-Cost frame, which has had an exceptional importance in the last two decades, as well as the cultural and organizational facts that are extremely influential within a company.

The characteristics of the Low-Cost industry are fascinating per se. We find here a business model which completely challenges what has been established in other companies, changing the landscape, and opening the door for new companies, and ways of thinking. In the aviation industry, this business model has been a determinant fact in the development of the industry, as well as the increment in the connections between countries, fact that has changed the way companies and people have worked.

To study this ‘‘Low-Cost’’ effect in depth, we are going to study the company which has been considered the pioneer in this ambit: Southwest Airlines. This company alone changed the way of the airlines business model, by developing a completely different approach, based on the use of simple processes.

In concordance with the main objective of this study, which is to prove why companies shall focus in the use of simple management, which is just a way of making the culture and strategies of the company just focused in what is really important: the customer service and the performance of the firm, we are going to study the company that best use gives to this way of thinking.

To study the culture and processes of this company, we have to study first several aspects of the organization: the management, the target market, the life cycle, the financial information, and, probably more important, the organizational information and the strategies that Southwest is going, and has implanted.

By extrapolating this study of the success of Southwest and its use of modern techniques, all being coherent with its culture and way of thinking, we pretend to demonstrate why in the low cost business model is more important the culture and the managerial practices than the model per se, and therefore, explain the reason of Southwest's success through the years and how it can be emulated.

Introducción (Español)

El principal objetivo de este estudio ha sido el desarrollo del concepto de Simple Management.

Es un estudio combinado de las prácticas administrativas en la industria de la aviación, especialmente dentro del marco de modelo de negocio Low-Cost, que ha tenido una importancia excepcional en las últimas dos décadas, y la cultura, así como los factores organizacionales que son extremadamente influyentes dentro de una compañía.

Las características de la industria Low-Cost son fascinantes por si mismas. Podemos encontrar un modelo de negocio que desafía completamente lo que había sido establecido por otras compañías, cambiando el entorno, y abriendo puertas a diversas empresas e industrias. En la industria de la aviación, éste modelo de negocio ha sido un factor determinante, tanto en la propia industria como en las conexiones entre personas y compañías, características que han cambiado aspectos cotidianos y culturales.

Para estudiar este efecto Low-Cost en profundidad, vamos a estudiar la compañía que ha sido considerada la pionera en éste ámbito: Aerolíneas Southwest. Esta compañía, por si sola ha cambiado el modelo de negocio de las aerolíneas, desarrollando un nuevo concepto, basado en el uso de procesos simples y directos.

En concordancia con el principal objeto de este estudio, que es probar porque las compañías deben centrarse en el uso de Simple Management, que es una manera de crear una cultura y desarrollar unas estrategias centradas en lo que es realmente importante para una empresa, vamos a estudiar la compañía que mejor representa éste espíritu.

Para estudiar la cultura y la forma de actuar de ésta empresa, primero tenemos que estudiar con profundidad diversos aspectos de la organización, tales como los procesos de gestión, el mercado objetivo, el ciclo de vida del negocio, la información financiera, y lo que es más importante, la información organizacional y las estrategias que Southwest Airlines ha desarrollado, y va a implementar.

Extrapolando este estudio del éxito de Southwest y el uso de sus modernas técnicas de gestión, todo siendo coherente con su cultura y forma de pensar, se pretende demostrar porque en los modelos de negocio de bajo coste, la cultura y las prácticas de gestión son más importantes que el propio modelo, y así explicar la razón del éxito de Southwest, y como puede emularse en otras compañías.

History

History of aviation industry

On December 17, 1903, the wright brothers changed history with their first powered flight in a heavier-than-air machine, moment that changed the history of transport forever. Before the aviation industry, the fastest way of transportation was the railway, which was expensive and not very efficient.

The first scheduled flight as an airline service was not going to be until several years later in Florida, where Glenn Curtiss had developed a plane that could take off and land on water, providing a much faster service than the already existing ways.

After the regular use in the First World War, the American government felt the necessity to create an experimental service that would change the post mail transport. The government invested nearly 100000 dollars in a joint project between the Army of the United States and its Post Office, which result in the transformation of a large amount of aircraft surplus of the war in an airmail service.

By the mid-1920s, the post office fleet was flying 2,5 million miles, and delivering 14 million letters annually.

However, the first modern airline wouldn't make money until the DC-3 model, commonly called 'the plane that changed the world', was developed. It quickly became the dominant

model in the aircraft industry, and with it, American Airlines, which played a key role in its design.

