

University of Texas at Dallas – 2014 Project Management Symposium

## **Leading Change at Southwest Airlines**

August 15, 2014

# Introduction

- David Harvey, Sr. Director Network Planning & Performance
- Started at Southwest in 1999 (Technology, Strategic Planning, Commercial)
- Currently lead Commercial and Capacity Planning



**“In life, the most prepared almost always wins”**

**- Herb Kelleher**

**“If you don’t know where you are going, you are  
certain to end up somewhere else”**

**- Yogi Berra**



# Contents

- Brief Southwest Airlines **business update**

- Starts with alignment on our **Purpose and Vision**
- Utilizing strong **3PM** (Portfolio, Program, Project) **practices** to lead change
- Modernizing and planning for future growth at **Dallas Love Field**



# Brief Southwest history

- Based in Dallas, TX with initial service starting in June, 1971
- Began service with just three aircraft serving three cities
- Southwest Airlines (*NYSE: LUV*) is the nation's largest in terms of domestic daily departures and passengers carried
  - 3,600+ flights per day; ~700 aircraft; 125M+ passengers annually
- Today serves 93 cities in 41 states, Puerto Rico, and six international countries
- Profitable for 41 consecutive years; approaching \$18B in 2014 revenues
- Lowest number of Customer Complaints since DOT began collecting stats in 1987
- Never had a layoff; most heavily unionized airline in the business; 46k employees



# State of the business

- Record 2Q'14 net income of \$485M driven by \$5.0B in operating revenues
- Record nominal profits for five straight quarters beginning 2Q'13
- As of June 30th, trailing 12-month Return on Invested Capital (ROIC) of 17.1%
- 3Q'14 showing favorable bookings and revenue trends
- All-time high stock price of \$29+ per share
- Balance sheet, liquidity, and cash flows remain strong
- At May '14 Shareholders meeting our Board of Directors approved 50% increase in our quarterly dividend and a new \$1B share repurchase program
- CEO recently announced a LUV cash award (\$200) as a Thank You to all employees



# Key milestones

- On July 1<sup>st</sup> Southwest launched international service (Aruba, Nassau, Montego Bay)
  - All seven AirTran international destinations to be converted by end of year
  - Strong growth opportunities in 2015 and beyond (50+ destinations)
- On schedule to complete integration of AirTran brand and network by end of 2014
- Very excited of recent acquisition of New York LaGuardia and Washington Reagan National slots enabling new service
  - By year end we will be 3<sup>rd</sup> in seat share in LGA and 2<sup>nd</sup> in DCA
- Full repeal of Dallas Wright Amendment on October 13, 2014!!!
  - Launching many new non-stop destinations from coast-to-coast
- HOU International terminal on schedule for end of year 2015 opening
- Recently named to FORTUNE's 2014 list of World's Most Admired Companies for the 20<sup>th</sup> consecutive year; Only commercial airline in the Top Ten



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# Historically we have executed a rigorous strategy better than any other airline



## Where to play?

Domestic, short-haul routes between underserved medium-to-large cities, targeting price sensitive leisure and business passengers

## How to win?

Why do customers choose us?

What competitive advantages must we have?

- 1 Create high **customer advocacy** through low fares, reliable and friendly service, and customer policies
- 2 Develop highest operational efficiency and lowest complexity in industry, leading to **lowest cost operations**
- 3 Create a culture of **employee empowerment**
- 4 Deploy a **repeatable market strategy**
- 5 Create **balance sheet strength** to fund investments



## Value Proposition

Unmatched simplicity and productivity in our activity system creates our significant cost advantage, enabling low fares that stimulate demand, and ultimately creates **defensible leadership positions**



# We continued to translate that strategy into a clear set of business choices

## “How to Win” elements



## Business Choices

### 1 Customer advocacy

- Simple pricing structure considerably below competition
- No fees
- High frequencies on many routes served
- “Fun” flying experience

### 2 Lowest cost operations

- Highly efficient, simple operating model:
  - Single aircraft type and product/configuration
  - High aircraft/gate/employee utilization
  - Point-to-point domestic network structure, w/ use of secondary airports

### 3 Employee empowerment

- Hiring for attitude vs. skill: employees that go out of their way to solve Customer problems and celebrate events

### 4 Repeatable market strategy

- Target new stations that match profile: base of underserved, short-haul routes between major cities, in high fare environment
- Add routes between leadership positions once established

