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The Sports Car

Southwest Airlines' acquisition of AirTran Airways opens new opportunities

Southwest Airlines' purchase of AirTran Holdings gives the airline access to new markets that appeal to leisure and business travelers alike.

■ By Mark Hess | *Ascend* Contributor and Lynne Bowers-Dodson | *Ascend* Staff

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SOUTHWEST

Buying a flashy sports car has long been held as a tell-tale sign that a man is speeding toward a mid-life crisis. The stereotypical event is triggered usually when the man realizes he wants to take a new direction in life rather than traveling down the same path. Similarly, does AirTran Airways represent the “sports car” that signals a new phase in the life of Southwest Airlines?

Business experts acknowledge that at some point in the lifecycle of every business, stakeholders come to the realization that fundamental change is needed. The first course of action is coming up with a vision of where the business is headed.

For Southwest Airlines, the US\$1.4 billion AirTran Holding purchase last year signals that it envisions a future where extended service to new domestic and international markets will accelerate its goal to boost profits and achieve financial targets.

The blockbuster deal will create the most expansive network of any low-cost carrier in the United States. It will also give the airline a chance to grab business travelers in the nation’s busiest markets.

Through the merger, Southwest, which already carries more domestic flyers than any other U.S. airline, will for the first time go head-to-head with Delta Air Lines on its home turf at Atlanta’s Hartsfield-Jackson International Airport, the busiest passenger airport in the world. It will also gain access to Reagan Washington National Airport in Washington, D.C., as well as capture increased

share at Boston Logan and New York LaGuardia. Southwest expects the acquisition will generate roughly US\$400 million in annual savings by 2013.

“Combining with AirTran makes good business sense for Southwest; it can add 38 cities relatively quickly, and many of these new markets are on the East Coast, where Southwest has had weak coverage,” said Tom Parsons, CEO of BestFares.com. “Without this acquisition, it would take Southwest eight to 10 years to add that many new cities.”

The Maturing Maverick

From its modest beginnings, linking Houston, Dallas and San Antonio, Southwest Airlines was a maverick set on revolutionizing air travel. It was affordable and it was fun. Its freewheeling culture, which famously showcased “hostesses” wearing skimpy hot pants who kept up an exuberant banter with passengers, was in stark contrast to the but-toned up network carriers.

Throughout the 1980s, Southwest remained the scrappy upstart, pioneering a new type of low-cost, low-fare, low-frills flying experience. It disproved the prevailing notion that passengers preferred service over price and stole market share from major carriers.

The carrier’s “cookie-cutter” method of moving into a new city and sharply cutting fares and driving up traffic was a driving force for dropping overall fares in its new markets. The so-called “Southwest Effect” was a phenomenon studied in business schools and by the U.S. Department of Transportation. In a 1993 report, DOT observed, “The principal driving force behind dramatic

fundamental changes that have occurred and will occur in the U.S. airline industry over the next few years is the dramatic growth of low-cost Southwest Airlines.”

Southwest grew organically and through acquisitions during the 1980s and 1990s. In the mid 1980s, it bought Dallas, Texas-based Muse Air. Nearly 10 years later, it acquired Salt Lake City, Utah-based Morris Air.

In 2005, it purchased assets from bankrupt ATA, but in 2009 it suffered a setback when it lost a bankruptcy court-sponsored auction to buy Frontier Airlines Holdings, Inc. Undeterred, CEO Gary Kelly said the carrier was still in the market for another deal. So it’s puzzling that the AirTran Airways acquisition last fall took much of the industry by surprise. Their route structures are complementary. And of their combined 604 unique markets, only 26 are served by both, less than a 5 percent overlap.

In a PBS interview, *USA Today* columnist and industry analyst Ben Mutzabaugh said the merger makes it apparent that Southwest plans to transform itself from a no-frills carrier into one that is more focused on business travelers.

“If you are going to be a serious business travel [carrier], you have got to be in the markets like Washington Reagan National, New York LaGuardia, Boston and Atlanta,” he said. “And this merger really positions them for that.”

Wall Street Journal analysts observed that Southwest has hinted for some time that it wants to shed its mantle as a traditional low-cost carrier. When the merger was announced, the news agency remarked that Southwest “is planning



LCCs Consolidate Southwest Airlines’ purchase of AirTran Airways forms the most expansive network of any U.S. low-cost carrier.

a raft of measures as it seeks to transition from a discount airline. The moves include a recently unveiled revamp of its frequent-flyer program to boost its appeal to high-value business travelers, a new reservations system, its planned US\$1.4 billion takeover of discount carrier AirTran and the purchase of bigger planes."