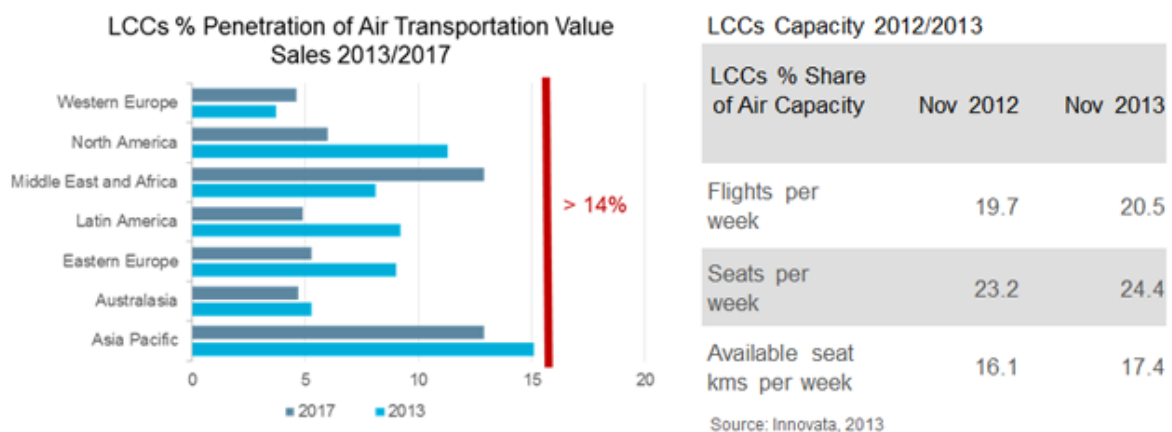
All this factors led to the quick development of the aviation industry and its characteristics, which we'll study in the next point.

In recent history, terrorism events such as the 9/11 attack in New York City changed the industry, specially the security problems, in which the aviation industry is extremely susceptible. This, united to the global financial crisis, which has been more than uncertain (specially the fuel prices, which are a key aspect of the daily operations of any airline company) have made the pricing and cost budget of the annual operations of American and global airlines a challenge, since the prices are really volatile.

Despite of this facts, the low-cost industry has been growing since 1971. The first low-cost airline is generally considered to be the American company Southwest which launched in 1971, with the then revolutionary concept that you could lower the cost of ticket prices by eliminating some of the extras and therefore save passengers money. The baton was picked up in the UK by Ryanair, in 1990, still the biggest contender in the field.

Southwest alone changed the way the airlines worked, and since then, the low-cost industry has been growing intensively, especially in the nineties and the 21st century.

Illustration – Low Cost Carriers Penetration



Source: Innovata 2013

This helps to understand the apparition of the low-cost industry, brilliantly led by Southwest airlines, and also the financial problems that most of the airlines, doesn't matter if American or from other countries have had.

Aviation industry characteristics

It's considerably easy to lose sight of the fact that the aviation industry is still a service industry. It doesn't offer a physical product, just the transportation of people and its belongings. The main characteristic of the aviation industry is its enormous need of capital, as when any company opens its door, they have to offer many security services, as well as a very expensive infrastructure. Most of the equipment is financed through loans or the issuance of stock.

Due to this characteristic, airline companies need constant profitability, which is not so common in this business, as there are many costs and need of financing which suggest these companies are not easy to manage.

In order to understand the airline profitability, we have to think about the metric known as break-even load factor. At a given level of expenses, cargo and ancillary revenues and average passenger yield (price paid per mile), it is the percentage of seats the airline (or industry) must sell to cover its costs. As revenue and costs vary from airline to airline and from flight to flight, so does the break-even load factor. Even in profitable years, most of the companies operate very close to this point. Is in this point, where the profitability of most airlines was in doubt, when Southwest was created, with its revolutionary low cost system, which in the long-term would turn into an effect that could change the shape and importance of whole cities and states.

History of Southwest

Southwest Airlines is the biggest and most important low-cost airline that operates within the United States of America. It is also the first one on introducing the low-model in the aviation industry and has set a precedent for numerous American and overseas airlines.

Southwest airlines started as a company in March 15, 1967, when Rollin King and Herb Kelleher reached an agreement to create an airline that would operate within the state of Texas. They believed that operating just in the state of Texas, Southwest Airlines would be able to avoid the federal regulation. After several legal actions conducted by other companies, Southwest wouldn't start business until 1971, 4 years later than expected. The huge legal costs and continuous battle in the court, leded the company to implement certain bootstrapping strategies, as selling one of the jets and operating just with 3 of them.

Other strategies like the “less than 10 minute operation” within the airport, turned into a key element within the aviation industry, and not just Southwest.

So, Southwest was turned into the first low-cost operating airline. The company realized that most people prefer a cheap, short flight over an expensive and comfortable one, and started to change the management practices. The most famous example is the decision of not serving food in the flights. Southwest started offering services that were more closed to the offered by a bus or a train that the offered by the rest of the top rated airlines.

The competitiveness and the “guerrilla” strategies made by the company, led to more than 40 years of consecutive profit (741 million dollars in net income last year). (Romo, Tammy. 2013. Annual Report Southwest)

Southwest

Management

The current Chief Executive Officer and chairman is Gary C. Kelly, who started in the company as a controller and replaced the co-founder Herb Kelleher in 2008 and Colleen Barrett, the same year. The Senior Vice President and Chief Financial Officer is Tammy Romo and the rest of the board of directors are, by alphabetical order: David W. Biegler, J. Veronica Biggins, Douglas H. Brooks, William H. Cunningham, John G. Denison, Nancy G. Loeffler, John T. Montford, Thomas M. Nealon and Daniel D. Villanueva.