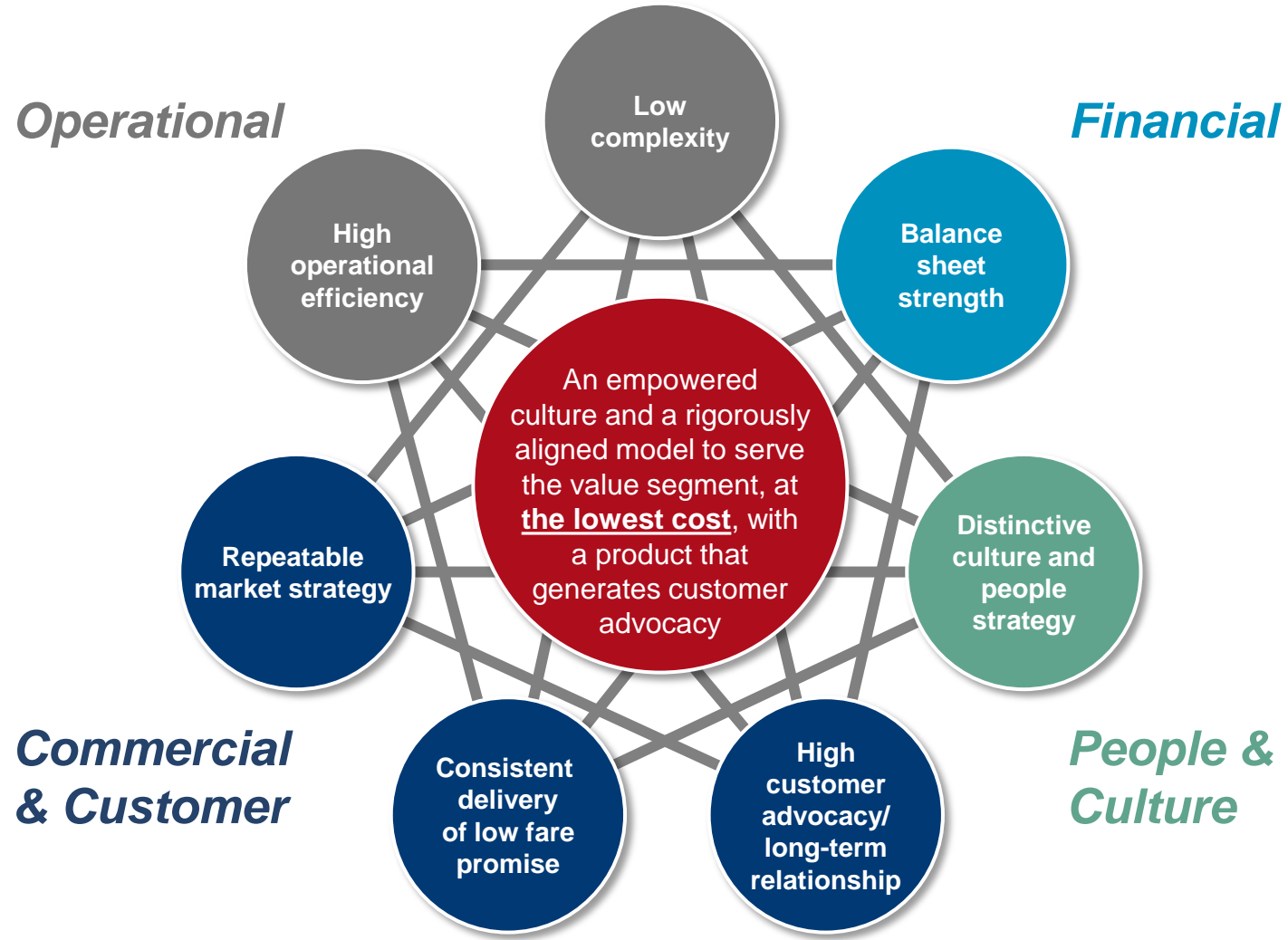
### 5 Balance sheet strength

- High cash balance to support operations
- Limited debt
- Financially sustainable growth initiatives



As a result, each element of our strategy reinforced our ability to win...

