Case 21 Southwest Airlines

*Is "LUV" Getting Aggressive?**

For 39 years, Southwest Airlines flourished with organic growth, betting that its competitive labor costs, low fares, and unique corporate culture comprised the best arsenal against rivals. Yet with the U.S. air travel market stagnant and larger airlines consolidating into more dominant competitors, Southwest has been forced to rethink its traditional business model in recent years. On September 27, 2010, Southwest announced an agreement to acquire all outstanding shares of common stock of AirTran Holdings Inc., the parent company of AirTran Airways (AirTran), for a combination of $1.4 billion cash and Southwest Airlines's common stock.[1] The acquisition, only the third in Southwest's history, gave the discounter its first service in Atlanta, a Delta Air Lines fortress for decades, and more flights from New York and Washington, D.C.[2] Nevertheless, it signaled a major departure from its traditional strategy of growing organically and conservatively.

Analysts say Southwest had little choice but to pursue growth through buying up a rival. After expanding its route map to 69 airports in 35 states by the end of 2010, organic growth during recession was no longer a possibility. Southwest was finding it impossible to expand at key business airports like LaGuardia, New York, or to break into Washington-Reagan and Atlanta because of facility constraints. To add to its woes, Southwest's sole source of business—domestic air travel—had contracted in recent years. As a result, the Dallas-based carrier posted a $120 million loss in the third quarter of 2008 (its first in 17 years) and has lost money in four of the past eight quarters. "We are not willing to make a bet on the economy or operating costs coming down," Chief Executive Officer Gary C. Kelly says. "And that naturally leads us to having a more energetic focus on 'Well, then how do we grow?' Fortunately for us, we found a situation that lets us do that."[3]

Background and Growth

The inconvenience and expense of ground travel by bus or automobile between the cities of Houston, Dallas, and San Antonio—the Golden Triangle that was experiencing rapid economic and population growth during the late 1960s—offered an opportunity for an intrastate airline. The idea was suggested by Rollin King, a San Antonio entrepreneur who owned a small commuter air service, when his banker, John Parker, complained about the issue. King then talked to Herb Kelleher—a New Jersey–born, New York University Law School graduate who had moved to San Antonio in 1967 to practice law. They soon pooled the seed money to start Southwest Airlines. The infant Southwest Airlines (SWA) fought long-drawn-out legal battles, primarily engineered by the major airlines, for over four years before it got its first flight off the ground in 1971. Later on, the company had to work around a regulation intended to penalize SWA's decision to operate out of Dallas Love Field instead of moving to the new Dallas–Fort Worth (DFW) airport. With Kelleher's brilliant legal expertise and extensive lobbying of the House of Representatives, the issue was settled and SWA was allowed to operate out of Love Field in 1979. The struggle for existence in the initial years worked to the advantage of the company, as the struggle created the esprit de corps for which the airline became so well known. The employees were caught up in fighting for the "SWA cause" that created "the warrior mentality, the very fight to survive," according to Colleen Barrett, who became the president and chief operating officer of SWA in 2001. (She now is the president emeritus.)[4]

Kelleher, however, was not the first chief executive officer of Southwest. Lamar Muse, an airline veteran who worked earlier with Trans Texas, Central, and Universal Airlines, was brought in to get the company off to a good start. That was followed by the brief tenure of Howard Putnam, another airline veteran, who was hired from United Airlines, where he worked from 1978 to 1982. Herb Kelleher served as the chairman of the board during that period; then he took the CEO position in 1982 and championed Southwest's expansion (at that time the company had only 27 planes and $270 million in revenues, and it flew to only 14 cities).[5] SWA was one of a kind right from its beginning. It was the pioneer of the "low-cost strategy." It flew planes point-to-point—short-haul flights bypassing the expensive hub-and-spoke operations. It chose less popular, less congested airports to achieve quicker turnarounds.

