

Southwest Airlines Corporation:
A Domestic Industry Analysis & Recommendation for Expansion

Joel L. Thomas

Chancellor's Honors Program
University of Tennessee
Senior Project

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Executive Summary

After almost thirty years of service, Southwest Airlines has emerged as one of the world's premier airlines. The Southwest approach to business and the industry at large have enabled the company to continue to grow at profit in times of true economic downturn. Presently, the market for air carriers is saturated and highly fragmented. Overcapacity has led the major United States airlines to compete with Southwest's low fare pricing strategy. However, due to the company's brand image of efficient and effective low fare service, Southwest has been able to ward off its competitors (e.g. Delta, United, and American Airlines) and maintain its position of market share leader in the United States. As the industry becomes increasingly commoditized and US demand slows, it is time for Southwest to consider global options so that it ensures its presence in the future, while maintaining profitability.

Southwest Airlines should seek global expansion by way of Asia. The emerging Asian market, already a major part of the world economy, will become an even bigger factor. Given the declining nature and saturation of the American domestic airline industry, Southwest should seek to implement short to medium haul, low fare operations abroad. A hypothetical network might include China, South Korea, Japan, and Taiwan. Instead of offering transcontinental service, for example United States to Japan, these hypothetical lines of operation should be explored within in Asia. An international move like this could maintain Southwest's position as market share and low cost leader for years to come.

United States Airlines Industry

The United States commercial airline industry was forever changed in October 1978, when President Jimmy Carter signed the Airline Deregulation Act. Prior to the deregulation, the Civil Aeronautics Board regulated airline route entry and exit, mergers acquisitions, passenger fares, and airline rates of return. During this time, two or three airlines might provide service in a given market; but, each route was covered by only one carrier. Price competition was virtually nonexistent, leaving the various costs increases associated with air travel to be passed along to customers. As described by Professor Inkpen and DeGroot in their case for Thunderbird, the airline industry operated on the basis of two distinct markets: “those who could afford to fly, and those who could [not]” (1).

Deregulation caused airline fares to reach record lows and allowed many new firms to enter the market. Subsequently, the fuel crisis of 1979, the air traffic controllers’ strike of 1981, and a recession all added to major difficulties during the first decade of deregulation. This period of time saw more than 150 startup airlines collapse into bankruptcy. However, experienced carriers fared no better with eight of the eleven major airlines dominating the industry in 1978, filing for bankruptcy, merging with other carriers, or simply exiting the industry. Three major carriers were able to maintain throughout this crisis—Delta, United, and American—ending with a combined 80% of domestic air traffic and 67% of trans-Atlantic business (Inkpen and DeGroot 2).

Emerging airlines created competition for the already established larger carriers, leading to lower prices for customers and an increase in demand that grew exponentially. By the mid 1990s the airline industry suffered from lost sales, as they struggled to meet demand. Inkpen and DeGroot report that air travel increased from 200 million customers in 1974 to some 500 million by 1995 (3). Despite this overwhelming increase, there were only five new runways built during this time period. As a result, the 1980s saw many airlines taking on substantial long-term debt to increase service levels and to meet the ever increasing demand. Despite the initial financial problems created by the deregulation, new firms continued to enter the market. According to FAA records, sixty-nine new airlines were certified from 1992 to 1995. The new low fare airlines created a second tier of service providers, which the “Thunderbird Southwest Airlines” case attributes to saving customers some billions of dollars annually. These smaller airlines were also able to gain market-share in those areas that had generally been ignored by major carriers.

Southwest Airlines History

In 1966 Rollin King proposed, to his then lawyer Herb Kelleher, the idea of creating a short-haul airline that would be comparable to the California based Pacific Southwest Airlines. It was determined that the airline would only fly within Texas to avoid federal regulations. The three cities that the airline would initially operate were

Dallas, Houston, and San Antonio. From the outset the company faced fierce opposition from other Texas –based airlines (i.e. Braniff, Continental, and Texas International). However, Keller argued his case before the Texas Supreme Court and won. The airlines tried to appeal to the US Supreme Court, which refused to hear the trial.