Still, Southwest executives say they have no plans to stray too far from the essential elements that have allowed the airline to post profits for the past 37 consecutive years.

"We have open seating; we have no plans to change that," said Gary Kelly in a press release announcing the merger. "We don't charge for bags; we have no plans to change that. We have single-class service; we have no plans to change that."

Driving Change

Conventional management wisdom says that companies, like people, must pass through a life cycle. Blogger Donald Sull, faculty director of executive education at London Business School, describes the progression.

"Start-ups begin their life in a period of rapid-fire experimentation, pass into the organizational equivalent of adolescence as the company scales its business model, eventually mature into the dull reliability of middle age, and then lapse into unavoidable decline," he said.

Sull rejects the inevitability of the metaphor, pointing out that companies do not pass through lifecycles. Opportunities do. Companies can avoid mid-life crisis and decline simply by seizing opportunities. And that's exactly what Southwest and AirTran Airways executives did last year as they read the handwriting on the recessionary wall.

Both carriers recognized that a flurry of legacy consolidations, such as Delta-Northwest and Continental-United, as well as the expansion of alliances, had created behemoth competitors for low-cost carriers. That combined with rising oil prices left stand-alone, low-cost carriers particularly vulnerable.

When the merger announcement came, AirTran Airways CEO Bob Fornaro stressed in a conference call with reporters that his airline had "done a lot with not much" in terms of financial resources, but that it was becoming less clear that AirTran Airways had the ability to grow and remain competitive in an industry where the size of a carrier's route network is increasingly important.

"Southwest has, relative to AirTran, vast resources," Fornaro said. It became clear that "we could do more with Southwest resources" than AirTran Airways could do on its own.

The combined airline will fly more than 100 million passengers a year out of more than 100 airports in the United States, the Caribbean and Mexico. And by creating a truly nationwide low-cost carrier, the merger will make Southwest a tougher competitor in the lucrative domestic business-travel market.



US\$1.4 billion purchase The purchase of AirTran Airways last year offers Southwest Airlines immediate access to 38 cities on the U.S. East Coast.

A merger will also open up more choices to budget-conscious leisure travelers since the Southwest Effect most likely will compel other carriers to match its low fares to virtually every corner of the country.

Last September, Parsons told *USA Today* reporters, "America needs this now. With this deal you can now go just about anywhere in the country, and to the Caribbean and Mexico, on Southwest. All the legacy airlines will have to set their prices based on whatever Southwest does."

The End Of An Era?

Not all industry insiders agree with Parsons' assessment that fares will remain competitive with a new super-sized Southwest. In fact, some think the opposite is just as likely.

Chief among the naysayers is blogger Carl Unger, who writes for *Today in Travel*.

"Southwest's costs have risen dramatically over the past 18 months, and are currently the highest among low-cost carriers," he wrote last October. "Its costs are still well below those of United, Delta or American, but the gap is shrinking. More and more, too, Southwest seems to be morphing into a somewhat traditional network carrier.

"Southwest has major hubs, especially in Baltimore, Chicago and Houston, and funnels much of its cross-country traffic through those cities. All of this — plus the fact that Southwest is eliminating a major low-cost competitor — suggests Southwest's role in the airline industry could be on the verge of changing. Even before the merger, *SmarterTravel* readers were noting that

Southwest no longer seems as low-priced as it had been. Perhaps that change is already under way."

David Grossman, veteran business traveler and former airline executive, also voiced concern that the Southwest-AirTran Airways deal may have implications beyond the merger of two airlines.

By agreeing to merge with Southwest, Grossman posits that AirTran Airways executives have conceded that their business as a stand-alone airline was at risk. If other low-cost carriers concur, he said in an article he wrote for *USA Today*, "this will likely not be the last merger or major action taken by an LCC. It could spell the end of LCCs as we know them if more consolidate, join alliances or morph into something better resembling traditional network airlines. That may not bode well for those who have enjoyed an extended spell of low fares."

Only time will tell if Southwest Airlines' midlife opportunity becomes a midlife crisis for a struggling low-cost carrier business model. Or perhaps the merger is added to the long list of things the carrier has done well throughout its impressive history. ■

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