SWA offered airfares so low that it gave the bus and car travel companies a run for their money. It served no meals on its airlines and provided only a snack of peanuts. That saved plenty of money and work. There was no assigned seating, which reduced boarding times and helped planes turn around faster. The average turnaround time for planes was around 25 minutes. The faster turnaround times and higher aircraft utilization enabled the airline to operate with fewer planes and gate facilities than would otherwise have been necessary. SWA's attractive flight attendants in hot pants were a source of live entertainment on flights (e.g., the flight attendants made funny presentations of the otherwise routine and boring safety

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instructions or performed preflight tricks such as popping out of overhead bins).[6] Southwest was the first major airline to introduce ticketless travel and one of the first to put up a website and offer online booking.[7] It operated a single aircraft type, the Boeing 737, that kept its training costs low and personnel utilization high, as having only one type of plane offered great flexibility in personnel deployment. Starting with three Boeing 737s in 1971, the company fleet grew to 548 Boeing 737 aircraft providing service to 69 cities in 35 states throughout the United States by the end of 2010 (see Exhibits 1, 2, and 3).[8]

The SWA Leadership and Culture

There are many stories about Herb Kelleher's flamboyant style as CEO. He smoked cigars, loved Wild Turkey whiskey, was often seen dressed up as Elvis Presley, and publicly arm-wrestled and defeated a rival company CEO to settle a dispute over an advertisement slogan.[9] Kelleher truly believed that business could and should be fun—at too many companies, people put on masks when they came into the office. At work, people were not themselves and would be overly serious, which explained why most business encounters were bland and impersonal. Therefore,

Exhibit 1 * **Financial and Operating Data for Southwest Airlines, 2006–2010** (year-end December 31)

Financial Data (in millions, except per-share amounts)	2010	2009	2008	2007	2006
Operating revenues	12,104	10,350	11,023	9,861	9,086
Operating expenses	11,116	10,088	10,574	9,070	8,152
Operating income	988	262	449	791	934
Other expenses (income), net	243	98	171	–267	144
Income before taxes	745	164	278	1,058	790
Provision for income taxes	286	65	100	413	291
Net income	459	99	178	645	499
Net income per share, basic	0.62	0.13	0.24	0.85	0.63
Net income per share, diluted	0.61	0.13	0.24	0.84	0.61
Cash dividends per common share	0.018	0.018	0.018	0.018	0.018
Total assets at period-end	15,463	14,269	14,308	16,772	13,460
Long-term obligations at period-end	2,875	3,325	3,498	2,050	1,567
Stockholders' equity at period-end	6,237	5,454	4,953	6,941	6,449
Operating Data					
Revenue passengers carried	88,191,322	86,310,229	88,529,234	88,713,472	83,814,823
Enplaned passengers	114,213,010	101,338,228	101,920,598	101,910,809	96,276,907
Revenue passenger-miles (RPMs) (000s)	78,046,967	74,456,710	73,491,687	72,318,812	67,691,289
Available seat-miles (ASMs) (000s)	98,437,092	98,001,550	103,271,343	99,635,967	92,663,023
Load factor	79.3%	76.0%	71.20%	72.60%	73.10%

(continued)

Exhibit 1 * **Financial and Operating Data for Southwest Airlines, 2006–2010** (year-end December 31) (*continued*)

Operating Data					
Average length of passenger haul (miles)	885	863	830	815	808
Average aircraft stage length (miles)	648	639	636	629	622
Trips flown	1,114,451	1,125,111	1,191,151	1,160,699	1,092,331
Average passenger fare	$130.27	$114.61	$119.16	$106.6	$104.4
Passenger revenue yield per RPM	14.72¢	13.29¢	14.35¢	13.08¢	12.93¢
Operating revenue yield per ASM	12.30¢	10.56¢	10.67¢	9.9¢	9.81¢
Operating expenses per ASM	11.29¢	10.29¢	10.24¢	9.1¢	8.8¢
Fuel costs per gallon (average)	$2.51	$2.12	$2.44	$1.7	$1.53
Fuel consumed, in gallons (millions)	1,437	1,428	1,511	1,489	1,389
Full-time equivalent employees at period-end	34,901	34,726	35,499	34,378	32,664
Size of fleet at period-end	548	537	537	520	481

* Refer to the appendix at the end of this case for a glossary of the terms used in this table.

Source: Southwest Airlines. SEC filings, Form 10-K, *www.sec.gov*.