By late 1970, Southwest was ready for takeoff and was equipped with three surplus Boeing 737s. Braniff and Texas International still posed a threat to Southwest's getting off the ground. The two companies somehow managed to get the underwriters for Southwest's initial public offering to withdraw, and a restraining order against the company was obtained two days prior to the inaugural flight. Once again, Kelleher argued his company's case before the Texas Supreme Court, receiving a favorable ruling a second time. SWA began flying the next day, June 18, 1971. In the Friebergs' study of Southwest's success they note that the carrier began operations with only the three planes and twenty-five employees. Human resource management seemed to be a defining factor for Southwest's advantage from the beginning. Their study also mentions the flamboyance of the personnel, noting that the flight attendants in the early days of operations wore hot pants. Location became a source of advantage as well, with the initial flights from Dallas and Houston exiting from locations closer to downtown than the international airports.

In the beginning months of operations, SWA management quickly discovered that there were two types of travelers: 1) convenience, time-oriented business travelers; and 2) price-conscious leisure travelers. As a result, Southwest developed a two-tiered pricing structure. Southwest quickly outperformed the competition in all of its target segments.

It seemed that the only problem involved convincing customers that the airline's prices were regular rates, and not promotionally priced.

Philosophy and Culture

As the largest carrier in terms of scheduled domestic departures, Southwest prides itself on flexibility, family-orientation, and fun. The airline's success and profitability stem from a lack of structure among employee/union relations; and, this transfers over to customer service. Although there is no formal structure according to labor unions at SWA, employees views are always listened to as part of management decision making. As CEO, Herb Kelleher was highly noted for his commitment to employees. Joan Magretta quotes him in an interview stating:

"if they're [employees] happy, satisfied, dedicated and energetic, they'll take real good care of the customer. When the customers are happy, they comeback. And that makes the shareholders happy." (199)

Family and friendship continues to be a staple of the SWA culture. Terminal walls are lined with photographs of employees, and television commercials showcase real Southwest employees. Also, the company boasts some 1,000 couples employed here.

SWOT Analysis

Threats

As of late, one of the greatest threats to Southwest Airlines are the ever increasing prices to crude oil and jet fuel. In October and March of 2005, crude oil prices peaked to a then high \$55 a barrel. However, the Wall Street Journal records the most recent crude oil prices nearing \$75 a barrel. With demand in the United States steadily increasing and the release of stores from OPEC remaining low, despite increased production, jet fuel prices can be expected to rise. Using March 2005 prices as a benchmark in which jet fuel prices were \$57 a barrel, current prices can be expected to be in the neighborhood of \$76-78 a barrel. Datamonitor, a business information company that specializes in industry analysis, records that while SWA is 85% hedged with derivatives that cap jet fuel prices, this still leads to higher fuel costs and pressurized margins (8).

Demand fluctuations also generate a major threat for Southwest Airlines and the industry at large. Since the airline industry is service based, variability depends solely on the buying patterns of customers. Customers buying patterns are linked to economic and environmental conditions and trends. Being a solely service-based company, if SWA fails to sell a seat on a plane the result is a lost sale for the company. The company is unable to hold inventory, or recoup what might have been from a future sale. Therefore, forecasting demand as accurately as possible becomes an ever important aspect of the industry. Running too many flights or planes during off-seasons can greatly raise

operational costs for the company in terms of maintenance, labor, administrative expenses, and depreciation. Southwest's first and fourth quarter (winter) operations normally reflect a deduction in travel demand (Datamonitor 8). In recent history, the events of September 11, 2001 and the ongoing war in Iraq have caused the typical seasonal fluctuations to be less predictable. These things further impact financials, making the firm's short-term liquidity condition more irregular.

Competition for customer demand among all airlines that fly nationally can be viewed as a threat to Southwest Airlines. SWA's low fare, short-haul strategy created many imitators. According to an Aerospace and Air Transport Survey conducted in 1996, by the second half of 1994 low fares were available on more than one-third of the industry's total capacity. However, most of these imitators were start-up companies. The most successful major airline to compete directly with Southwest within the target-market is the Shuttle, by United. United launched the Shuttle in October 1994 with many of the same operational elements as Southwest (i.e. a fleet of 737s, low fares, short-haul flights, and less restrictive union rules). The Shuttle offered basically a no-frills service, but maintained assigned seating and offered access to airline computer reservations systems online.