**SWA historical source of competitive advantage:**



# Over time, external and internal pressures placed stress on our strategy and model

## MACRO CHALLENGES

- Fuel price escalation and volatility
- Frequent and deeper economic shocks (2001, 2008, 2012)
- Increasing regulation

## COMPETITIVE CHALLENGES

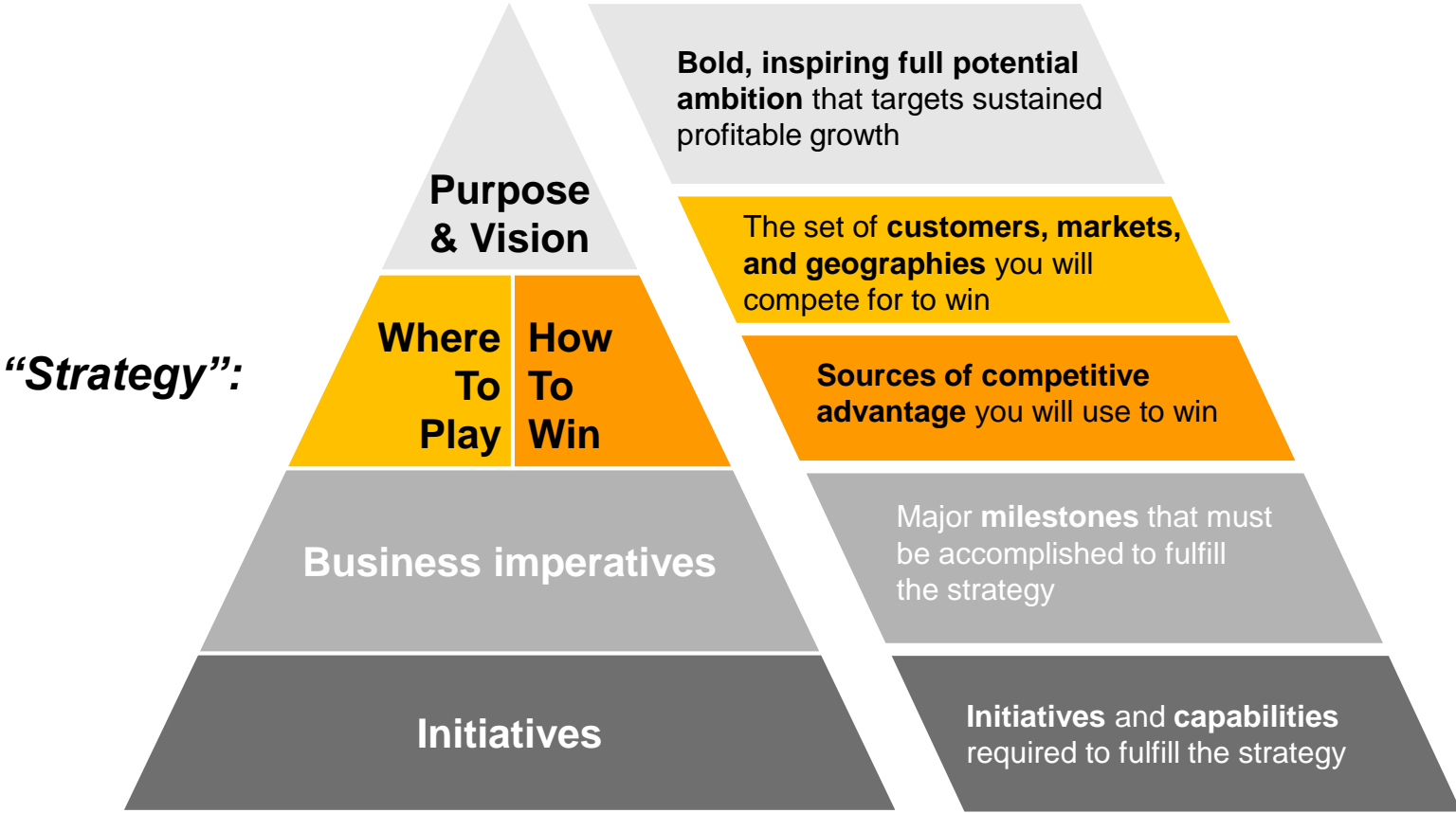
- Emergence of “ultra-LCCs”
- Industry consolidation
- Legacy carriers cost reset via restructuring/ Chapter 11
  - Unbundling of services (smaller visible fare differential)
  - Flat U.S. domestic capacity

