

Finding the Formula for Success At



Few companies have achieved the performance and consistent awards that Southwest Airlines has. It has been able to develop an organization that is highly desirable to both employees and shareholders. While many companies attempt to study and emulate this organization, few have been able to achieve it. Let's review a few of the results this 25-year-old airline has achieved.

1. Southwest was named by Fortune magazine in 1998 as the number-one Best Place to Work, and it is consistently selected for other attributes such as best airline, most admired airline, and safest airline by other publications.
2. It has been the most profitable airline in the industry in the 1990s and has been profitable every year since 1973.
3. Southwest has been the fastest-growing company in revenues of all major airline carriers.
4. Southwest earned the Department of Transportation (DOT) "Triple Crown," which is the highest DOT ranking of all major airlines for on-time performance and fewest mishandled baggage, five times in a row. Best customer satisfaction was earned for seven straight years.
5. Southwest has one of the lowest operating costs of all major airlines, achieving around seven cents per available seat mile. This has enabled the airline to offer low-cost fares that routinely beat the competition.

While the list can go on, the important point is that Southwest Airlines has achieved remarkable performance by almost any standard. This is within an industry environment that is undergoing major change. The airline industry is both consolidating, as the major carriers form alliances and mergers, and experiencing many new entrants in local markets. While the current cost of fuel is low for recent historical standards, the competition is becoming more intense. This has kept prices relatively low and offered passengers more choices.

The pressure on margins is quite intense. The cost of equipment is growing and labor costs continue to be an important component of the total operating costs. Deregulation of

the markets, with intense regulations of operations, equipment, and procedures, requires multiple responses to regulatory pressures. Many experts indicate that this is the most difficult industry in which to compete.

So what has been the secret to Southwest's success? The answer is not due to any particular technology, equipment, market niche, or program. The success of Southwest Airlines is due to its culture. But a culture does not just happen; it is created. This case study will examine how reward systems have played a supporting role to building and sustaining this culture of high performance.

Overview of Southwest Airlines

Southwest Airlines was started in 1971 by the current chairman, chief executive officer, and president, Herb Kelleher, and board member Rollin King. The concept was to build an airline that provides lower-cost point-to-point services delivered with more efficiency and service than any of the major airlines. The company has grown from a regional airline to a major national force. The company has been able to survive recessions, oil embargoes, and deregulation. It achieved a profitable operation after three years from start-up. The company has had no furloughs or layoffs in its history and seeks to continue this track record. More than 85% of its 26,000 employees are unionized. The relationship with the unions is clearly one of mutual commitment, trust, and support.

The culture of the company can be characterized in many ways. First, there is a great deal of freedom and responsibility. People are encouraged to contribute ideas and take actions that will serve the customer and improve the organization. People know the regulations of the industry and maintain an intense commitment to meeting these core requirements. By maintaining a high commitment to the industry regulations, people are able to focus on serving the customers.

Second, there is a high level of involvement throughout the company in making decisions and recommendations for change. People see their ideas seriously considered and many implemented. The company prides itself in constantly renewing and seeking better ways to do things. For example, there are more than 120 people on the Corporate Culture Committee, and even more in culture committees established in each department and location. People at all levels are involved making improvements to promote and enhance the culture—operations and services are addressed in their functional areas. These committees have formed the backbone of the culture-building process for the organization.

Third, most of the culture is sustained by hiring people who match the profile of the desired employee of the company. There is perhaps no more important decision than who is hired for the organization. Even with the tremendous growth in the company and decreased availability of qualified workers, Southwest has not lowered its standards to fill jobs. Herb Kelleher believes the culture starts with the hiring process.

The recruitment and selection process involves a great number of people and reflects the commitment by sustaining the desired culture and retaining the individual. Much of the interview process is based on examining how people have handled various situations in their experience and how they would address current situations. From these in depth interviews, the true character of the person emerges, and the selection team can determine the degree of fit with the organization. They want people to be successful and to be themselves during the interview process. This applies to how they select pilots, operations staff, and administrative support staff. Every hiring decision is a commitment to the person and a statement about the company's culture.

