Should Your Company Pull a "Southwest?"[1]

Since late 2000, the US economy has been in a malaise. Business investment has fallen, hundreds of thousands of jobs have been lost and the stock market was in a three-year slump and only now starting to gain some upward momentum. As a result, industry is suffering drastic restructuring. Phrases like "going back to our core values or returning to our traditional business models," translate to "abandoning *get rich quick* businesses and going back to what we know and do best."

That's all well and good. However, accompanying this reorganization, most firms have stopped investing in their most important assets, their people. Hiring of both new and existing staff has plummeted. In addition, training initiatives are not well supported.

The lack of professional business development training is somewhat paradoxical. Wall Street Analysts and CEOs universally are complaining about slow revenue growth, but firms are not investing in training their people to spur that growth and take advantage of now emerging opportunities.

We believe that now is the time for forward-looking companies to put programs in place to capture the next wave of economic prosperity. While economic data is still mixed, the preponderance of the key indicators point to accelerating economic growth over the next 12 months, barring any additional unplanned geopolitical events.[2]

Given this set of circumstances, what should a firm do?

- Lean down to traditional businesses and sit on the sidelines until the evidence of economic rebound is clear, or;
- Validate their core business model; make appropriate people and business training investments and attack markets with a vengeance.

The Southwest Story

A recent lesson from history will provide support for the latter strategy in these unclear times. On September 12, 2001, Herb Kelleher, James Parker and Colleen Barrett, the senior executive team of Southwest Airlines, awoke to a devastated industry after the tragic attacks of September 11. As the executive team stated later, "For the airline industry, this

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[1] Due to publishing lead times, this article was written in early May 2003. By providing this date, readers can appreciate the time context of the article's content.
[2] Anders, Jason, "Economist Predict Growth Will Stay Modest Into 2004 – Expansion Will Accelerate Following War But Other Worries Remain," May Update of Wall Street Journal's Semiannual Economic-Forecasting Survey, May 9, 2003, Online.wsj.com.

was not merely Dante's purgatory. It was indeed, Dante's pure "hell," created in one amazing and tragic day."[3]

Over the next few weeks Southwest watched as their competitors implemented the following strategies:

- Deferring and canceling scheduled new aircraft deliveries;
- Determining how many flights to cut and how many employees to lay off;
- Engaging bankruptcy legal counsel.

However, where the airline industry saw economic devastation, Southwest saw opportunity. It implemented the following strategy over the last 3 months of 2001:

- Operated 100 percent of its aircraft capacity;
- Provided 100 percent job security with no layoffs for their employees;
- Maintained their long-term commitment to employee training, including customer service agents who typically earn less than $10/hour;
- Funded employee profit sharing in the amount of $197.5 million;
- Increased 2001 fourth quarter capacity by 6.4% over 2000 levels; and consequently,
- <u>Increased market share by 2.0%!</u>

What were the results of a strategy that was completely at odds with the rest of their industry?

- A net profit of $63.5 million for the fourth quarter 2001 with 100% employment; while,
- The rest of the industry reported a loss of $3.3 billion for the same time period and "furloughed" 100,000 employees without pay.

The skeptics will now say, "Well Southwest was lucky in 2001. What did they do in 2002?" The wisdom of their business model and strategy proved to be even more compelling in 2002 when Southwest accomplished the following:[4]

- Expanded its share of the domestic airline market to 10 percent by adding a net 20 aircraft;
- Increased Shareholders equity by $407.6 million;
- Maintained their commitment to employee training; and,
- Provided job security for 33,705 active employees and a $155.6 million contribution to their collective profit sharing and savings plans.

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[3] Kelleher, Herbert; Parker, James; and Barrett, Colleen, Shareholders Letter, February 1, 2002, Southwest Airlines 2001 Annual Report, Dallas, Texas, February 2002.
[4] Kelleher, Herbert; Parker, James; and Barrett, Colleen, Shareholders Letter, January 20, 2002, Southwest Airlines 2001 Annual Report, Dallas, Texas, January 2002.