## INTERNAL CHALLENGES

- Exponential increase in input costs
  - Fuel hedge expiration
  - Labor wage escalation
- Increased scope & scale driving new business complexity
- Aging/ restrictive infrastructure
- Diminishing number of highly attractive new markets



# To confirm our strategy and long-term company plan we began to re-examine our Purpose and Vision back in 2010

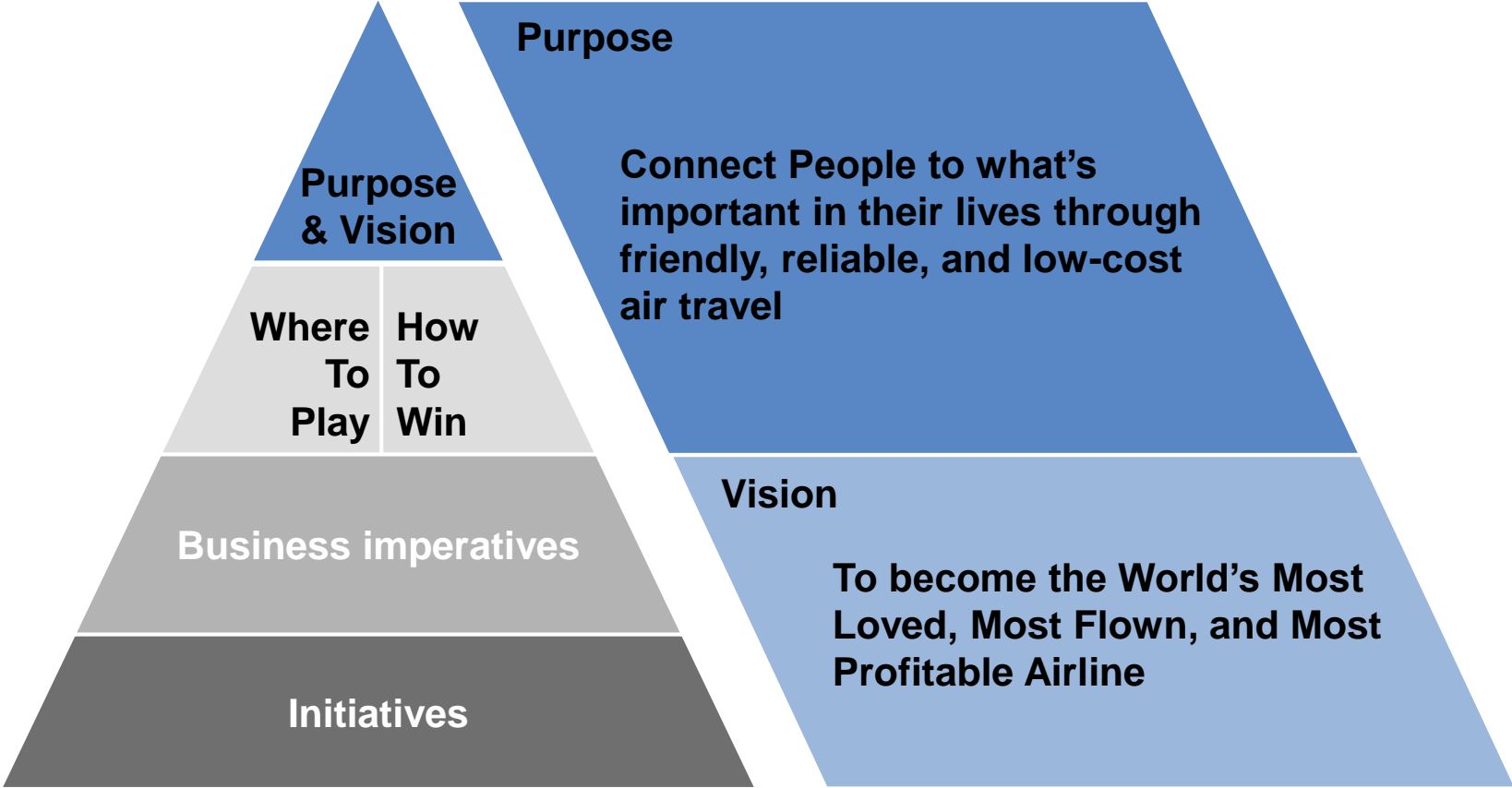


**A good strategy...**

- ...articulates exactly how we will beat the competition and in which markets
- ...defines business imperatives and provides a compass for deciding which initiatives to undertake or not