Fourth, training is strongly supported and emphasized at all levels in the organization. But training goes beyond skill development. The purpose is not to train people to just do their jobs, but to “color outside the lines” and to use their initiative to fill the gaps in functions, departments, and operations to better serve the customer. So, even in the training process, the culture of involvement, action, and customer service is reinforced. Finally, Southwest seeks to remain flexible in how it utilizes employees and to respond to career aspirations of their people. New hires usually join the company at an entry level in the organization, including the pilots, who join as first officers. They are then expected to progress within the organization as they acquire better skills and become proponents of the culture. People are selected for internal promotions and transfers based on a combination of technical skills and personal style. Managers who are not strong reinforcers of the firm's culture seldom advance and usually leave the company. Managers are leaders within the organization and need to operate consistently with the values and principles of Southwest Airlines.

Consequently, the hiring, training, placement, and development of people have become the key levers by which the organization sustains its culture of high performance. Libby Sartain, vice president of people, has said, “The Southwest Airlines culture is designed to promote high spirit, avoid complacency, and prevent a hierarchy or bureaucracy from slowing down creativity and innovation. Breaking the rules is often rewarded, and employees are expected to do the right thing when tough situations arise—they do. It's the airline's philosophy that employees with a sense of ownership in the company usually will make the right decisions for the company.”

Integrating Rewards into the Fabric of the Organization

Southwest Airlines has characterized its reward systems as basic. However, they are viewed as a process for supporting and reinforcing the airline's philosophy. In a 1992 letter to shareholders, CEO Kelleher stated, “Material rewards are important—to a point—but they also prove hollow unless accompanied by the satisfaction of pride, excitement, fun, and collective fulfillment. Our people provide these essential intangibles to each other and to our customers.” Hence, Southwest views salaries, variable compensation, and recognition programs as part of the process of management and highly integrated with the things leaders and people do on a day to day basis.

Since unions represent most of Southwest's employees, the wages and salaries are covered by union contracts. For most people this means that pay is related to seniority. This is important because Southwest values retention and long-term commitment to the organization.

Furthermore, pay levels are either consistent with or slightly below the wages for various markets. In fact, starting rates are low relative to the market, but they progress more rapidly than others to desired market levels. This keeps the salary costs in line with the low-cost provider philosophy of the company.

The CEO is compensated at below the median of the market for executives in companies of similar size. Other senior managers are paid slightly higher relative to the market, but they retain a smaller portion of the company's stock. The philosophy is to underpay the executives for cash compensation but let them share in creating greater value for the shareholders by building a stronger, more competitive airline. The stock options are not discounted, and executives have the same opportunities for stock purchases as other employees. The emphasis is on long-term growth and development of the corporation. Furthermore, there is a strong commitment to make the compensation levels and pay opportunities internally fair.

There are limited variable pay programs. Perhaps the most inclusive is a corporate wide profit-sharing program. This program was started in 1973 and encourages everyone to keep costs as low as possible. Everyone shares equally based on their earnings and the company's profits. Those who work longer hours or fly extra trips receive a larger piece of the profit-sharing payouts. Historically, the program has paid a mix of cash payments and deferrals to retirement accounts. Employees requested several changes in the program, and in 1990, the total contribution was made on a deferral basis. This enables employees to build a larger nest egg for their retirement.