Southwest organizational structure is characterized by a strong hierarchical structure, where the top level managements ensure all the decisions within the company. This gives an extremely efficient and functional corporation but it also makes it quite rigid, given a certain amount of bureaucratic processes which are necessary in such a large-scale company.

Southwest is famous for not using the “hub and spoke” transportation system where most of the routes are directed through a “hub” which would be a major city in where most of the operations are centrally managed. In other words, A hub-and-spoke network concentrates passengers from several satellite airports (spokes) at a major airport

(hub) en route to their final destination airport. By not concentrating operations, and instead using the point-to-point system, described in the 2013 annual report of Southwest, where the routes are not managed through a major city but instead, they make direct routes, which has allowed Southwest to have more non-stop direct routing, giving a much better customer service.

As Jody Gittel stated in his book *The Southwest Airlines Way* (2005), many airlines have attempted to copy Southwest's business model, and in most of the cases it has resulted in failure.

When trying to copy the model of Southwest, airlines only focus in three aspects:

- Flying only one type of aircraft, which result in a much lower cost in training and maintenance
- Use smaller airports with less traffic, which permits the companies to avoid most of the problems with schedules caused by multiple aircraft demands
- Not giving a meal service or a seating assignment, which gives more flexibility to the way the pilot can drive the plane.

Nevertheless, although many companies have tried to copy this model (most famous example is Ryanair and Wizzair in Europe), most of them have failed. Jody Gittel (2005) gives 2 keys which are the actual reason for the huge success of Southwest, all of them managerial and organizational techniques.

- 10 organizational practices that help to join efforts from the top levels of the organization to the frontline employees. These practices are (quoted from the book):
 - Outstanding business leadership
 - Invest in the front-line leaders
 - Hire and train for relationship excellence
 - Use conflicts to build relationships
 - Bridge the work-family divide
 - Create positions that span boundaries
 - Use broad performance metrics
 - Highly flexible job descriptions
 - Partner with the unions
 - Build the supplier relationships
- Shared goals, knowledge and mutual respect environment

- Communications techniques which are frequent, timely and focused in the problem solving.

These organizational techniques are highly complementary, since the goal of all of them is to make the workers feel not in isolation but in a company that empowers the union and synergy between them.

“To learn successfully from Southwest, the key is to adopt organizational practices that support relationships over the long term, between managers and frontline employees, among frontline employees, and with external parties, and to be rigorous about seeking consistency among those practices. One bad apple – or inconsistent practice – really can spoil the whole bunch.”

– Jody Gittel (2005. The Southwest Airlines ways)

Target Market

We can consider the target market of Southwest Airlines under several looks:

- The most obvious segmentation is the price and cost conscious traveler. Southwest is overall a low-cost company and most of its customers are choosing it because of the price.
- Demographically speaking, we could consider the target market male/female professionals between 24 and 55 years old.
- Related to the price cost conscience, we shall consider too the high frequency traveler, which flies at least 1-3 times per month.
- Dissatisfied customers from other airlines

We can consider this target market in a extremely wide range, due to the fact that every person is able to fly, regardless of its age, gender and, in the low-cost market, of its income.