# We ended up revising our Purpose and Vision to guide decisions and investments out to 2020 and beyond



# Many of the ways we are evolving our business model enable lower costs, new capabilities, and ultimately profitable growth

“We are in the midst of a bold, five-year strategic plan that began in 2011. We continue to focus on key strategic initiatives: **AirTran integration**, **All-New Rapid Rewards®** frequent flyer program, **fleet modernization**, the addition of the **Boeing 737-800**, and new **reservation system and international capabilities**.”

Gary Kelly, 2012 Annual Report

SWA in the past	SWA in the present / future
•Single fleet type	•Multiple fleet types
•Domestic flying only	•Domestic and International flying
•Short haul flying	•Mix of short haul and long haul flying
•Point-to-point network	•Blend of P2P & flow
•No airline partnerships	•Codeshare with other airlines
•Single class of service	•Product differentiation
•High frequency markets	•More low frequency markets

Where and how we win clearly aligns with our Purpose and Vision



# Southwest continues to transform to meet the demands of our Employees, Customers, and Shareholders



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**EARLYBIRD  
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**INTRODUCING!** **THE ALL-NEW RAPID REWARDS®!**

- No blackout dates • Every seat is a reward seat • Points don't expire

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In a very volatile environment we choose to plan and act, rather than react

**U.S. Airline Industry Bankruptcies, 2000-2011**

<b>Chapter 7</b>	 2008	 2004	 2003
	<b>Chapter 11</b>	 2011	 2008
 2005		 2005	 2005
 2005		 2004 & 2002	 2003
 2002		 2001	 2001

SOURCE: Airlines for America (A4A)



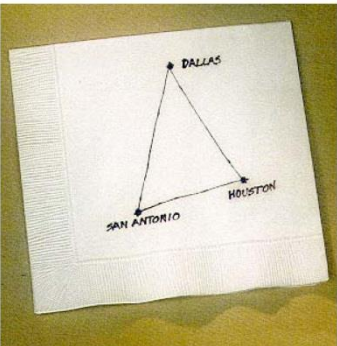
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# As Southwest has grown, our planning capabilities have expanded