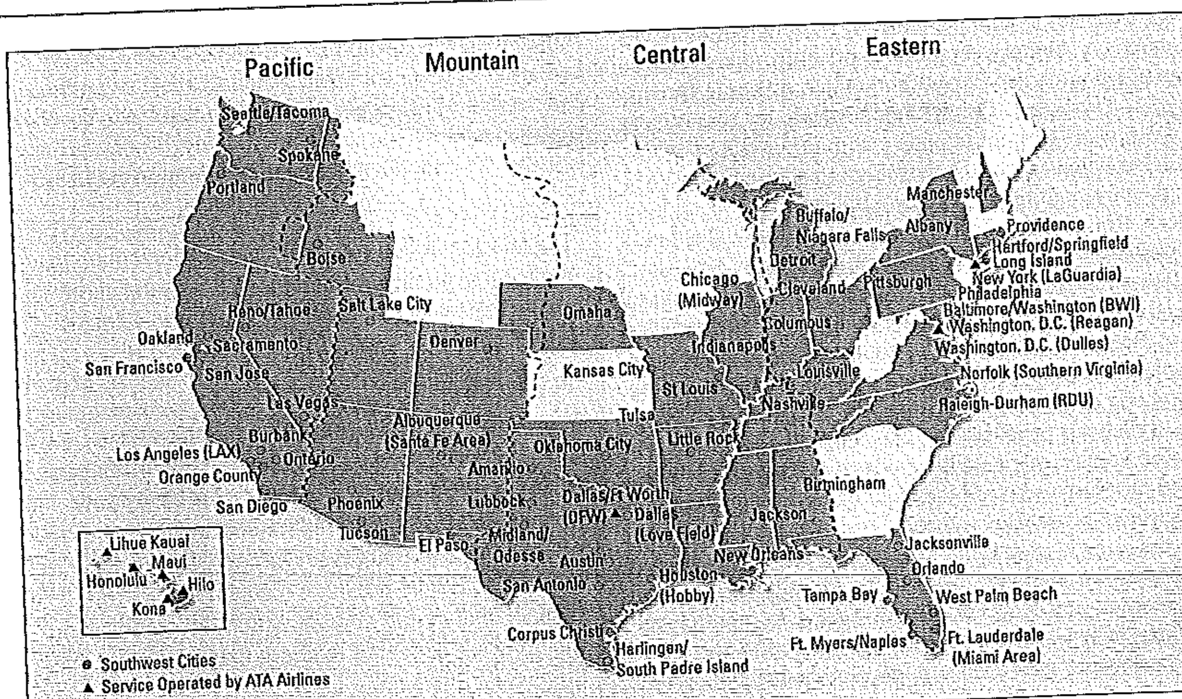

Exhibit 2 Cities Served by Southwest Airlines

Source: Printed with permission from Southwest Airlines, *www.southwest.com/about_swa/routemap.html*.

Exhibit 3 **Growth in the Number of Cities Served by Southwest Airlines, 1996–2010**

Year	Number of Cities Served
1996	49
1997	51
1998	52
1999	56
2000	57
2001	58
2002	58
2003	58
2004	58
2005	61
2006	63
2007	64
2008	64
2009	68
2010	69

Source: Southwest Airlines. Forms 10-K filed with SEC.

SWA tried not to hire people who were humorless, self-centered, or complacent. Not surprisingly, there was no human resource department but, rather, a People Department at Southwest. The guiding principle for recruitment at SWA was "Hire for attitude and train for skills," which Kelleher believed was the most important principle. When an employee from the People Department said to him, "Herb, I'm getting a little embarrassed because I've interviewed 34 people for a ramp agent position in Amarillo," Kelleher replied, "If you have to interview 134 people to find the appropriate person to be a ramp agent in Amarillo, do it. Because the most important thing is to get the right people, and if you get the wrong ones they start poisoning everybody else."[10]

Kelleher's penchant for laughter and fun became a part of Southwest's culture. Prospective employees were asked how humor helped them out of a difficult situation. Prospective pilots were sometimes asked to pull on shorts, and the ones who saw fun in it passed the interview. All people at the company were to be treated with dignity and respect, and Kelleher did not believe in hierarchical barriers. When a vice president complained to the CEO that customers, gate agents, pilots, and baggage handlers had more access to the CEO than he did, Kelleher said to him, "Let me explain this: They're more important than you are." Kelleher recognized that the key to satisfied customers was having satisfied employees. So employees came first, and that orientation was embodied in the airline's mission statement (Exhibit 4).