Life cycle of Southwest

Life cycle of Southwest

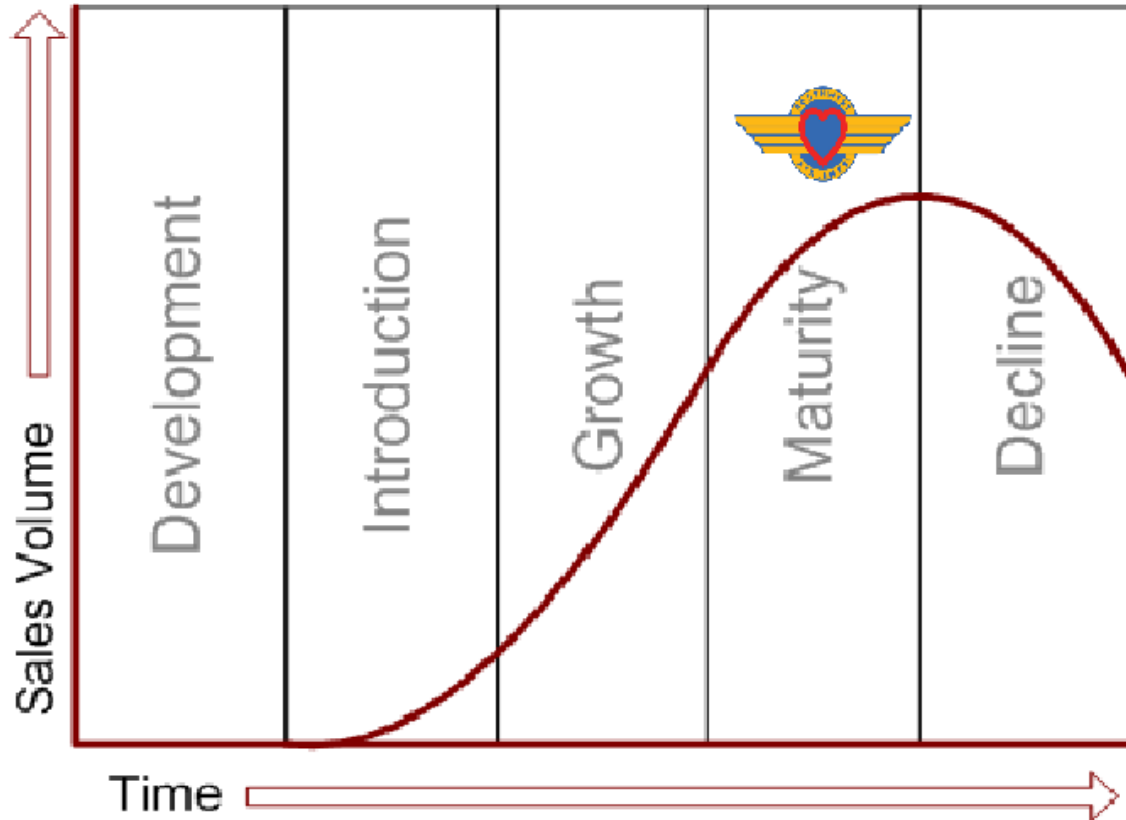


Figure 1 Own elaboration

which will enlighten us in its current strategies, and how Southwest is formulating and implementing the solutions which will help to solve the challenges of the company.

Southwest Airlines has been working since 1971, and its business model has barely changed. Due to its conservative growth strategies, southwest is still in its maturity stage, although it still has plenty of potential to grow, if the international strategies are successfully implemented. The overall industry is in its maturity stage as well, and it will probably not enter in the mid/long term.

Financial information

All the data in this chapter has been extracted from the annual report of Southwest Airlines. First we shall analyze the Return on Invested Capital which is a calculation used to assess a company's efficiency at allocating the capital under its control to profitable investments. The return on invested capital measure gives a sense of how well a company is using its money to generate returns.

ROI Southwest

Return on Invested Capital (ROIC) (in millions) (unaudited)

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Operating Income, as reported	\$ 1,278	\$ 623	\$ 693
Add: Net impact from fuel contracts	84	32	—
Add: Acquisition and integration costs	86	183	132
Add: Asset impairment, net (1)	—	—	14
Operating Income, non-GAAP	\$ 1,448	\$ 838	\$ 839
Net adjustment for aircraft leases (2)	143	117	129
Adjustment for fuel hedge accounting	(60)	(36)	(107)
Adjusted Operating Income, non-GAAP	\$ 1,531	\$ 919	\$ 861
Average invested capital (3)	\$ 11,664	\$ 12,575	\$ 12,439
Equity adjustment for hedge accounting	50	145	184
Adjusted average invested capital	\$ 11,714	\$ 12,720	\$ 12,623
ROIC, pre-tax	13.1%	7.2%	6.8%

(1) Net of profitsharing impact

(2) Net adjustment related to presumption that all aircraft in fleet are owned (i.e., the impact of eliminating aircraft rent expense and replacing with estimated depreciation expense for those same aircraft).

(3) Average invested capital represents a five quarter average of debt, net present value of aircraft leases, and equity.

Figure 2 - Balance sheet – Annual Report Southwest

Southwest's annual report establishes a Return on invested capital goal of 15% for the next year, goal that its planned to be achieved by reducing costs increasing revenues and implementing the different strategies that we have mentioned as key to the future success of the company as:

- AirTran integration

- Fleet modernization
- The continued incorporation of the new aircraft Boeing 737-800
- International capabilities and New reservation system
- Southwest's Rapid Rewards frequent

Balance sheet

Item 8. *Financial Statements and Supplementary Data*

SOUTHWEST AIRLINES CO.
CONSOLIDATED BALANCE SHEET
(in millions, except share data)

	December 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,355	\$ 1,113
Short-term investments	1,797	1,857
Accounts and other receivables	419	332
Inventories of parts and supplies, at cost	467	469
Deferred income taxes	168	246
Prepaid expenses and other current assets	250	210
Total current assets	4,456	4,227
Property and equipment, at cost:		
Flight equipment	16,937	16,367
Ground property and equipment	2,666	2,383
Deposits on flight equipment purchase contracts	764	416
Assets constructed for others	453	331
Total	20,820	19,497
Less allowance for depreciation and amortization	7,431	6,731
Total	13,389	12,766
Goodwill	970	970
Other assets	530	633
	\$ 19,345	\$ 18,596
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,247	\$ 1,107
Accrued liabilities	1,229	1,102
Air traffic liability	2,571	2,170
Current maturities of long-term debt	629	271
Total current liabilities	5,676	4,650
Long-term debt less current maturities	2,191	2,883
Deferred income taxes	2,934	2,884
Construction obligation	437	331
Other noncurrent liabilities	771	856
Stockholders' equity:		
Common stock, \$1.00 par value: 2,000,000,000 shares authorized; 807,611,634 shares issued in 2013 and 2012		
	808	808
Capital in excess of par value	1,231	1,210
Retained earnings	6,431	5,768
Accumulated other comprehensive income (loss)	(3)	(119)
Treasury stock, at cost: 107,136,946 and 77,292,145 shares in 2013 and 2012 respectively	(1,131)	(675)
Total stockholders' equity	7,336	6,992
	\$ 19,345	\$ 18,596

Figure 3 - Balance sheet – Annual Report Southwest

As we may see in the image above, extracted from the annual report of Southwest (2013), we find a steady recovery (compared with the previous years, not displayed in this report). Nevertheless, Southwest has significant contractual obligations and commitments primarily with regard to future purchases of aircraft, payment of debt, and lease arrangements. In FY2014, the company's total contractual obligations are estimated to be \$2,510 million, as compared to \$1,208 million in FY2010. (Huu, Liu. 2012)

We may find now a short summary of the financial statistics of Southwest Airlines, integrally extracted from its corporate website.

