Herb Kelleher

Southwest Airlines

Introduction

Herb Kelleher created Southwest Airlines with partner Rollin King in 1967. After years of litigation fighting for the legal right to offer its service, Southwest debuted its first flight in 1971, turning its first profit in 1973. Southwest has flourished ever since, turning a profit every year thereafter even at times when other airlines were bleeding red ink through fare wars, recessions, oil crises, and other disasters.

Kelleher created Southwest's success while defying some of the standard practices of the airline industry. For example, Kelleher eschewed travel agents and the computer reservation system. For years, he offered no frequent flyer program and conducted no yield management. He never implemented a hub. And all the while, he offered deeply discounted fares.

Customers flocked to Southwest for its cheap fares, convenience and dependable, light-hearted service. Analysts and academicians pointed to Kelleher's tight cost controls and high capacity utilization as the keys to Southwest's success, recognizing that the degree of their effectiveness is attributable to Kelleher's people management. Southwest's work force is described as loyal, with a sense of family and Southwest has enjoyed the industry's lowest turnover. During tough times, Kelleher never resorted to laying off employees.

Kelleher stepped down as CEO and president on June 19, 2001. Jim Parker, the company's longtime general counsel, became Southwest Airline's new CEO and Colleen Barrett, who started out as Kelleher's assistant, was named Executive Vice President. Kelleher remained as chairman of the board and has left us all with a remarkable and inspiring story.

Background

In late 1966 Rolling King, owner of a small, Texas commuter air service, pitched the idea of an intrastate airline to Herb Kelleher. At the time, Kelleher had a small law practice in San Antonio, Texas and Colleen Barrett was his legal assistant. Kelleher liked the air service idea and he and King went to work, incorporating Southwest Airline Company in 1967. They planned to offer the new air service to three Texas cities: San Antonio, Dallas and Houston - fast-growing cities too far apart to conveniently access by ground transport. And, by serving only Texas cities, the airline bypassed federal government jurisdiction, giving Southwest autonomy over its schedule and fares[1].

True to the industry's nature, competing airlines fiercely fought this new entrant. Kelleher filed Southwest's application to fly on November 27, 1967. It would be four years before Southwest gained the right to fly.

On February 20, 1968, Southwest's application to fly was approved. The next day, Braniff, Trans Texas and Continental won a restraining order prohibiting Southwest from receiving a certificate to fly in Texas[2].

Kelleher had anticipated a litigious beginning, and he and King raised twice the capital they expected to need, to cover legal costs. They sought that capital from top Texas politicians and business leaders, raising $543,000[3].

However, Southwest lost its first trial to obtain a certificate to fly. Southwest appealed, and the case went to the Texas State court. Southwest lost again. By this time, Southwest had burned through its $543,000 and several board members thought it was time to quit. Kelleher persevered, persuading the board members by offering to pay Southwest's court costs out of his own pocket and deferring his own pay.[4] Southwest appealed again and this time the Texas Supreme Court overturned the decision.

Braniff, Continental and Trans Texas appealed the Texas Supreme Court decision to the U.S. Supreme Court. The Court refused to hear the appeal, and so, in late 1970, Southwest received its certificate to fly.[5]

The competition wasn't ready to quit. They filed complaints with the Civil Aeronautics Board (CAB) to protest Southwest's service. Two days before Southwest's inaugural flight, the CAB threw out the complaints. The competition had by then obtained a restraining order, grounding Southwest's upcoming flights. Kelleher immediately flew to Austin to wrangle a last-minute Supreme Court meeting. He was granted a meeting with all of the justices the following morning; Kelleher spent the entire night preparing his case. The following day, the Texas Supreme Court ruled again in Southwest's favor and ordered the lower court not to enforce the injunction. That is how, on June 18, 1971, Southwest Airlines finally inaugurated its first flight.[6]

This fierce fight for survival served two important roles at Southwest. First, it delayed its operations for several years, draining Southwest's funding and jeopardizing its future. Second, it infuriated Kelleher, his colleagues and employees, creating a warrior mentality at the fledgling airline and laying the foundation for a united culture to which Southwest's future successes would be attributed.