The culture was put into operation through a number of policies and programs. The casual-dress policy reinforced the company's desire that people be themselves on the job. Celebrations such as spirit parties, culture parties, and weekly deck parties were organized at headquarters regularly to bring employees together. Activities at the events included gong shows, talent shows, dance contests, limbo contests, and famous-person look-alike themes. The culture committee at SWA welcomed new employees with a "New Hire Welcome Kit" that included a bag, T-shirt, badge holder, pen, and welcome letter. To build solidarity across all departments, there was an employee recognition program in which employees recognized each other's achievements. This practice helped community building within and across departments. For example, one work group committee recognized flight attendants 10 times a year with "Hokey Days," named for the broom apparatus used by flight attendants to sweep the cabin after the flights. Committee members chose two locations at which to honor flight attendants, greeted each arriving plane, waited until passengers got off, and then boarded with goodies. Flight attendants were asked to relax while the committee members cleaned the plane for them. There were similar programs to honor other departments as well.[11] There was also the "Walk a Mile Program," designed to foster problem solving and cooperation, in which an employee could do somebody else's job for a day (while operations people obviously could not fly the airplanes, pilots could do the

Exhibit 4 **Mission Statement of Southwest Airlines**

The mission of Southwest Airlines is dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.

To Our Employees

We are committed to provide our Employees a stable work environment with equal opportunity for learning and personal growth. Creativity and innovation are encouraged for improving the effectiveness of Southwest Airlines. Above all, Employees will be provided the same concern, respect, and caring attitude within the organization that they are expected to share externally with every Southwest Customer.

Source: Southwest Airlines. *www.southwest.com/about_swa/mission.html*.

work of operations agents).[12] Further, the company had the "Star of the Month," a program that recognized the distinct contributions of employees toward excellence in customer service—outstanding employees were featured in *Spirit*, Southwest's in-flight magazine.[13]

The company also expressed warmth toward its employees in other ways. At Southwest's headquarters in Dallas, the walls were covered with more than 10,000 picture frames that contained photos of employees' pets, of stewardesses in miniskirts, of Southwest planes gnawing on competitor's aircraft. Also there were teddy bears, jars of pickled hot peppers, and pink flamingos. There was cigarette smoking and lots of chuckling. "To me, it's comfortable," said Colleen Barrett, who was most responsible for nurturing the Southwest culture from its early days. "This is an open scrapbook. We aren't uptight. We celebrate everything. It's like a fraternity, a sorority, a reunion. We are having a party!" she said. Barrett also regularly traveled to meet the employees and personally sent them birthday cards, not so much to win their loyalty as to communicate the true spirit of a family. The company celebrated with its employees when good things happened and grieved with them when they had devastating experiences.[14] Barrett said, "What we do is very simple, but it's not simplistic. We really do everything with passion. We scream at each other and we hug each other."[15]

Cost consciousness was another important part of the culture. "Yes, our culture is almost like a religion," said Gary Kelly, the erstwhile CFO and the present CEO of Southwest. "But it's a dichotomy. In many ways we are conservative. Financially, for instance," he added.[16] According to Herb Kelleher, close attention to costs had produced the kind of financial success Southwest had seen. He said, "Even in the best of times, we kept our costs low and questioned every expenditure. For years, I used to approve every expenditure over $1,000. Why? To encourage a cost-conscious culture. I couldn't look at all of them, of course. But I would question them selectively, and that kept people paying attention."[17]

Treating employees well at Southwest did not mean that they were paid high salaries. By creating value through intangibles, the company kept wages lower than those of competitors. Officers at Southwest were paid about 30 percent less, on average, than their counterparts at other airlines. But the airline made stock options widely available, so all employees—not just executives—could share in the company's financial success. Southwest even had a policy that its officers received pay increases that were no larger, proportionally, than what other employees received. But employees were also expected to take pay reductions when times were not good. Job security was ensured, however, with a "no-furlough policy," and Southwest did not lay off a single employee during the economic downturn after the terrorist attacks on September 11, 2001, while many of its competitors did.[18] Caring for employee happiness showed positive results. Southwest had less employee turnover than its competitors. For years, Southwest enjoyed the loyalty of its employees despite the high level of employee unionization. "Once labor leaders realize that you're trying to take care of your people, most of the edge [in contract negotiations] is gone," said Kelleher.[19]