## 1971



3 Cities  
3 Planes  
195 Employees  
\$3.7M Loss

**Shoebox**


## 1990



34 Cities  
106 Planes  
8,620 Employees  
\$51M Profit  
\$480K/plane

**Lotus & Quattro-Pro**

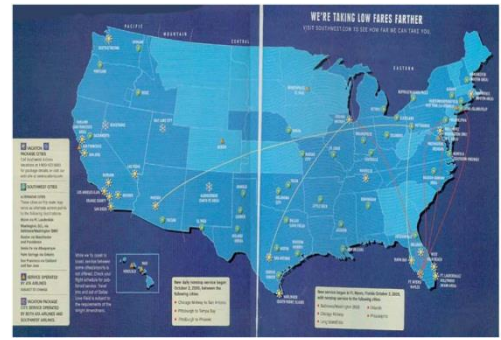
## 2000



58 Cities  
344 Planes  
29,274 Employees  
\$625M Profit  
\$1.8M/plane

**Hyperion Pillar & Essbase**

## 2005



62 Cities  
445 Planes  
32,000 Employees  
\$548M Profit  
\$1.2K/plane

**PMO Processes and Tooling**



**Today we have 93 cities, ~700 planes and 46K Employees**



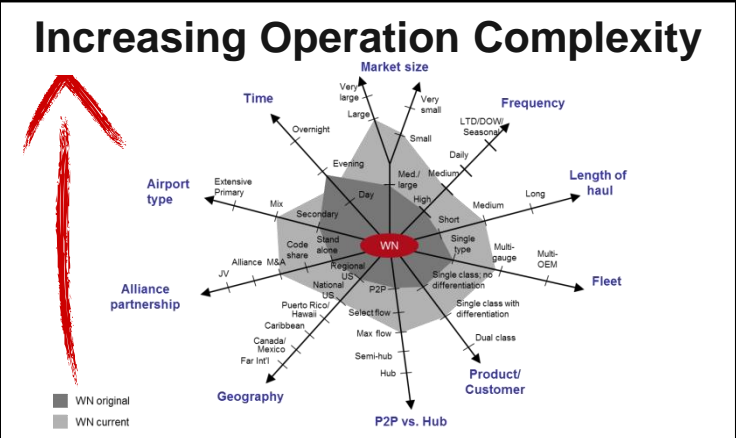
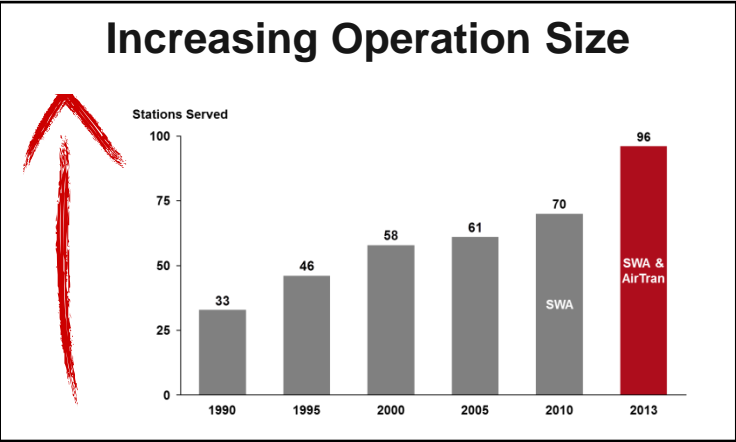
In recent years, our company faced new planning and coordination challenges as our operation became more complex

## ORGANIZATIONAL CHALLENGES

- Increased need for additional cross-functional planning coordination
- More clouded view of interdependencies amongst larger projects and initiatives
- Planning efforts overloaded during **Annual Operating Plan (AOP)** season

## BUSINESS IMPLICATIONS

- Occasional reactionary “fire drill” decision-making
- Duplicative work efforts across functional groups
- Infrequent “blind spots” for project interdependencies

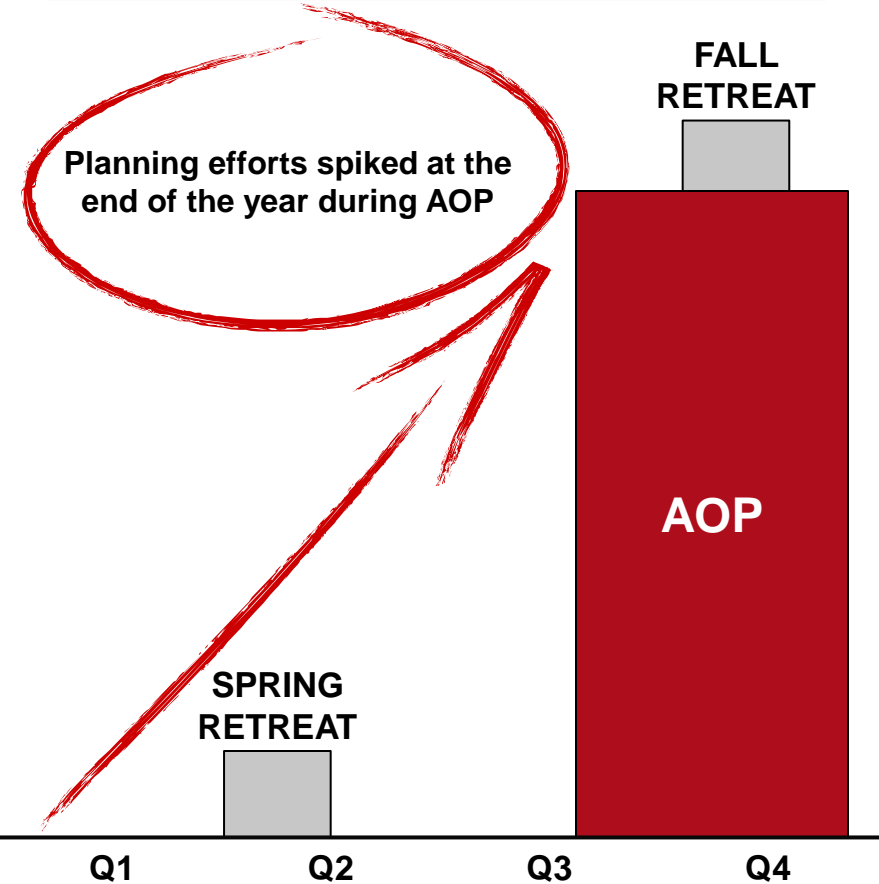


# The growing size and complexity placed additional strain on planning efforts for the organization during AOP season

## AOP CHALLENGES

- Many planning efforts condensed and squeezed into AOP season
- Strategic fleet and capacity discussions competed with AOP budgeting efforts
- First cuts at future project prioritization, financial targets, and scenario planning took place late in the year, placing additional planning strain on the organization