Southwest's Humble Start

Although finally cleared for takeoff, few passengers were buying seats on Southwest flights. A series of savvy moves helped boost its passenger loads. One of its earliest ideas endures today: provide service to convenient, downtown airports wherever possible. In the beginning, Southwest implemented the strategy to boost weak demand in Houston, a move that distinguished Southwest from its competitors and doubled its passenger loads.[7] The idea worked so well Southwest turned the idea into a strategy that has benefited the airline and its customers enormously.

A second smart idea resulted in pioneering off-peak fares - an experiment that tapped the latent consumer demand for low fare leisure air travel and has fueled Southwest's revenues ever since. The idea was the result of penny-pinching then-CEO Lamar Muse. Muse was bothered by the empty planes that flew back to Love Field for servicing, and decided on an experiment: he would offer the seats on the Dallas-bound flights headed to home base for servicing to customers at deeply discounted fares[8]. These were late-night flights unpalatable to the business traveler and Southwest expected little demand for the seats. With little marketing support, however, the seats sold out in record time. It wasn't business travelers buying the seats, but grandmothers and college students, average consumer travelers eager to fly for the right priced ticket. Southwest coined the flights and fares "off-peak" and the concept has taken off among all airlines since.

Southwest also made excellent marketing decisions. During its fare wars, Southwest made extremely successful appeals to consumer sentiment and the tendency to "root for the underdog". Another brilliantly successful fare war tactic was to offer free liquor to business travelers who paid full fare. Both tactics helped Southwest weather the war and encouraged its competitors to end the battles quickly. But it was the decision to stay at Dallas' Love Field that fueled its marketing efforts, image and culture for years to come.

The Love Field Fight

As previously noted, one of Southwest's earliest successful strategies was to service the convenient downtown Houston airport to provide the most appeal to its business customer. However, Houston city officials disapproved when Southwest switched its service to downtown Hobby airport from the recently-completed Houston Intercontinental Airport located just outside the city. When Southwest informed Dallas officials it would continue to serve centrally-located Love Field, instead of moving to the new Dallas-Fort Worth Airport, officials banded together and took action. City officials from Houston and Dallas sued Southwest for breach of contract.[9] It was a devastating blow to Southwest: not only would DFW's inconvenient location deter customers from flying Southwest (instead of driving) but the higher costs of serving DFW could drive Southwest out of business.

The suit's foundation lay in its bond provisioning. The bond funding construction of DFW Airport specified that all certificated airlines must move their operations to DFW Airport. Kelleher discovered the "certificated" loophole - luckily for Southwest, the airline had never been certificated - and Southwest got to stay at Love Field.[10] Not only that, but the entire Love Field" controversy had generated a great deal of press coverage. Southwest incorporated "love" and Love Field into its branding, initiating an extremely successful advertising and marketing campaign for years to come.

A 30-Year Growth Spurt

From the beginning, Kelleher, then a board member and the airline's chief counsel, was Southwest's "master strategist"[11] and led development of its point-to-point, intra-Texas, discounted fares for business travelers.

Southwest considered the automobile its primary competition, and priced its flights to present a faster, more convenient alternative to driving. Its 1971 premier flight from Dallas to Houston cost $20 per ticket. The cheap fares were revolutionary. Other airlines charged three times as much. To make money on such low fares, the upstart airline was very strict on minimizing costs. From the beginning, that meant no frills. As time went on, those cost savings expanded to include a fast turnaround - 10 to 20 minutes in and out of the gate. Since then, Southwest's business model hasn't changed. Its planes have never served a meal and the 20-minute-turnaround is a Southwest hallmark. As a result, Southwest's costs are 22% below the industry average. Its operating margins (16.5%) are triple the industry average.[12]