Southwest's employees worked more hours than their counterparts at other airlines. Southwest pilots flew nearly 80 hours a month, compared to United's 50 hours. Southwest pilots were paid by trip, not per hour, which created a strong interest in keeping flights on schedule. Also, the pilots tended to be cost-conscious because a big part of their compensation came from stock options. On some occasions, pilots even pitched in to help ground crews move luggage to ensure on-time flights—something virtually unheard of at Southwest's bigger rivals. Flight attendants at Southwest worked about 150 hours a month, compared with 80 hours at many other airlines, according to union president Thom McDaniel. Southwest attendants were required by contract to make a reasonable effort to tidy the airplane between flights, a job performed by maintenance personnel at rival airlines. According to an airline labor expert, senior flight attendants at United got as many as 52 vacation days a year (compared with 35 days for veterans at Southwest), and they never had to clean up after the passengers.[20]

Maintaining focus on the core business was another element for both controlling costs and pursuing a niche strategy. Kelleher consciously ensured that the company did not diverge into allied businesses, such as car rentals or reservations. Most of Southwest's growth had been organic; that is, it occurred by adding more flights on its existing routes and by connecting more dots (adding cities). The airline started complementing its short-haul flights with long-haul flights and began transcontinental services. According to Kelleher, the airline did not plan to have international flights, as they would require a total change in the way it operated and would involve training its 35,000 employees to handle that change.[21]

The cost consciousness and employee commitment translated into operational excellence and increased profitability (Exhibit 5). Southwest's planes flew about 10.9 hours per day, much more than any other airline except JetBlue, which flew close to 13.0 hours per day. Southwest could offer lower fares—as much as 50 percent lower than its major rivals—and still remain profitable. With such low costs, it created what was called the "Southwest effect," an explosion in the numbers of people traveling by plane, including many who would have gone by car before.[22] The term *Southwest effect* was coined by the U.S. Department of Transportation to refer to the consistent phenomenon of a decrease in average fares and a stimulation of demand that occurred when Southwest Airlines entered any market.[23]

In May 1988 Southwest became the first airline to win the coveted Triple Crown for a month: Best On-Time Record, Best Baggage Handling, and Fewest Customer

Complaints. Since then, Southwest has won it more than 30 times, as well as five annual Triple Crowns for 1992, 1993, 1994, 1995, and 1996. Southwest crossed its $1 billion revenue mark in 1990, thereby becoming a major airline, and topped the monthly domestic originating-passenger rankings for the first time in May 2003. It was also the largest carrier on the basis of scheduled domestic departures. Stories of Southwest employees providing excellent customer service abound, and Southwest even set up an internal TV system to show how its employees treated customers.[24]

The Changing Times and Challenges

Southwest Airlines had a change in leadership in August 2001 when Herb Kelleher relinquished power to two of his close aides. Colleen C. Barrett, vice president for customers, became the president and chief operating officer; and James F. Parker, general counsel, became the chief executive officer. Barrett and Parker had worked together for over 22 years, and both had worked with Kelleher for much longer—from the time he was a lawyer. In contrast to Kelleher's obtrusive personality, Parker was a quiet diplomat. He had been the company's lead labor negotiator for years, and his opponents said he pursued the company line quite forcefully, if politely, in talks. "He will surprise you because he doesn't look like he's tough, but he doesn't give anything away," said a former vice president of the airline's pilot association.[25] Unlike Kelleher, Parker was not as fond of celebrations, because he didn't see them as contributing to productivity. But he came to realize that the party preparations were a model of teamwork and employee bonding, and he started participating in the celebrations in 2002.[26]

Barrett had been the culture keeper of Southwest since the earliest days of the company. However, she was a reluctant public speaker. Thus, she let Parker take the lead with Wall Street and the media. It was too early to guess whether the lieutenants could replace the "rock star" personality of Kelleher, who had exuded warmth to his employees. Kelleher remained chairman of the board and focused on long-range strategy and government affairs. He maintained control of schedule planning and aircraft acquisitions, the backbone of Southwest's strategy during the period of transition.[27]