Currently, the United States market has become saturated in that the number of available flights far exceeds the demand for business and leisure customers. Overcapacity has lead US carriers to pull down costs by any means. Since 2000, the industry has witnessed a tremendous downturn, in which more than 110,000 people have lost jobs, experienced wage reduction, and declining pensions. United Airlines and US

Airways are engulfed in bankruptcy, with Delta also running in high losses. These factors have led most airlines in the United States to adapt to the low cost carrier mold. This market has historically been Southwest Airlines niche segment within the industry. With all major airlines cutting fares, increased competition within the low cost segment will begin to decrease Southwest Airline's stronghold on market share.

Opportunities

Expanding its services to new areas is Southwest's primary opportunity to gain more market share. Since 2004, Southwest has begun an expansion campaign that created three new flight services in that year. These include Philadelphia, PA to Hartford, CT, Philadelphia to Jacksonville, FL, and Philadelphia to Oakland, CA. In January 2005, Southwest announced that flights would begin to be offered to and from Pittsburgh, PA by May of that year. April 2005 saw Southwest continue expansion even further, with the announcement that new nonstop flights would be added in the following regions: Baltimore/Washington, Fort Lauderdale/Hollywood, Las Vegas, Long Island/Islip, Oakland, Orlando, Philadelphia, Raleigh-Durham, San Diego, Tampa Bay, and West Palm Beach (Datamonitor 6). All these added services should boost future revenues for the company. As low cost seemingly becomes the industry trend, increasing the number of service areas to make Southwest readily available should be a primary goal.

In December 2004, Southwest was selected as the winning bidder at a bankruptcy auction for various ATA Airlines assets. The following January saw Southwest begin codesharing with the Chapter 11 filed ATA Airlines. As a result, SWA was able to connect Chicago Midway with the following ATA destinations: Boston Logan Airport, Denver International Airport, Southwest Florida International Airport (serving Fort Myers/Naples), Honolulu International Airport, Minneapolis/St Paul International Airport, New York's LaGuardia Airport, Newark Liberty International Airport, San Francisco International Airport, Sarasota-Bradenton Airport, St Petersburg/Clearwater International Airport, and Ronald Reagan Washington National Airport (Datamonitor 7). These events have enabled Southwest to further expand into various regional markets at liquidation prices. Both ATA and Southwest are known for their low fares, so the acquisition of assets as well as codesharing correlates with Southwest's corporate goals and strategies.

Recently there has been positive outlook for the United States airline industry, as the declining industry has experienced recent growth. The Bureau of Transportation Statistics (BTS) reports that 2004 saw an increase of 7.2% more domestic passengers and 3.3% more domestic flights from 2003. In a similar report, BTS announced a 4.1% increase in passenger traffic in 2005 from 2004. Although the industry continues to suffer from overcapacity, these are signs of improvement. If this trend continues, Southwest, which performed with relative strength amidst the downturn, should benefit from an increase in revenues as a result of customer confidence and increased investment.

Weaknesses

Mergent Online reveals that Southwest currently sits in a poor short-term liquidity situation. Year end reports for 2005, shows SWA has a current ratio of 0.94 and a quick ratio of 0.72. In comparison, the average current ratio among the airlines industry was 1.3, while the average quick ratio was 0.9. While Southwest airlines numbers are low, they do not compare well with the industry average either. This in turn creates a disadvantage for the airline.

Southwest Airlines has remained free of alliances within the industry. Many major United States airlines have created marketing alliances. They include Northwest Airlines/Continental Airlines (these two airlines are also part of the global SkyTeam alliance), American Airlines/Alaska Airlines, and Continental Airlines/America West Airlines. Southwest's recent codesharing with ATA was more a result of the acquisition of certain assets, than due to alliance. Marketing alliances allow the company to expand the flight network available to their customers, without having to invest as much capital as would be required for acquisitions or establishing a base at a new destination (Datamonitor 7). Furthermore, alliances allow the company to take advantage of larger fleets without having to purchase new planes. Southwest's not partnering with another strong industry player could limit the airline's offering.