In 1982, SWA's then-CEO Howard Putnam departed for Braniff and the board insisted Kelleher assume the role of CEO. With 27 planes, $270 million in revenues, and 2,100 employees, Southwest was then flying to 14 cities. By 2002, it was a $5.7 billion business, with more than 33,000 employees, flying to 58 cities--from Ft. Lauderdale to Boston to Los Angeles and Chicago. At $14.5 billion, Southwest's market capitalization was bigger than American's, United's, and Continental's combined. And it still offered some of the cheapest fares in the industry: a one-way ticket from Nashville to New Orleans cost $56.[13]

Kelleher's Strategy

Kelleher's strategy, broadly stated, was low cost, low fare, and strong-but-manageable growth to yield high profits. Specifically, Southwest appealed to customers with affordable, enjoyable, reliable service and made that service profitable through tight cost controls and high capacity utilization. At the heart of it all -- the key to the successful implementation of cost controls, great service and 20-minute turnarounds -- were Southwest's employees.

Kelleher's Cost Savings Approach

Kelleher took a direct approach to the airline business - on many points, the reverse strategy of other airlines and one nobody thought would be successful. This direct approach afforded him tremendous cost savings and included such elements as bypassing travel agents and selling directly to his customers. This approach alone saved SWA between 5 and 10% of each fare, a savings no other airline enjoyed. A second cost savings occurred when he rejected the computer reservation system to which most airlines paid a fee for each reservation. A third major differentiation and cost savings was to offer no meal service or other in-flight frills.

In return for the no-frills flight, Kelleher offered in-flight thrills. SWA began by selling sex appeal, advertising hot-pant-clad flight attendants and service to Dallas's "Luv" field. A decade later, when hot pants were no longer fashionable and the flight attendants began balking at the attire, Kelleher switched its emphasis to "fun, friendly, relaxed" atmospheres on the flights, emphasizing friendly, joking staffers in shorts and sneakers.

A fourth, key cost control that Kelleher implemented and maintained, contrary to all other airlines, was to only purchase Boeing 737 aircraft. By training pilots and mechanics only on 737s and having access to the interchangeable parts, SWA earned tremendous training and maintenance efficiencies.[14] Although Kelleher resisted the temptation to buy flashy new airplanes, he did allow some of his new 737s to be painted to resemble the Texas flag and Shamu, a popular whale at Sea World, for one of the more successful airline public relations campaigns in memory.

A fifth important cost control was to carry a low debt load, giving SWA low interest costs, especially relative to other airlines. Sixth, Kelleher held off expanding into new markets until assured there was sufficient demand for a minimum of 4 daily flights. A side benefit of this approach was that as SWA expanded slowly, it also added new employees slowly, preserving its culture.

Kelleher's Capacity Utilization Approach

Southwest's capacity utilization is remarkable, even today, in the airline industry. In mid-1972, Southwest had been in business one year but was not yet self-sufficient. In financial jeopardy, Kelleher was readying to sell a plane. The sale of one of his four jets meant a 25% reduction in capacity which, in turn, meant layoffs. His employees created an unheard-of plan and brought it to Kelleher: maintain the existing four-plane schedule with only three planes[15].

It required an unbelievable ten-minute turnaround at the gate, but Kelleher gave it a go. Everybody pitched in - pilots and management helped with the bags, flight attendants streamlined the cabin clean-up and ground crews revamped the beverage re-stocking process. The 10-minute turnaround accomplishment, combined with the uncomplicated back-and-forth, city-to-city schedule, kept Southwest's planes in the air an average of nearly 12 hours a day, far above the industry average. [16]

Another key element in the turnaround is Kelleher's point-to-point service approach, rather than the hub-and-spoke flight schedules favored by the industry. The back-and-forth service enabled the ten-minute (now 15 or 20-minutes, due to congestion and safety regulations) turnaround and the greatly increased flight schedule per plane.