2013 Financial Statistics

- Net income: \$754 million
- Net income, excluding special items: \$805 million
- Total revenue passengers carried: 108 million
- Total RPMs: 104 billion
- Average passenger load factor: 80.1 percent
- Total operating revenue: \$17.7 billion

Organizational information

Employees

Nearly 45,000 People work to deliver exemplary Customer Service throughout the Southwest and AirTran systems.

Stock

Common stock is traded under the symbol "LUV" on the NYSE. Beginning in the fourth quarter 1976, Southwest Airlines paid its first of 149 consecutive quarterly dividends to our Shareholders. In 2013, the Company returned \$611 million to Shareholders through repurchases of \$540 million of common stock (38 million shares) and distribution of \$71 million in dividends.

Cities served

Illustration – Southwest’s Functional Airports



Illustration – Annual Report Southwest

Southwest/AirTran Top Ten Airports by Departures

Reflects October 2013 Schedule

Cities	Daily Departures	Number of Gates	Nonstop Cities Served	Year Established	WN	FL
Chicago (Midway)	233	32	64	1985		1994
Las Vegas	210	19	54	1982		2003

Baltimore	206	28	57	1993	2001
Denver	167	19	56	2006	2003
Houston (Hobby)	161	19	45	1971	1997
Phoenix	162	24	46	1982	2007
Atlanta	165	31	44	2012	1993
Dallas (Love Field)	124	15	18	1971	-
Orlando	120	20	43	1996	1998
Los Angeles	109	12	23	1982	2003

Illustration

Strategies

In southwest airlines there is a clear message for the organization. Keep things simple. Making operations simple means the company has fewer things to take care of, and fewer mistakes that can ruin the whole process.

For example, we may consider the fleet of Southwest, which is entirely composed of one single aircraft, the Boeing 737. This means that the employees need less dedication to learn how to use the machinery, and in case there is any problem with the plane, parts are interchangeable, which means a huge reduction in the mechanical costs. This is also a benefit for the customers, because in case that there is any problem and the aircraft cannot fly, the passengers can just change to another one, as there is the same number of passengers in each one.

Also, the policy of ‘‘bags fly free’’ which can be considered unique in this type of low-cost company, not only gives a nice image of the company, but also helps with the operations costs, which are significantly reduced in this matter.

All those strategies permit Southwest to reach a high level of efficiency and flexibility that are hardly achieved by the competitors.

Now we're going to analyze several strategies made and planned for the company in its annual one report (Romo, Tammy. 2013. Annual Report Southwest 2013)

Integration of AirTran Airways.

This is a major milestone for Southwest. On May 2, 2011, Southwest Airlines finished its acquisition of the former competitor AirTran Airways. By buying all its outstanding common stock, corporate identity and operating assets of AirTran, Southwest not only eliminates a direct competitor, but will also have access to Atlanta Airport, one of the most transited and important airports of the United States.

Southwest plan is to fully integrate AirTran Airways' networks and operations by the end of 2014, including the conversion of AirTran's international and remaining domestic markets.

The highlights of the operation are (As stated in the report):

- 400 million dollars in annual net pre-tax synergies.
- Fully development of customer connection between the two airlines. This allows customers to book connecting itineraries between the two carriers flying between any of the combinations without further expenses.
- Expansion of Southwest Cargo to the AirTran network
- Southwest service in all AirTran domestic airports
- 65% of AirTran's employees have been transferred to Southwest organizational structure.

There is a remarkably mention in the Rapid Reward program, which Southwest has converted into one of the most successful fidelization techniques, giving the chance for the loyal customers to redeem its frequent flyers point not only in Southwest but also in AirTran, which result is one combined flexible program with multiple options.

Fleet modernization

One of the keys of the strategy of simplicity in Southwest is its use of only one type of aircraft, the Boeing 737. In order to have a significant reduction in unit operating costs (especially in fuel expenses), and becoming more friendly-environment (reducing the greenhouse gas emissions), Southwest Airlines has implemented a schedule where they're

planning to change all the fleet by the end of 2027, making a total of 547 Boeings 737 MAX.

Southwest expects to earn more than 700 million dollars with this change.

International expansion

Southwest is the biggest low-cost domestic airline in the world. Although right now is quite focused in the integration of AirTran Airways, Southwest Airlines hasn't stopped in its plans of expansion. Southwest has planned to offer the firsts international flights in July 2014, to Nassau (Bahamas), Montego Bay (Jamaica), and Aruba. The expansion plans don't end here though, as Southwest is also planning to offer 3 new international routes to Mexico (Mexico City, Cancun and Cabo San Lucas) and to Punta Cana, in Dominican Republic. (Maxon, Terry. 2013. DallasNews)

SWOT

By studying the SWOT analysis, we pretend to evaluate Southwest's characteristics in order to successfully formulate strategies, and proceed to a better understanding of its success. This analysis has been supported in the study of Robert Borughton (2014) and Hiu Liu (2012).