The retirement plans offer a variety of investment options, including Southwest stock. The employees currently hold between 9% and 10% of the company. When the stock performs well, everyone gains. Many long-service employees have retired quite wealthy from this investment. But once again, individuals need to take responsibility for their own retirement; the corporation makes the process easier (a further reflection of Southwest's culture). Company stock is an important device for sharing the risks and rewards of the company's performance. In addition to profit sharing investment options, employees can purchase stock with payroll deductions at a discount through the employee stock purchase plan. Furthermore, the recent pilot union contract enables pilots to gain even greater investments in the company through stock options and deferral of wage increases. The profit-sharing and stock options programs have encouraged everyone to share in the task of holding costs down and working together to benefit the airline and the customer. Finally, it is important to note that the stock price is displayed in each facility, and people watch it everyday.

Southwest makes limited use of team or unit-based incentive programs. Instead, it relies on an extensive series of special recognition programs to encourage and reinforce desired

behaviors. These programs have limited the need to provide special incentive compensation programs, and they have supported the cultural values of Southwest.

There are a wide variety of both corporate and local-unit based recognition programs. They change every year and remain exciting, involving, and fun. For example, “Heroes of the Heart” is a way to recognize teams of individuals whose behind-the-scenes work make a major impact on customer service. They may be groups from maintenance, service, or support roles. They are selected through an extensive nomination and review process.

They are honored by having the group’s name painted on an airplane for one year. The award ceremony is one of the major events of the company, and many people share in the excitement of the presentation.

The senior executives acknowledge every commendation made to both the person who received it and the person who gave it. This enhances the importance of the awards given to individuals and reinforces those who provide them. Furthermore, there are numerous programs to recognize and reward individuals, teams, and entire departments for their contributions. These programs are encouraged and supported with advice, financial resources, time, and experiences from other locations.

Space does not allow for a full description of these programs, but note some of the titles:

- Together We Make It Great
- Ticket to the Future
- Walk a Mile
- Helping Hands
- Stuck on Service
- Go See Do
- Winning Spirit

Furthermore, some of the awards are as creative as the programs. These include:

- Joe Cool Award
- President’s Award
- Top Wrench Award
- Superstars
- A Shining Star
- Voice Award

Many of these programs were developed and managed by local committees of employees. The “people department” provides advice and assistance as needed and may refer developers to other locations for ideas and solutions to problems.

The key concept is to reward everything that people like; they celebrate everything—birthdays, anniversaries, promotions, and especially special efforts. For example, when Southwest Airlines took over several Midway Airlines operations in Chicago, the

transition team discovered that another airline had taken over some of Southwest's gates. The Southwest Airlines employees took the facilities and properties back and created the logistics for the airline to operate at the airport.

When they returned to their home base, they were welcomed with banners that read: Welcome Home, Chicago Banditos! People in the crowded lobby cheered when the team entered, and everyone took great pride in their achievements.

Recognition is part of everyday life. Celebrations occur daily and weekly somewhere on Southwest property. They have taken the spirit of recognition to new levels of excitement and involvement. It is an important responsibility of managers to support these activities, and many, many people are involved. Furthermore, the awards are presented in a meaningful and fun manner. Some of the awards include small cash awards, gift certificates, savings bonds, books, tickets to events, champagne, watches, extra time off, extra breaks, t-shirts, flowers, and whatever is creative and meaningful to employees. The awards are always changing. The important message is to not rely on a single program or a single award; they must be continually refreshed with spirit and innovation.

Have You Discovered the Secret Yet?

Southwest Airlines indeed has a secret. It can share this information because the answer does not lie in the programs. Instead, the culture fosters a process and the process fosters a culture. It is an environment where people can experiment, make mistakes, learn, and try again. Initiative is expected, encouraged, and rewarded.

They have transformed compensation into rewards, pay programs into appreciation. They gain a high positive impact from the various reward programs because of the way they are delivered. There are many avenues by which people are told they are valued by the company. In turn, people value the customers and the company. Consequently, commitment is high and employee turnover remains one of the lowest in the industry. This has resulted in an organization that is highly competitive, resourceful, and achieves remarkable results.

Herb Kelleher has stated, "The difference is in the dedication and spirit of our people. And, that is very hard for our competitors to emulate."