The growth of the company and the consequent increase in the number of employees also posed challenges to keeping the culture intact. The distance between the rank and file and top management was growing. While Colleen Barrett could reach all the employees through personally signed birthday cards when the company was small, the task was becoming increasingly unrealistic. Even though she continued to sign cards, she could reach only a fraction of Southwest's 35,000 employees dispersed in different cities. Keeping in close touch with employees was becoming

Exhibit 5 Comparison with Key Competitors and Industry

Measures of Comparison	Southwest	AMR Corp.	JetBlue	UAL	Industry (Regional Airlines)
Market cap	8.72B	2.17B	1.63B	7.65B	986.31M
Employees	34,901	78,250	11,121	N.A.	11.12K
Quarterly revenue growth (YOY)	14.80%	10.40%	13.00%	101.10%	20.30%
Revenue (TTM)	12.10B	22.17B	3.78B	23.23B	2.62B
Gross margin (TTM)	25.13%	23.03%	33.00%	29.44%	27.92%
EBITDA (TTM)	1.62B	1.40B	563.67M	2.60B	348.98M
Operating margins (TTM)	8.16%	1.39%	8.81%	7.22%	8.49%
Net income (TTM)	459.00M	−471.00M	97.00M	252.00M	N/A
EPS (TTM)	0.61	−1.41	0.31	1.08	0.69
P/E (TTM)	19.20	N/A	17.87	21.57	12.38
P/S (TTM)	0.72	0.10	0.43	0.33	0.45

Note: YOY = year over year; TTM = trailing 12 months.

Source: yahoofinance.com, March 2, 2011.

an increasingly challenging task. In earlier times of difficulty, Herb Kelleher personally addressed and rallied his troops, but such an exercise was no longer easy.

In addition, the warm employee relations at Southwest seemed to chill over time. Unions were becoming more aggressive in expressing their frustration, in contrast to earlier days when disputes were resolved more amicably and peacefully. In the summer of 2001, ramp workers picketed near company headquarters with signs that read "Record Profits Empty Pockets." They complained that staff shortages, combined with Southwest's record passenger loads and its drive to improve on-time performance, meant that they had to lift more bags and had to do so more quickly, which put them at risk of injury.[28] And, for the first time in company history, in July 2002 Southwest's mechanics union asked federal mediators to intervene to break a contract deadlock over pay. While the company was nowhere near a strike, the incident clearly signaled the strains appearing in employee relations.[29]

In 2002 the company was also engaged without much success in a contract renegotiation with flight attendants. In July 2003 a group of flight attendants staged a demonstration at the headquarters, carrying signs stating "Spread the LUV" and handing out cards to travelers that read "Give our flight attendants a break." The move was an expression of frustration over management's idea of increasing the flight attendants' work hours. Also, workers who had been working hard to boost the productivity of the company were not seeing much return from profit sharing and a stock value that was falling. After years of hard work, some long-time employees felt that they had no more to give. Karen Amos, a 26-year Southwest veteran, said, "We have been there for them. There comes a time when it becomes too much."[30] The company had to drop the move to increase work hours, but still could not get a deal made with the flight attendants. Some workers perceived that the company had been fairer in its negotiations in past years.

In November 2003, after 11 rounds of talks without success, the flight attendants threw a Thanksgiving party at Salt Lake City International Airport, primarily as a means of putting pressure on management to accept their demands for holiday pay and better working conditions. Kevin Onstead, a Southwest negotiator and flight attendant, said, "We are concerned about the culture of the airline. We are fighting for the recognition of our contribution to that culture. We've been key in Southwest Airlines' success. Flight attendants are prepared to strike as a last resort. We are willing to do whatever it takes to get a fair contract."[31] The negotiations had not borne fruit by early 2004. Thom McDaniel, president of the Transport Workers Union, said that the flight attendants were willing to return to the negotiating table. However, he made the point that the latest management offer fell short of their expectations. "We feel that our culture is at risk because of the actions taken by Southwest's management during these negotiations."[32] Many of the employee groups started feeling that Southwest Airlines was no longer the underdog and that their pay should match the profitability of the company. Love (LUV) alone no longer seemed to be enough. That meant a twin challenge in terms of culture and costs.