## LEVEL OF PLANNING EFFORT



# Cross-functional teams adjusted existing processes and created new tools to further enhance planning and coordination

## ENHANCEMENT OBJECTIVES

- Increased cross-functional planning coordination
- Greater project interdependency visibility
- Earlier identification of issues and key decision points
- More evenly distribute planning efforts throughout the calendar year
- Launch of a single portfolio reporting tool for major company initiatives
- Creation of multi-year financial guidance tied to business plans



**Company Master Plan**  
Key items reported throughout the year  
Highlights at risk projects & key upcoming dates

**Mid-Term Plan**  
3-year financial forecast based on strategic plans  
Aligns Business Area actions and plans

**Functional Planning**  
Commercial Master Plan  
Ops Master Plan  
Integrated Fleet Plan

**Enterprise Performance Management**  
Enterprise Performance Reviews



As Mid-Term Plan matures, prioritization and analysis work is feeding more seamlessly into AOP

**Mid-Term Plan**  
*February-June*  
Strategic Fleet and capacity discussions  
Forward-looking project prioritization  
Initial view of next year's financial position



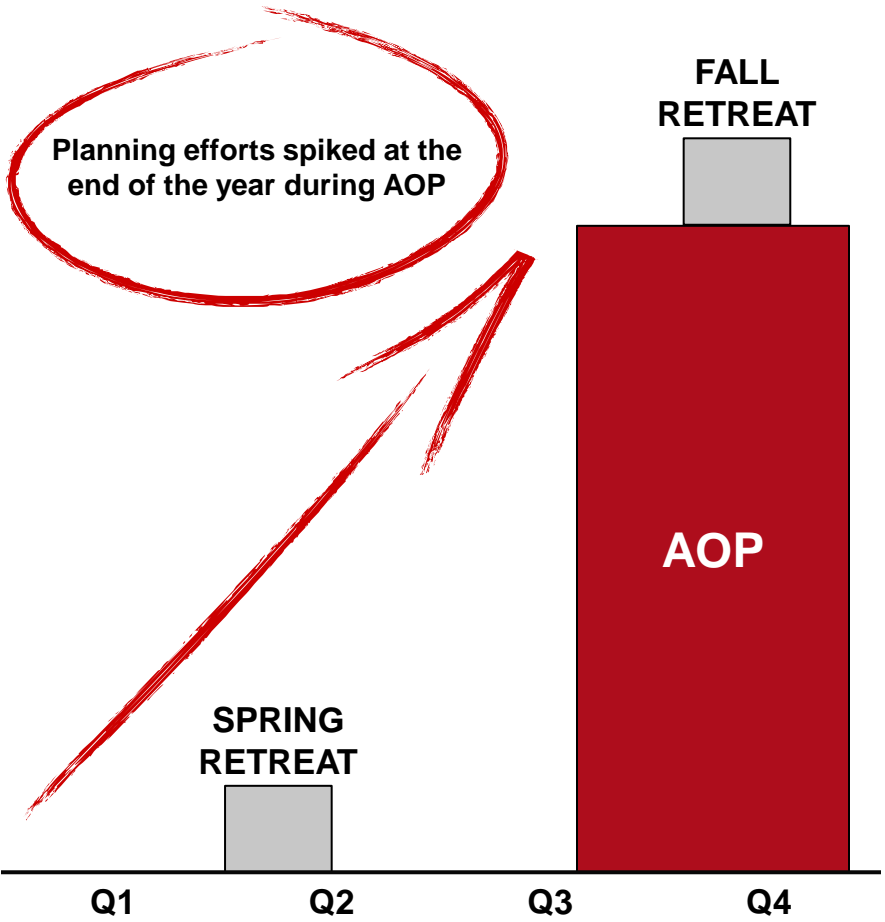
**AOP**

***AOP continues to be the bedrock of our planning processes, and the new tools are beginning to further enhance this traditional area of strength***