Kelleher's People Strategies

Kelleher once related, "my mother told me that in business school they'd say, ‘This is a real conundrum: Who comes first, your employees, your shareholders, or your customers?' My mother taught me that your employees come first. If you treat them well, then they treat the customers well, and that means your customers come back and your shareholders are happy."[17] Kelleher followed this advice and the corporation's enjoyed a nearly 30-year profit growth streak, the lowest turnover rate in the airline industry - 9%[18] and "the industry's fewest customer complaints, the fewest lost bags, and the most on-time arrivals."[19]

Kelleher exemplified the "employee first" philosophy in his people policies. His managerial toolbox included, first and foremost, an extremely selective hiring process. According to Fortune magazine, "…SWA hires only 4% of nearly 90,000 yearly applicants. The time and money spent on the hiring process … has enabled Southwest to maintain a strong, unified culture in the face of enormous growth and to groom management talent within it. Less than five "outsiders" hold senior management positions at the airline, and many began their careers in entry-level positions. EVP Colleen Barrett, for example, started out in 1971 as CEO Herb Kelleher's legal secretary."[20]

Once hired, Kelleher utilized several important managerial tools to serve his employees. Several of the key ways in which he did so included:

1. Empowerment
   Kelleher's organization was much leaner than many, greatly empowering his employees. Kelleher once said "we are not an airline with great customer service. We are a great customer service organization that happens to be in the airline business."[21]

   With this philosophy, Kelleher gave his employees the instruction and leeway to "do the right thing"[22]. For example, Southwest gate agents were empowered to make decisions and even break rules in order to best serve customers. Kelleher believed strongly in acting quickly; empowering his employees was one of his best tools in ensuring that situations were efficiently and satisfactorily resolved.

2. Communication
   Kelleher believed strongly in communication, and Southwest was "fanatical about making information readily available to the front line. Employees have the opportunity to learn every aspect of the business … the solid knowledge of the company gives the people of Southwest Airlines the confidence and power to truly make a difference in the lives of their customers."[23]
3. Positive Culture
   Analysts attribute Southwest's success in no small part to the culture Kelleher has created. According to Kelleher, "Our esprit de corps is the core of our success. That's most difficult for a competitor to imitate. They can [buy] all the physical things. The thing you can't buy is dedication, devotion, loyalty--feeling you are participating in a cause or a crusade."[24]

   Kelleher was a gifted leader and instilled a sense of ownership and pride in Southwest among his 25,000 employees. The fierce pride and ownership, and the tradition of sharing it with employees, traced back to the firm's early-days warrior mentality. Kelleher is also credited with having created a family atmosphere - and actively promoted the family sentimentality. In his written communications he often reaffirmed his love for the employees, crediting them with making Southwest a success.

   Another tool in creating a positive culture was recognition of good work and major milestones. Recognition was commonplace at Southwest, rewarding and celebrating employees' excellent contributions. In addition to the Annual Awards Banquet, a major celebration honoring employees' achievements, Southwest awarded "special awards from year to year to honor unique contributions."[25] Some of those special awards included the Sense of Humor, Most Spirited In-Law, Tell It Like It Is, Hairdresser of the Year and Positively Outrageous Customer Service awards.[26]

   Clearly, a critical element in creating a positive culture was Kelleher's leadership in having fun on the job. Southwest was legendary for its flight attendants and their penchant for lighthearted, irreverent fun. Flight attendants were famous for singing hellos and good-byes and telling jokes over the speakers. Southwest's Halloween observance was also legendary and at corporate headquarters and Southwest gates alike, Halloween meant raucous gate parties with costumed employees.