Strengths

Southwest's greatest strength is its ranking number one in US domestic airlines, in terms of number of passengers, by the BTS. In 2004, Southwest was recorded by the bureau's statistics as serving an amazing 81,121,296 passengers, accounting for 12.9% of total passenger enplanements (4). If trends continue, Southwest will continue to stay far ahead of its closest competitor Delta Air Lines. In 2004, Southwest recorded 1.7 million more enplanements than Delta. Currently, Southwest serves more than 59 cities in 31 states and operates more than 2,900 flights each day. SWA's market leadership helps the company effectively counter competition.

Southwest's low cost business model is of equal importance to success. One of Southwest's primary competitive advantages is its formula for achieving low operating costs across the system. The airline has the lowest costs on a per mile basis of all the major airlines, as recorded by Datamonitor (6). Contributing factors to this low cost structure include the use of a single aircraft type and the highly efficient, high-frequency ad point-to-point route scheme. Due to the commoditization of the industry, passenger profiles have changed with business and first class seat demand in great decline. This correlates perfectly with Southwest's position of no assigned seats or class designations. Competing companies have been forced to introduce low fare options in attempts to regain lost market share from low priced air carriers. Because Southwest's strategy has

always been low cost, and standardized travel, they have not had to change strategy. This has saved them what could amount to millions on restructuring costs. As a result, the company now benefits from its long time distinction as the low cost airline leader, which allows the company to capitalize significantly off of brand recognition.

Despite lower than industry average short-term liquidity ratios, Southwest Airlines demonstrates strong financial performance. SWA recorded revenues in excess of \$6.530 million during the fiscal year ending December 2004. According to Mergent Online, this was an increase of 10% over 2003. The operating profit for the company was \$554 million during 2004, an increase of more than 14% from the previous year. For the year ending March 2005, the company recorded operating and net margins substantially above the industry averages. Return on investment during the same period was 4% and return on equity was 6.6%, both much higher than industry average. Southwest continues to outperform its peers in the industry in terms of financial performance, making this a true source of competitive advantage.

Macro-environmental Analysis

Porters Five Forces

Supplier power within the industry is relatively weak. As a service company, Southwest supplies its services to those needing to travel. Southwest is dedicated to low fares for its customers. In order to achieve low fare air travel, the company must keep its costs low. Southwest, naturally, selects suppliers that will deliver products at low cost for the highest quality possible. Productivity, standardization, and efficiency are all key components of maintaining low systems costs.

The threat of substitutes is the most influential force within the Porter's diagram. Switching costs for customers are low, as most would choose to fly on an airline that provides the lowest possible cost. The availability of flights and seats on a particular flight would be of great importance to those customers needing to maintain a rigid schedule that allowed for little variability. Southwest's business customers would fall into this category, as opposed to the leisure passenger that would generally have more flexibility on flight scheduling. The location of the airline's service areas is also an important factor. If the airline does not offer flights out of an airport that is most convenient for the consumer, sales are lost. For example, Southwest loses business in Knoxville, because they do not offer flights leaving Tyson-McGee airport. To fly Southwest, one would have to fly out of Hartsfield International in Atlanta or Nashville International.

Within the established major airlines, barriers to entry into the low fare niche market are low. The major airlines have already begun to cut prices to gain market share from SWA. Air travel has become commoditized, and there is an excess of availability. The only thing to prevent other major airlines from edging out Southwest within this segment would be the great deal of long-term debt that they have assumed. With declining dividends and overcapacity, the other major carriers will need to decrease price, but cannot do so on the same levels that Southwest would be able to, because of their debt ratios. Also, Southwest has established a distinct brand identity within the minds of its customers as well. SWA provides a relaxed, fun environment, and this is how it is marketed to customers.