The SWOT analysis will evaluate the strengths, weaknesses, opportunities and threats of Southwest Airlines as a whole, including its AirTran integration:

Strengths

- Standardization of the fleet. By using the same aircraft in all its flights, Southwest implements a better service, and a huge reduction of costs, not just in maintenance, but also its interchangeability plays a great role in Southwest strategies.
- Point-to-point system. With the implementation of this scheme, Southwest greatly reduces its costs and increases its number of nonstop routes.
- Flexible hours. Although most of the employees in Southwest Airlines are unionized, the working hours are quite flexible.
- Scale economies. Being more than forty years in the industry gives Southwest a huge advantage over potential competitors. This is not only a characteristic of this particular company but of the industry as a whole.

- Established brand. Although Southwest suffers of the overall reputation as a low-cost company, its high customer service has distinguished it from the rest, giving an incredibly great advantage over any competitor.
- Employee satisfaction. Southwest takes care of its employees, and this not only changes its management efficiency but also its customer service, being one of the most customer-oriented airline companies. (Friendliest staff in the industry recognized as having the “Friendliest Flight Attendants and Crew” in a poll by Smarter Traveler readers)
- Although the model can be easily copied by other companies, its management style is what gives Southwest its success. I’ll proceed to give a further explanation by the end of the report.

Weaknesses

- Debt. Southwest is currently working with a huge debt in its books, which should be overseen.
- Customer service is worse than the top-cost airlines. In terms of customer services, Southwest cannot compete with the top airlines that offer seat segmentation, although it still gives an excellent service compared with other low-cost airlines. This results in a missed change of getting extra incomes.
- Revenues are highly dependent on passengers (94%)
- Southwest hasn’t still executed its international flights plans, which makes Southwest position in the market much weaker than other international companies.
- Although it can be as a strength (and so we have explained it) having just one type of aircraft makes Southwest vulnerable to its supplier.
- The model is easily copied, although, as we will explain with more detail later, Southwest true key to success is not just its business model.
- Growth strategy is quite conservative (some people may see it as a strength though)
- Costs are extremely dependent on the oil prices.

Opportunities

- Being just a domestic airline with plenty of loyal customers and a great reputation, Southwest may find a great opportunity, if well handed, in the international expansion.
- Acquisition of AirTran may give Southwest a boost in the domestic market
- Southwest has been famous for having employees with a lot of enthusiasm and less skill than in other similar companies. With the financial crisis, which has shrunk the labor market, Southwest should find potential employees with both qualities.
- There has been a huge recovery of the American aviation industry, especially after the terrorist attacks and the global crisis. The airline industry is expected to recover at least a 2,3% until 2025

Threats

- Volatility in the fuel market. As we said before, Southwest is extremely dependent on fuel prices, and this market has historically been fluctuating in very large proportions.
- The global crisis has caused a huge downturn in the number of passengers within the United States, and although the predictions are favorable, inflation and high unemployment rates are currently a great problem for the industry, especially in the low cost segmentation.
- The terrorist attacks have not only caused the willingness of the people to fly to decrease, but has also cause a huge cost in security, which is also paid by the operating airlines. Although this cost is not as big as it was in the past, due to the 9/11 events, is still increasing costs annually.

Southwest cultural impact: The Southwest Effect

In 1993, Randall D. Bennett and James M. Craun of the Department of Transportation's Office of Aviation Analysis coined this term. They studied this phenomenon in several cities where Southwest Airlines had started to work and reached the conclusion that in any city where Southwest landed, the average fare price would experiment a huge decrease, and the traffic, on the other hand, would rocketed, sometimes as much as a 300%.

As soon as Southwest enters in any new market, the fares would dramatically decrease in order to compensate such a disruption, making Southwest a catalyzer of a much bigger effect.

We can't just focus on the fare prices. Southwest also creates a cultural change in the city where it lands. Since the company usually chooses airports with low competition, those airports are usually found in cities where the development is not as big as the top cities in America (E.g. New York, Los Angeles) but instead, much smaller places. With the apparition of Southwest in any of these cities, the cultural impact is incredibly important, for it transforms it in one of Southwest's "point-to-point" cities. This situates the new city in the map, since now it may become a place with much more traffic.

This directly change the morphology of the city, which is now an important place to carry passengers, so it has to reach the level of economical intensity required for such a city.

This translates into a much bigger effect than the caused within the airport: The entire city may change with it.

Although this may seem as an advantage for the costumer, there are several studies that challenge this statement

For example, we may see the study of Daniel Webb (2012, The evolution of the Southwest effect) in which a further study shows that the Southwest effect, previously mentioned usually wears off after some time, although it has first stimulated traffic and low fares in its new routes. In addition, once Southwest dominates the market, it slowly turns into a previous image of the fares, making the effect much less important that it once was.