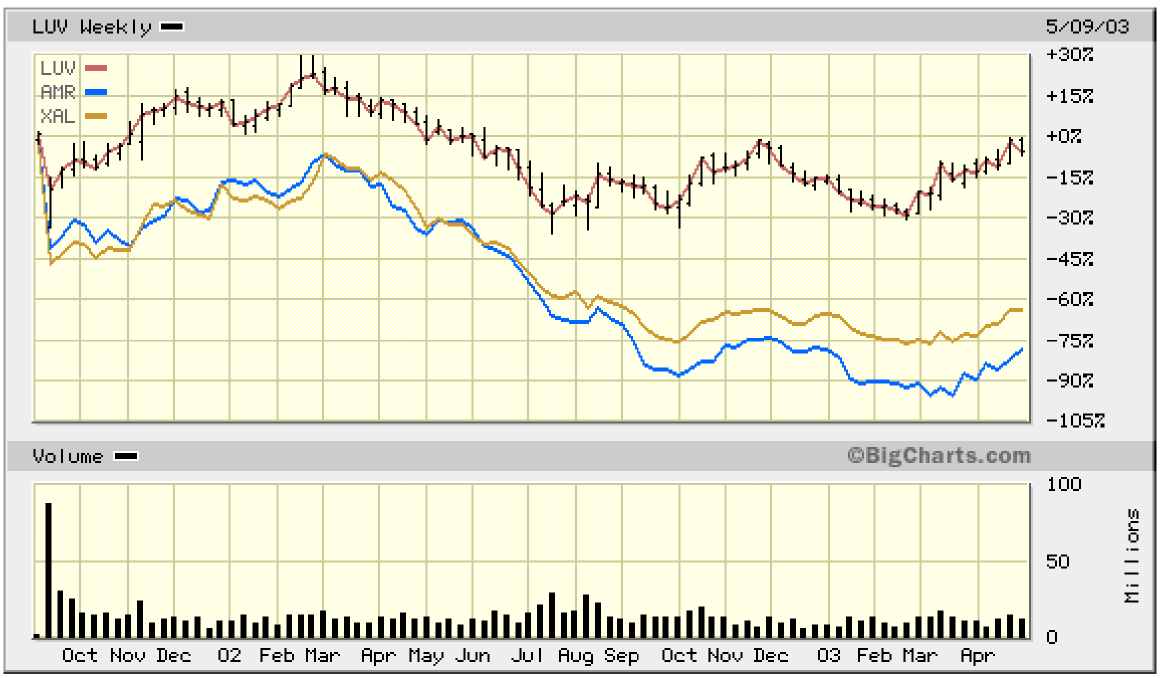
Meanwhile, the rest of the US airline industry reported an aggregate net loss of $10 billion, and two companies filed petitions for bankruptcy. *At the end of 2002, Southwest Airlines' market capitalization (or total stock market value) exceeded that of all other major airlines, combined.*

The impact of this strategy on their stock price is demonstrated in chart one. This chart tracks the performance of Southwest Airlines (LUV) stock from September 10, 2001 till early May 2003 and compares that performance to the airline industry as a whole (XAL) and American Airlines (AMR), the world's largest airline in fleet size.

As indicated, Southwest's stock is almost back to where it was before September 11, 2001, while American's is down about 80%, and the combined industry is down about 63%.

So, the new phrase for business strategists when facing adversity: "Should we pull a Southwest?"

Chart One
Southwest Airlines, American Airlines and Airline Industry Index Performance September 10, 2001 to May 9, 2003



Lessons Learned

What lessons can be learned from Southwest's experience? When facing adversity and uncertainty, we recommend you:

- Reaffirm or return to your traditional business model. Southwest's business model was perfect for the times, since they had the lowest operating costs in the industry.
- Align your strategy. Southwest's organizational design, cost structure, marketing, sales and operations all align with its over all strategy.
- Invest in your people – they are critical to your long-term competitive advantage. This includes training them to ensure they are delivering at their peak performance in all areas.
- Move aggressively when opportunity presents itself, even if the opportunity was the result of a tragedy or scandal. The "hunker down" approach is deadly … no matter the industry.

Implications for Your Company

Many business executives are pondering their future post-Iraq War/post-Enron strategy. Should we stay in the bunkers with our attendant lack of investment, or should we move proactively within our traditional capabilities to secure operational efficiencies and spur revenue growth?

MBD^i believes now is the time to invest in those initiatives that positively impact revenue results. This includes retooling your sales and marketing teams for the current economic environment that demands not only an improved effectiveness, but also a proactive, customer-focused mentality. Investments in training and other productivity tools will pay handsome dividends to those managements that have the vision and courage to implement proactive, value-driven business models.

In short, should you "pull a Southwest?" Should you invest in your people to gain a significant advantage as this economy emerges from its malaise?

The legendary college basketball coach, John Wooden, may have said it best:

To do better in the future you have to work on the "right now."[5]

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[5] Wooden, John, with Steve Jamison, "Wooden: A Lifetime of Observation and Reflections On and Off the Court," Contemporary Books, 1997, Chicago, IL, p. 184.