Aside from the major airlines, smaller airlines would face barriers to entry first along the learning curve and the economies of scale that result. Southwest, along with other major airlines, has been in operation since 1971. During this time, its workers and corporate level leaders have learned how to maximize efficiency, reduce systems costs, and have developed a distinct brand name. These are things that a newly created airline could not copy. The economies of scale aspect become a factor in the many locations that Southwest and the other major carriers can operate. They have the financial ability to increase or decrease their service areas as needed. Experience and capital are the most important barriers for smaller or startup airlines.

Buyer power within the airline industry is great. Customers can easily choose to fly on another of the many airlines within the United States. The ability for customers to easily access various airline websites for flight times and costs, along with the advent of

websites like Expedia and Travelocity, have added to customer buyer leverage. It is now easier than ever for a customer to get the flight time and day they want, at the desired cost. Price sensitivity and availability (time and location) remain the two greatest sources of buyer power.

The degree of rivalry among carriers is currently at its greatest, as the trend has been to decrease costs by any means. Exit barriers for major firms are relatively high, due to the highly specialized aspects of the industry. Fixed costs of air-carriers is extremely high, so exit comes in the form of mergers or acquisitions by larger airlines, military entities, large corporations, or third party logistics service providers as well as the United States Postal Service. The industry has become more concentrated, with a substantial decline in industry growth, as the supply of flights exceeds demand, and trends move towards lower fares. The drive for lower fares has lead to a blurring of product and service differences among the various airlines. It has become much harder and a lot less profitable to start an airline today, than fifteen years ago, when the FAA certified sixty-nine new airlines in a period of three years.

Corporate Level Strategies

The mission statement of Southwest Airlines is to provide “dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.” SWA can attribute its thirty plus years of

profitability to maintaining its commitment to customer service. At Southwest, customer service starts first with employees. SWA consistently ranks in Fortune's top 10 businesses to work for, and has been regarded as one of the world's most admired companies. The family-oriented, fun, and flexible atmosphere has led employees to take ownership and a general reverence for the company. This esteem shines through all employees, and is passed along to customers, who in turn value and regard Southwest's service. Maintaining the lowest operating cost structure of any domestic airline industry has enabled Southwest to pass along reduced fares to its customers. It has also allowed Southwest to profit despite the various economic trends and conditions it has faced (e.g. recession, oil and fuel increases, and September 11, 2001). Customer satisfaction is shown in the accolades that Southwest has received. SWA ranked as the most admired airline worldwide from 1997-2001. The Wall Street Journal reported SWA as first among airlines for customer service satisfaction in 2002, according a survey conducted by the American Customer Satisfaction Index.

An initial source of Southwest Airlines profitability lies in their initial decision to use one kind of aircraft. This decision greatly reduces maintenance costs and allows for standardization, eliminating the possibility of various expenses (i.e. labor, parts inventory, knowledge as it relates to job duty and investment in human capital). The choice by corporate leaders to use less congested airports (e.g. Baltimore instead of Washington D.C.'s Dulles or Reagan; Manchester, NH instead of Boston, MA) allowed for a more efficient process as well as a reduction in operating costs. Professors Vijay Gavindarajn and Julie Lang of Dartmouth's Tucker School of Business regard

Southwest's leadership opting not to apply the "hub-and-spoke" approach, used by other major airlines (e.g. Delta, United, and American), as a major source of comparative advantage and cost reduction (2). The Southwest approach is to offer short-haul (average flight times of fifty-five minutes), point-to-point flights, such as Dallas to Houston or Los Angeles to Phoenix, at a high frequency. All of Southwest's corporate level decisions have enabled it to reduce systems costs, maximize profits, and build customer relationships with superior service, while passing these savings to consumers.

Business Level Strategy

Southwest employees are among the highest paid in the industry. This results from various cost reductions across the entire system. SWA's good will towards employees and its high-energy, friendly environment have lead to extremely low employee turnover. In their Southwest Airlines Corporation study, Gavindarajn and Lang found that in 2001 the company reviewed 194, 821 resumes, while hiring only 6, 406 new employees (3). Clearly there is no shortage of individuals wanting to work for the company. The hiring process at Southwest is unique in that peers screen candidates and conduct interviews (e.g. pilots hire pilots; gate agents hire gate agents).