Moreover, this effect can also be neutralized if another low-cost carrier was already on the area, showing that it may not be an exclusive Southwest effect, but a Low-Cost Effect.

The Low-Cost effect

First we have to consider the industry, which has been previously studied. We find 2 segments: a brand-loyal segment and a price-sensitive segment. Once a low-cost company enters the markets, two effects are immediately triggered, the competitive effect and the displacement effect.

Brand-loyal segments, which are usually fidelized to companies where quality is more important than price, will actually benefit from this entrance, since its brand is consistently improving its image, considering that the service provided is one of its milestones.

On the other hand, the price-sensitive segments are extremely challenged. After a dominant low-cost carrier as Southwest enters a market, prices are immediately decreased in a dramatic way, in what we have previously called The Southwest Effect.

Kerry M. Tan considers two types of carriers: legacy carriers and low-cost carriers. Legacy carriers are the ones that operate through a hub-and-spoke network, while low-cost carriers commonly use the point-to-point system, popularized by Southwest Airlines. Both carriers suffer the impact of a new low-cost company entering the market, although in a very different way, as we have seen before.

The conclusion of Kerry M. Tan in his study, *Incumbent Response to Entry by Low-Cost Carriers in the U.S. Airline Industry* (2011) was that Legacy carrier incumbents tend to decrease their average airfare, discount fares, and full fare price before and after entry by a low-cost carrier. However, low-cost carriers do not significantly alter their prices in response to entry by a rival low-cost carrier. The key idea in his paper is that although the strongest entry response occurs when Southwest Airlines enters a new route, legacy carrier incumbents tend to respond in a similar, yet weaker fashion to other low-cost carriers.

Consumers have benefitted from the rise of the low cost sector in terms of more competition, more destinations, greater frequencies, and a greater diversity of fares. While there has been some impact on the major airlines, around 50% of the traffic carried by low cost airlines is newly generated, and there is little evidence that the hub and spoke networks of the major carriers are being adversely affected to any great extent.

The feed of the major carriers may be squeezed on certain routes that are subject to point-to-point competition from low cost carriers, but indications are that they are more likely to respond by reducing aircraft size than by withdrawing from routes altogether.

The dark side of low-cost effect

There are a number of issues for aviation policy makers connected with the expansion of the low cost sector. These include mitigating environmental effects, especially at hitherto secondary airports, since the majority of the low cost carriers tend to select routes between regional airports. These airports are often confronted with a tremendous traffic growth,

which requires large capital expenditure for infrastructure investments. Ensuring passenger rights are upheld, especially since some low cost carriers have different conditions of carriage compared to the traditional carriers; ensuring the maintenance of a level competitive playing field; maintaining high standards of safety in Europe's increasingly crowded skies; and organizing the allocation of ever scarcer capacity at congested European airports.

Although at first it may seem as the entrance of low-cost carriers may affect positively a small city, translating it within the 'point-to-point' system it's been also proven that after a low-cost airlines stops the relation with the given city, it actually becomes a problem, since these small towns have been quite 'transformed' in order to satisfy and nurture from its benefits.

Conclusion

Although at first sight it may seem as Southwest's success with its business relies exclusively in its low cost business model, the study of the company shows much more than just the application of the model, which is not just 'low cost' but what I'd like to call, 'simple management'.

Southwest's business model is not based on the costs saved by its practices, but instead, it is based in the simplicity of the system. We may find not only practices that are focused to lower the costs of the company, but instead, we find practices that serve as a catalyzer of its work culture: keeping things simple. We may find several examples of this working culture, as the use of only one type of aircraft, or not charging extra baggage if not completely necessary. This way Southwest manages to optimize its work, not just expending less money, but by giving better and simpler service.

By keeping the managerial processes simpler than other companies, Southwest achieves two goals: lower costs by making sure there are not unnecessary processes, and to give much better customer's service.

This is one of the reasons why Southwest's business model hasn't been successfully emulated in other countries. Or even within the United States, although the business model per se has actually been copied. Most of the companies rely entirely in its model, but they do not focus in making managerial processes as simple as possible, and therefore, they fail.

Not only must the costs be attended, but also the company's culture, as well as its customer service as well.

This translates not only in a highly well delivered service and low fees that are extremely competitive in the current market, but also in a immaculate image that translates into high customer loyalty. On the other hand, we may find cases of low-cost companies that implement a policy of low investment in the consumer and in the optimization of the processes, and this is directly translated into an atrocious image that sooner or later affects the entire company.

In Europe we may find the now famous case of Ryanair, which has been a perfect example of failure in this aspect. While Southwest has been maintaining its fame of excellent, fast and customer-friendly service, Ryanair has done the opposite. Through several policies that were searching the short-term income and by trying to trick the customer into buying and paying extra charges in their fees, Ryanair has acquired a very bad fame. Although they've been successfully working since 1990, now that the market is starting to get saturated, they are paying this bad image.

The adjustment between the culture and the strategy implementation of a company therefore, is much more important that we may think in first place. If a company's strategy is not coherent with its inner culture, an adjustment must be made.