In July 2004 James Parker abruptly resigned as CEO of Southwest amid strained labor negotiations with the flight attendants. Some people said that Parker had spent too much time in the back offices of Southwest and was never really cut out for a job in the limelight.[33] Herb Kelleher stepped into the negotiations, and the flight attendants walked away smiling with a 31 percent pay raise.[34]

Gary C. Kelly, former chief financial officer of Southwest, took the helm. Kelly was certainly energetic, showing up at the office Halloween party in 2004 dressed as Gene Simmons, leader of the rock group Kiss.[35] He, of course, decided later that he was better off being Kelly than someone else. Kelly audaciously acquired six gates at Chicago's Midway Airport from bankrupt carrier ATA and signed Southwest's first ever code-share agreement with ATA, primarily in response to AirTran eyeing a move into Chicago. In December 2008, the airline agreed to provide an online link to WestJet's booking portal that helps its customers book flights to Canada. Later, Southwest formally filed an application with the Department of Transportation for rights to fly its own planes to Canada.[36] Southwest was already experiencing cost increases per average seat-mile (ASM), a key metric used to measure performance in the industry, primarily due to increases in fuel costs and wages. The cost per ASM went up from 7.07 cents in 1995 to 11.29 cents in 2010, with fuel costs, wages, and benefits as the major contributors (Exhibit 6). Southwest's cost per average seat-mile, however, remained below that of the big carriers. The company was already working hard on controlling costs. With more of its customers making reservations online and the labor cost advantage narrowing between major airlines after restructuring, further cost squeezing appeared to be a difficult proposition. Though Kelly did not concede it openly, he understood that further cost reductions would be hard to come by without modest fare increases and possible employee layoffs—something that was totally against Southwest's culture.[37] In 2007, a new fare structure was introduced that included Business Select, which gave customers priority in boarding.[38]

Intensifying competition in the low-fare segment was another factor that had become difficult to ignore. While competitors such as JetBlue and AirTran were not direct threats to Southwest on its existing routes, further expansion of those carriers could bring them head-on with Southwest. These new airlines offered far more attractive services, such as leather seats and in-flight entertainment systems, for almost the same fare. Therefore, these rivals could make the no-frills approach of Southwest pale before them. Whether Southwest's loyal customers would still stick with the airline when they could get

Exhibit 6 Southwest Airlines' Operating Expenses per Average Seat Mile, 2002–2010 (in cents)

Category	2010	2009	2008	2007	2006	2005	2004	2003	2002
Salaries, wages, and benefits	3.76	3.54	3.23	3.22	3.29	3.27	3.18	3.10	2.89
Fuel and oil	3.68	3.11	3.60	2.55	2.31	1.58	1.30	1.16	1.11
Maintenance materials and repairs	0.76	0.73	0.70	0.62	0.51	0.52	0.60	0.60	0.57
Aircraft rentals	0.18	0.19	0.15	0.16	0.17	0.19	0.23	0.25	0.27
Landing fees and other rentals	0.82	0.73	0.64	0.56	0.53	0.53	0.53	0.52	0.50
Depreciation and amortization	0.64	0.63	0.58	0.56	0.56	0.55	0.56	0.53	0.52
Other	1.45	1.36	1.34	1.43	1.43	1.41	1.37	1.37	1.47
Total	11.29	10.29	10.24	9.10	8.80	8.05	7.77	7.53	7.33

Source: Southwest Airlines. 2002–2010. Form 10-K filed with SEC.

more value for their money elsewhere was a significant question. Southwest's investments to automate and significantly streamline the ticketing and boarding process with computer-generated bag tags, automated boarding passes, and self-service boarding pass kiosks, and its investments to increase the functionality of its website, along with its moves to enhance aircraft interiors with leather seats, can hardly be described as *not* being motivated by competition.[39] That JetBlue caught Southwest's attention was clear by the comment that Southwest was studying the possibility of introducing an in-flight entertainment system, although at the time it was too costly to adopt. Thus, matching amenities with those of the emerging competition could pose additional challenges to SWA's low-cost strategy. Kelleher's reaction to the emerging competition was simple—he had seen that movie before.