To better understand what Southwest looks for in a candidate, top management interviews top employees at each job function (e.g. baggage handlers, grounds crew, attendants, etc). Common strengths are identified among these employees, and from

there profiles are created to identify top candidates for hire. Southwest President Colleen Barrett emphasizes that the carrier “hires for attitude and trains for aptitude,” which has become a credo for the company. Top management believes that job duties and other related tasks can be learned. A great attitude, characterized by hard-work, creativity, and personal initiative, mean a great deal more to Southwest.

Once hired, personal development is further achieved at the organization’s University of People, which serves to reinforce the need for high-energy and local autonomy among employees. CEO and founder Herb Kelleher is quoted saying “we want people who do things well, with laughter and grace” (Frieberg 65). For those employees exhibiting stellar leadership and initiative, Southwest also offers advanced training in leadership through its Managers In Training program (MIT). This program is a development school for senior leaders to learn more about the company across all departments, and to have a more global view of the goals which the company seeks. Continuous learning and improvement is truly at the core of the Southwest organization.

Customer Analysis

The key aspect of successfully entering a new market is correctly identifying one’s target market. The economic expansion of Asia continues to swell, creating one of the most profitable and largest target segments of the past 25 years. China’s population and rapid economic expansion alone, could offer tremendous possibilities as President Hu

Jintao seeks to maintain relations with US companies. Upon entering the Asian market, Southwest would continue to provide low fare, short-haul flights with high-frequency. The demographic of the Asian customer would be slightly different. We would expect to see more business travelers than leisure customers, as average salaried worker are paid far less than their US counterparts. However, with increasing industrialization and economic development, it seems safe to assume that over the next ten years there would be a definite increase in leisure travelers. This would be the result of a substantial increase in living wage, increased westernization, and tremendous improvements along the lines of travel. Along with the ever increasing business-worker demographic in Asia, middle and upper class travelers, and college-aged students would be targeted as well.

Marketing Objectives and Goals

Initially, Southwest should seek to gain knowledge of the countries' economies and cultures. Often times the greatest mistake a company makes, when expanding globally, is not having knowledge of the way the country works in terms of business, government, and culture. While these countries are becoming more Westernized in terms of their approaches to business and government, there are still distinct characteristics that each possess. Southwest should invest a substantial amount in market research before first engaging in building operations. As a wholly US firm, it may be necessary to bring in

new leadership from outside the company. These new hires should have experience in international startups, or be familiar with the customs and economies of each country.

Next, Southwest should seek to buyout smaller established firms within the respective countries. Acquisitions of assets from other companies should also be explored. Although Southwest has never engaged in a joint venture or marketing alliance, it could prove highly effective in this situation. Engaging in a joint venture greatly reduces financial obligations, along with the risk associated in establishing oneself in a completely foreign environment. In doing so, Southwest would have access to the supplier channels of an established brand. This would also facilitate learning more about the country's culture and economy.

Investment in advertising will be a large part of an effective startup. There should be a minimum of five percent revenue reinvested each quarter. Ads will run locally and regionally in news papers, trade journals, business magazines, general magazines, business journals, traveler's guides as well as on television. Marketing alliances could prove a great option for Southwest to establish a brand name within the new territories. Attaching the Southwest name to an already recognizable carrier, would make an immediate impact in terms of gaining market-share.

In Taiwan and South Korea, Southwest should attempt to gain a fifteen to twenty percent market share within the respective countries. Southwest will have to confront the larger and more established markets of Japan and China with more fervor, in hopes to achieve at least an eight to twelve percent share of the market. To aid in market penetration and expansion, Southwest should reinvest fifteen percent from its second and

third quarter earnings, as these are typically the highest, into research and development of the new markets. Research and development is needed to tailor the results of the marketing research to their target market. Also, there will be great capital expenses to start the project in motion.