In the case of Southwest, it is important to notice its culture of keeping the processes simple. Making operations simple means the company has fewer things to take care of, and fewer mistakes that can ruin the whole process. In the modern organizations, this can be translated into lower costs, which are the key aspects of the modern airline low cost industry.

Many companies think that the low cost industry is just about making the processes with the cheaper and worst ways possible. But is in fact, the process of making the whole company's culture about making the processes simple, and not engage the workers and resources in activities that are not quite necessary for the company's result. Therefore, Southwest brilliantly leads this way of thinking, and this has resulted in more than 40 years of continuous success.

So, throughout this study we have found the true reasons of why Southwest's business model has been successfully implemented in the United States.

This may not only serve as helpful for the competency of Southwest, but also for any other company, even the ones that don't follow a low- cost policy. By making the processes simplest as possible, improving the internal communication channels, and reducing bureaucracy at minimum, any company shall experiment a huge step through success.

Conclusión (Español)

Aunque a primera vista pueda parecer que el éxito de Aerolínes Southwest pueda descansar exclusivamente en su modelo de negocio, el estudio realizado tanto de la compañía como de la industria de la aviación muestra que es necesario más que la simple implantación del propio modelo, lo que me gustaría llamar: Simple Management.

El modelo de negocio de Aerolíneas Southwest no se basa en los costes ahorrados en sus prácticas, sino en la simplicidad del propio sistema. No solo encontramos prácticas centradas en la optimización de costes de la compañía, sino que encontramos prácticas que sirven como catalizadoras de la cultura organizacional: simplificar los procesos. Podemos encontrar varios ejemplos en el estudio previo, como el uso de un solo tipo de nave, o la política de no cobrar el equipaje extra si no es necesario. De esta manera, Southwest consigue optimizar su trabajo, no solo gastando menos dinero, sino también ofreciendo un servicio barato, simple y de calidad.

Manteniendo un sistema más simple que el de la competencia, Southwest consigue realizar dos objetivos: reducir los costes necesarios para las operaciones de la empresa, y mejorar el servicio base de la compañía.

Ésta es una de las razones por las que el modelo de negocio de Southwest no ha sido exitosamente emulado en otros países, o incluso dentro de los propios Estados Unidos, aunque el modelo en sí haya sido copiado. La mayoría de las compañías se centran exclusivamente en el modelo de negocio de bajo coste, pero no centran sus esfuerzos en mantener los procesos tan simples como sea posible, y por ello fallan. No solo los costes deben ser atendidos y optimizados, sino también la cultura organizacional y su servicio de cara al cliente final.

Esto se traduce no sólo en un servicio de calidad, y unas tarifas que son extremadamente competitivas en el mercado actual sino en una imagen inmaculada que se convierte en una alta fidelidad por parte del cliente. Por otra parte, podemos encontrar casos de compañías

de bajo coste que implementan una política de bajas inversiones en el cliente final y en su optimización de procesos, lo que se traduce directamente en una imagen atroz que tarde o temprano afecta a la compañía por completo.

En Europa podemos encontrar el ahora famoso caso Ryanair, que ha sido un ejemplo perfecto de fallo en este aspecto. Mientras que Southwest ha mantenido su fama de servicio excelente, rápido y amigable para el cliente, Ryanair ha conseguido lo contrario. A través de determinadas políticas que buscaban las ganancias a corto plazo, intentando engañar al cliente con trucos y prácticas de dudosa legalidad, para subir sus ingresos, Ryanair se ha encontrado con una muy mala fama. Aunque esa táctica ha hecho que los resultados fueran buenos desde 1990, ahora que en el mercado está empezando a aumentar la competencia y saturarse, Ryanair está pagando esta mala imagen.

El ajuste entre la cultura y la implementación de la estrategia en la compañía, es por tanto mucho más importante de lo que se puede considerar en un primer momento. Si la compañía posee una cultura que no es coherente con las estrategias formuladas, se debe de hacer un ajuste.

En el caso de Southwest, es importante observar la cultura de mantener los procesos simples. El hacer las operaciones cuanto más simples posibles, significa que la compañía tiene menos factores que estudiar, y menos errores que pueden arruinar el proceso por completo. En las organizaciones modernas, esto se puede traducir en unos costes menores, que es uno de los aspectos fundamentales en el modelo de negocio en las compañías de bajo coste.

Diversas compañías proceden a formular estrategias de bajo coste como la mínima inversión en materiales, personal y procesos. Sin embargo, la estrategia de convertir la cultura organizativa en una cultura de hacer los procesos simples, y no proceder a realizar actividades innecesarias, es la auténtica clave en las compañías exitosas de bajo coste. Southwest lidera este modelo de negocio y forma de pensar, con sus más de 40 años seguidos de éxito.

Así, a través de este estudio, hemos encontrado las auténticas causas del éxito de Southwest Airlines en los Estados Unidos de América.

Este sistema de Simple Management no sólo es útil para empresas que sigan la política de bajo coste, sino que es útil para prácticamente cualquier compañía. Haciendo los procesos

tan simples como sea posible, mejorando los canales de comunicación internos y reduciendo al mínimo la burocracia, cualquier compañía, independientemente de su segmentación de mercado puede dar un gran salto hacia el éxito.

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