Meanwhile, Southwest entered the Philadelphia market, a stronghold of US Air, in May 2004. The Philadelphia market was one of the most overpriced and underserved. Southwest aimed at capturing the market with its tried and tested low-cost, no-frills formula, albeit with leather seats on some of its newer planes. US Air responded, "We will be a vigorous competitor to Southwest in Philadelphia on every route they fly."[40]

In addition to establishing the ATA code share for Chicago's Midway,[41] Kelly added Phoenix to the code share in April 2005.[42] Then Kelly directed Southwest's entry into Pittsburgh in May 2005, announcing, "The Pittsburgh International Airport will be a great addition to our system."[43] In October 2005 Southwest began service out of Southwest Florida International Airport in Fort Myers, making it the 61st Southwest city.[44] Robert M. Ball, executive director of Florida's Lee County Port Authority, said after courting Southwest for nearly a decade, "We have been working closely with Southwest for many years and are pleased they have selected Southwest Florida as their newest destination."[45] Kelly was on hand to wave the banner, and he said, "Now, our Southwest Florida customers have to look no further than their own backyard for Southwest's legendary low fares and great customer service." Denver, Colorado, and Washington Dulles International Airport were added to the list in 2006. From 2006 to 2010 the number of cities served increased from 63 to 69.[46]

Wright Amendment and Beyond

With legacy carriers achieving significant labor restructuring agreements and thus eroding SWA's once considerable wage-rate advantage, overcapacity in the East pushing down passenger yields lower than SWA would prefer, and other low-cost carriers such as JetBlue and AirTran carving their niches and reducing the "underserved and overpriced markets" that form the heart of Southwest's commercial strategy, further growth and even cost reductions have been difficult to come by.[47] Kelly pushed for the repeal of the Wright amendment.[48] Southwest entered into an agreement with the City of Dallas, the City of Forth Worth, American Airlines Inc. (which has its hub at Dallas–Fort Worth airport), and the DFW International Airport Board, following which these five parties sought enactment of legislation that would amend the original Wright amendment. Congress responded with a reform act that substantially reduced earlier restrictions.

This has worked to Southwest's advantage, because it can fly to many more destinations from Love Field than earlier, provided the flights stop first in a state within the Wright perimeter. This includes New Mexico, Oklahoma, Missouri, Arkansas, Louisiana, Mississippi, Kansas, and Alabama, along with Texas.[49] Southwest controls about 90 percent of the Love Field market. Southwest's passenger traffic at Love Field has risen by about 18 percent since the Wright restrictions were loosened in October 2006. This, of course, has a price war brewing between American and Southwest.[50]

None of the members of senior management would concede that Southwest is becoming a different creature. This is primarily because of the huge psychic investment the airline has in being the "underdog." "We're bigger, let's put it that way," says Kelleher. "I think the airline business is fundamentally an opportunistic business. . . . We suddenly have some opportunities materializing that are new to us."[51]

From being an underdog and a company pursuing a very conservative organic growth strategy, Southwest now looks to be compelled to grow through acquisitions. Southwest announced an agreement to acquire all outstanding shares of common stock of AirTran Holdings Inc., the parent company of AirTran Airways (AirTran), for a combination of $1.4 billion cash and Southwest Airlines's common stock in September 2010. This acquisition gave access to Atlanta, a Delta Air Lines fortress for decades, and more flights from New York and Washington, D.C. Whether or not Southwest overpaid for this acquisition is another matter for debate. Nevertheless, this acquisition will put the company more squarely in the sights of Delta, the major airline that turned Atlanta into the world's busiest airport with the "hub-and-spoke" system of funneling passengers to their destinations. In July Delta and its regional affiliates controlled 76 percent of passenger traffic at Hartfield-Jackson Atlanta, according to figures from the airport. AirTran's market share was 17 percent in the same month. To Kelly, that signifies a high-fare environment ripe for Southwest service. "We need more flights on a combined basis [in Atlanta] than AirTran has today," he says. "And I do mean significantly more flights—more than a couple." Such a move could spark a fierce response from Delta, akin to a "defend the fortress hub strategy," as Hudson Securities analyst Daniel McKenzie wrote in a note to clients.

It is a known fact that most M&A's end up destroying value for the acquiring company's shareholders. If Southwest's growth is going to be driven by M&A's going forward, is this growth going to be profitable and will it be sustainable?

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