Channel/Distribution Strategy Considerations

As the mantra follows, location and the availability of ones product is everything in business. Thorough market research and statistical analysis should be conducted to ensure that the location Southwest Airlines chooses is most ideal in terms of customer reach, systems costs, and as well as logistical responsiveness. In Southwest's American operations, the company has maintained expansions within secondary and downtown airport locations. The decision to service from these locations, as well as the use of a single jet type, have allowed for tremendous cost reductions across the total system. Southwest should maintain its focus on secondary and downtown airports and will continue to use the standard Boeing 737 jet within its new markets. The downtown areas will be the greatest populated, and therefore will attract the business and college type demographic. It will also be most convenient to the customer, as the road systems within these countries are not as sophisticated as in the United States. Southwest's ability to reach the greatest number of people will lend it the greatest opportunity for success, as a result of a more recognizable brand name.

China's economy has been the fastest growing in Asian economy over the past 20 years. The World Bank records that real GDP grew more than 9.5 % in the first half of 2005. In terms of purchasing power parity China maintained 12 %, second only to the United States. Also, Chinese foreign exchange reserves exceed \$700 billion (second only to Japan), and are growing at a reported \$200 billion each year. Estimates show that by the year 2020 there will be 70 to 100 cities with over one million people, representing close to 30 percent of the national population. Population growth is fastest in smaller cities and peri-urban areas of large metropolises where manufacturing and other industries are being set up. Southwest may seek to establish its services within these areas in anticipation of economic development.

Currently, the urban areas of China's eastern coastal provinces from north to south, Helongjiang to Guangdong, have been the engine of the economy and the source of innovation and commerce to the rest of the world. These coastal areas represent a population of 480 million, produce two thirds of China's GDP (\$606 billion), and attract 85 % foreign direct investment. Naturally, Southwest seeks to target this area as an area of service.

A population of more than 49 million people and GDP in excess of \$680 billion renders Korea an obvious choice for international expansion. Foreign economic development and investment have afforded South Korea with one of the most stable countries in the Asian market. The manufacturing industry in here is booming as of recent years, and development and improved education has given Korea a sizeable

middle-class. These factors prove very promising for Southwest. Seoul or a city comparable in access and population would be the most likely for expansion.

Taiwan's dynamic capitalist economy and its ever decreasing government regulation in the private sector, make it a promising location for Southwest Airlines. Exports have fueled the industrialization of the economy, and trade surplus is substantial. Currently, Taiwan's foreign reserves are the world's third largest. Taiwan is a major investor throughout Southeast Asia. In 2005, China became Taiwan's largest export market, just ahead of the US. As industrialization leads to more specialization and development, the service sector in Taiwan has grown to 69% of the country's GDP. The expanding service sector and declining unemployment provide Southwest with the large business traveler market it seeks. Taipei becomes the city of focus for Taiwan expansion.

Government-industry cooperation, a strong work ethic, and high technology characterize the final choice for expansion. Japan currently ranks as the second most technologically powerful economy in the world and has the third-largest world economy. The CIA fact book holds Japan's GDP at an estimated \$3.914 trillion. As one of the most stable economies in the world, Japan is a seamless fit in regards to the global expansion aims of Southwest. Tokyo and Osaka are likely choices for expansion based on population and generated revenue.

Pricing Strategy

In accordance with Southwest Airlines Company strategies of maintaining a low cost structure realized by customers in the form of low fares, prices will be created based on the same formula used in the United States. Measures will be taken to ensure that Southwest's competitors in the new market do not operate with greater efficiencies or effectiveness; thereby, delivering customers lower prices than Southwest. It is probable that prices in Japan and South Korea will be more expensive than those offered in China and Taiwan. These price differences will be a direct result of operating costs and the presence of a larger middle-class society, which has a substantially higher average disposable income.

The same family-oriented, fun, and relaxed atmosphere will be transplanted in the new areas. Hiring practices will be characteristics will be comparable to those in the United States. Southwest believes that friendly, self-motivated, and hard-working individuals span cultural differences. Southwest will continue to "hire [on] attitude and train for aptitude."