Even as Southwest grew into a large corporation Kelleher perpetuated the culture through new hires. As related in Fortune magazine's May 2001 article:

> Once hired, employees go through rigorous people-skills courses at the University for People, Southwest's training center in Dallas. In one recent class a group of new hires learned to read body language. One demonstrated "negative body language" by stomping past another, head down, hands folded across her chest. In another class a group of mechanics learned the art of positive reinforcement. "If one of your guys is having a bad day, instead of telling him what a bad job he's doing, maybe it's better to say, 'Hey, you've been doing a great job. Here are some ways you can do even better,' " offers one student, Steve Dosset. To protect Southwest's tradition out in the field, the company has set up "culture committees" at each airport it goes into. They are responsible for making sure the new site carries on the spirit of Southwest: the gate parties, the jokes, and the games. So far the committees appear to be paying off. At one recent gate party in Islip, N.Y.--1,600 miles from headquarters--Jeff Haag, a young customer service rep who's never met Kelleher or worked in Dallas, gushes, "This is what Southwest is about--our culture, it's huge!"[27]

4. Employee Ownership
   In addition to implementing an employee stock ownership program, Kelleher was known for instilling a sense of ownership in his employees:

   > Southwest's "esprit de corps" and sense of ownership made the difference during the rising fuel cost crunch plaguing the airlines in 2000. In February 2000, Kelleher sent a letter about the current fuel crisis to all of his employees. Jet fuel was $1 a gallon, three times the previous year's cost. Southwest was using 19 million gallons a week. "Our profitability is in jeopardy," Kelleher wrote. He asked each worker to help out by saving $5 a day, which would, he explained, save Southwest $51 million annually. The response was immediate. One department offered to do its own janitorial work. A group of mechanics figured out how to heat the planes more cheaply. Within six weeks employees had already saved the company more than $2 million.[28]

   Kelleher also instills a sense of ownership through showing respect for employee's ideas, saying:

   > "if you need a suggestion box, then you're not doing what you should be doing. You shouldn't have to interpose the box between you and the people with the ideas. You ought to be talking to them on a regular basis. You ought to be with your people enough that they are comfortable to just pop on in and give you their ideas." [29]

   Kelleher's rule at Southwest is:

   > "If somebody has an idea, you read it and respond to it instantaneously. The answer may be no, but (the employee) is given a lot of reasons why you're saying no, or you may say we're going to experiment with it in the field, see if it works. But I think showing respect for people's ideas is very, very important because as soon as you stop doing that, you stop getting ideas."[30]

Conclusion

Herb Kelleher and Southwest Airlines have a remarkable story.

From the legal battles, so fierce and costly that it's remarkable that Kelleher chose to persevere, to its unblemished growth and profitability record, Southwest is unique in the airline industry. Analysts point to Herb Kelleher's tight cost controls, high capacity utilization and emphasis on profitability as well as its productive work force. Kelleher might point to a lean organizational structure, scenario planning and managing in good times for bad times, and the people who've made it all happen.

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1 Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: pp26.

2 Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway Books, 1996: p. 16.

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6 Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: p 27.

7 Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway Books, 1996: pp 22-23.

8 Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: p. 33.

9 Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway Books, 1996: p. 24.

10 Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: p. 28.

[11] Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: pp26.

[12] Booker, Katrina. "The Chairman of the Board Looks Back." *Fortune*, May 28, 2001.

[13] Ibid.

[14] Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: pp286.

[15] Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: pp31.

[16] Petzinger Jr., Thomas. *Hard Landing*. New York: Time Books, 1995: pp286.

[17]Colvin, Geoffrey and John Huey. The Jack and Herb Show." *Fortune*, January 11, 1999.

[18] Booker, Katrina. "The Chairman of the Board Looks Back." *Fortune*, May 28, 2001.

[19] Ibid

[20] Booker, Katrina. "The Chairman of the Board Looks Back." *Fortune*, May 28, 2001.

[21] Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway Books, 1996: p. 282.

[22] Ibid

[23] Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway Books, 1996: p. 285.

[24] Ibid

[25] Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway

Books, 1996: p. 193.

[26] Freiberg, Kevin and Jackie Freiberg. *Nuts*. New York: Broadway Books, 1996: p. 194.

[27] Booker, Katrina. "The Chairman of the Board Looks Back." *Fortune*, May 28, 2001.

[28] Ibid

[29] Ibid

[30] Ibid