Marketing Control Considerations

Southwest Airlines will establish marketing control systems in China, South Korea, Japan, and Taiwan, based on the system already in place in the US. Performance

standards are determined for which the new service areas will be evaluated against. Performance standards are a combination of corporate goals and strategies, pricing, branding policy and effectiveness, and productivity. Pricing and branding effectiveness are external measurements. Prices will be directly compared to competitor's figures. Brand awareness will be a result of surveys and enplanement numbers from the new service areas. An analysis of control standards should be performed after each quarter. More importantly, the first quarter numbers will provide us insight on chance for true concern according to company strategy. However, a solid contingency plan will prove most effective.

Contingency Plan

It is imperative that Southwest's Airlines maintain a contingency plan that ensures long life in the emerging Asian market. All factors will be weighed in order to avoid disruptions by the market or other economic conditions. The plan calls for risk analysis of all the proposed regions of new market entry. As characteristic of Southwest expansion, secondary and downtown airport locations will be targeted within major cities. Direct competition with the already established domestic airlines, in the respective regions poses as the largest threat to obtaining a substantial market share. Air travel will grow almost exponentially within these regions as they become more developed. There will be a natural increase in income per capita associated with this development. As

income increases, logically the target market and demand for air travel does. Southwest will need to position itself to take full advantage of the opportunities that the new market offers. SWA plans to compete on the efficiency and responsiveness of the system to lower total costs, enabling lower-fares passed along to the customers. Quantitative and qualitative risk analyses will be performed to assess the possible threats that may endanger corporate stability. Controls will be designed for the analysis to determine the necessary countermeasures if faced with certain emergencies. The process of contingency planning for Southwest Airlines' international expansion has seven parts. First, the company will establish a project team to create a recovery strategic plan consisting of international management, finance advisors, and marketing consultants. Next, the international project team will assess the problems within the company. The team will focus on eliminating the chance of unforeseen concerns that may affect profitability in the new areas. Third, the plan will acknowledge the impact of those possible threats to the company. These include competition, customer retention, supplier loss, employee turnover, and equipment and capital problems. After the impact of these threats are determined, backup profiles of the international systems will be created. Fifth, SWA will take the database of competitors, threats, mishaps, etc. and develop a detailed plan for each country. Next, tests will be run to ensure the validity of the system. Finally, the employees must be educated so that they are knowledgeable about job duties and to maintain levels of productivity.

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SENIOR HONORS PROJECT: ADVISOR PROGRESS REPORT
University Honors Program

Faculty Project Advisor' Name: Mark Collins

I have met with Joel and reviewed the progress being made on her/his Senior Honors Project.

Progress is satisfactory ✓

Progress is unsatisfactory

If progress is unsatisfactory, please note here the plans that have been made to move the project forward.

Student's Signature: [Signature] Date: 5/2/06

Faculty Advisor's Signature: Mark E Collins Date: 5/1/06

Student should return this form to University Honors by the ninth week of the term.

(January 2006)

SENIOR PROJECT - PROSPECTUS
UNIVERSITY HONORS PROGRAM

Name: Del Thomas

College: Business Department: Marketing

Faculty Project Advisor: Mark Collins

PROJECT TITLE: Southwest Airlines Corporation: A Domestic Industry
Analysis & Recommendation for Expanding Operations

PROJECT DESCRIPTION (Attach not more than one additional page, if necessary):

In this project I take the role as consultant to a firm, Southwest Airlines, whose domestic industry is in decline due to over-capacity & a trend towards commoditization. I perform a thorough analysis of Southwest's macro-environment within the US, & explore potential sources for maintaining & creating new demand & profit. The best opportunity is found in geographic expansion, but through implementing the same formula in an ever-growing Asian market that has been the key to 30 yrs of success at home.

Projected completion date: 5/2/06

Signed: [Signature]

I have discussed this research proposal with this student and agree to serve in an advisory role, as faculty project advisor, and to certify the acceptability of the completed project.

Signed: Mark E Collins, Faculty Project Advisor

Date: 5/4/06

Return this completed form to The University Honors Program, F101 Melrose Hall.

(January 2006)