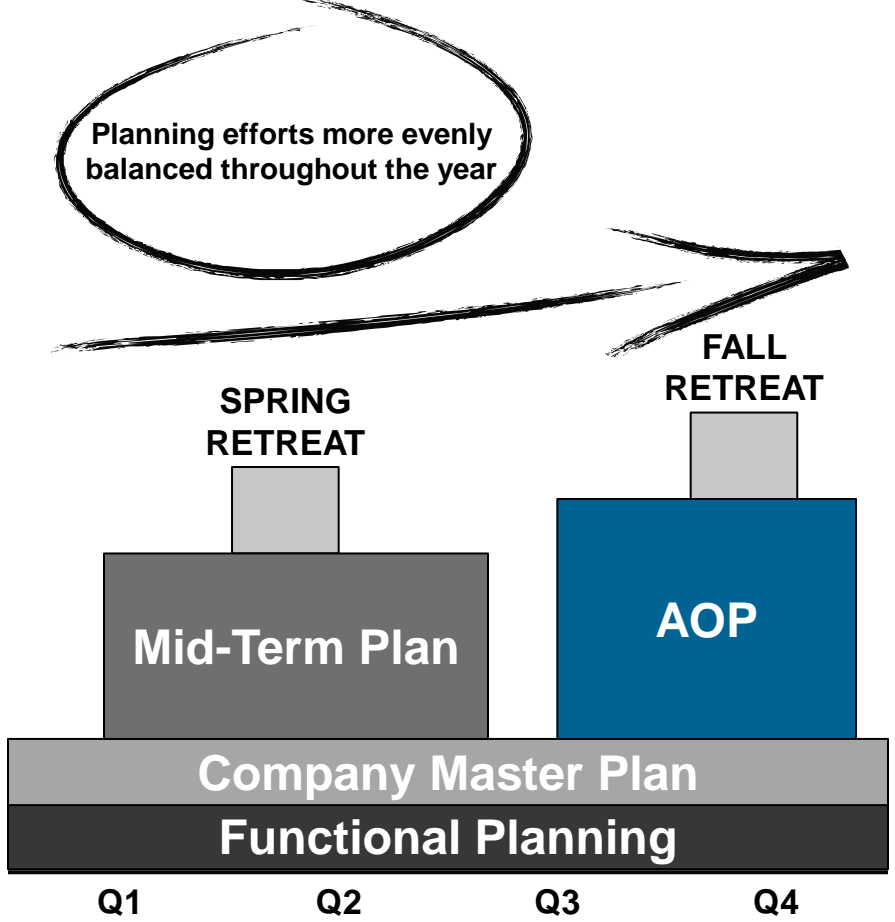


The addition of Mid-Term Plan is helping smooth and balance the level of planning efforts more evenly throughout the year

### PRIOR YEARS



### PLANNING GOAL





# Southwest's investment in improved planning capabilities

- Realization that company planning begins with Purpose and Vision, strategic plan and financial objectives
- Decision to strengthen planning process and investment in both corporate-wide planning (i.e. Mid-term / Master Plan) and functional planning
- Key integrated functional areas with focused investment
  - Commercial / Customer
  - Operations
  - Fleet
  - Labor
- Strengthening core business through geographically segmented approach (expectations, planning, performance)
- Implementing capabilities to rapidly monitor, report, and adjust plans



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# Dallas Love Field Modernization Program (LFMP)

# LOVE | EVOLUTION

THE NEW DALLAS LOVE FIELD AIRPORT



Airport aerial – July 2014



# Customer reaction to New Love Field: “Wow!”



*Customers love the new DAL facility. Their enthusiasm is clearly evident:*

"I believe the overall feeling of Love Field is great. Very customer-friendly." *Arriving Customer*

"Jaw dropping! Wow. Beautiful surroundings. State-of-the-art technology. Convenience."  
*Departing Customer*

"OMG, it is beautiful! Wonderfully renovated. Huge windows, artwork. Hard to believe I was at Love Field." *Departing Customer*

"I think the work that has been done lifts travelers' spirits. Traveling is tiring, people are weary, and in older airports the lighting is dim. I found Love Field to be just the opposite. It seemed people were energized by the light and cleanliness." *Arriving Customer*

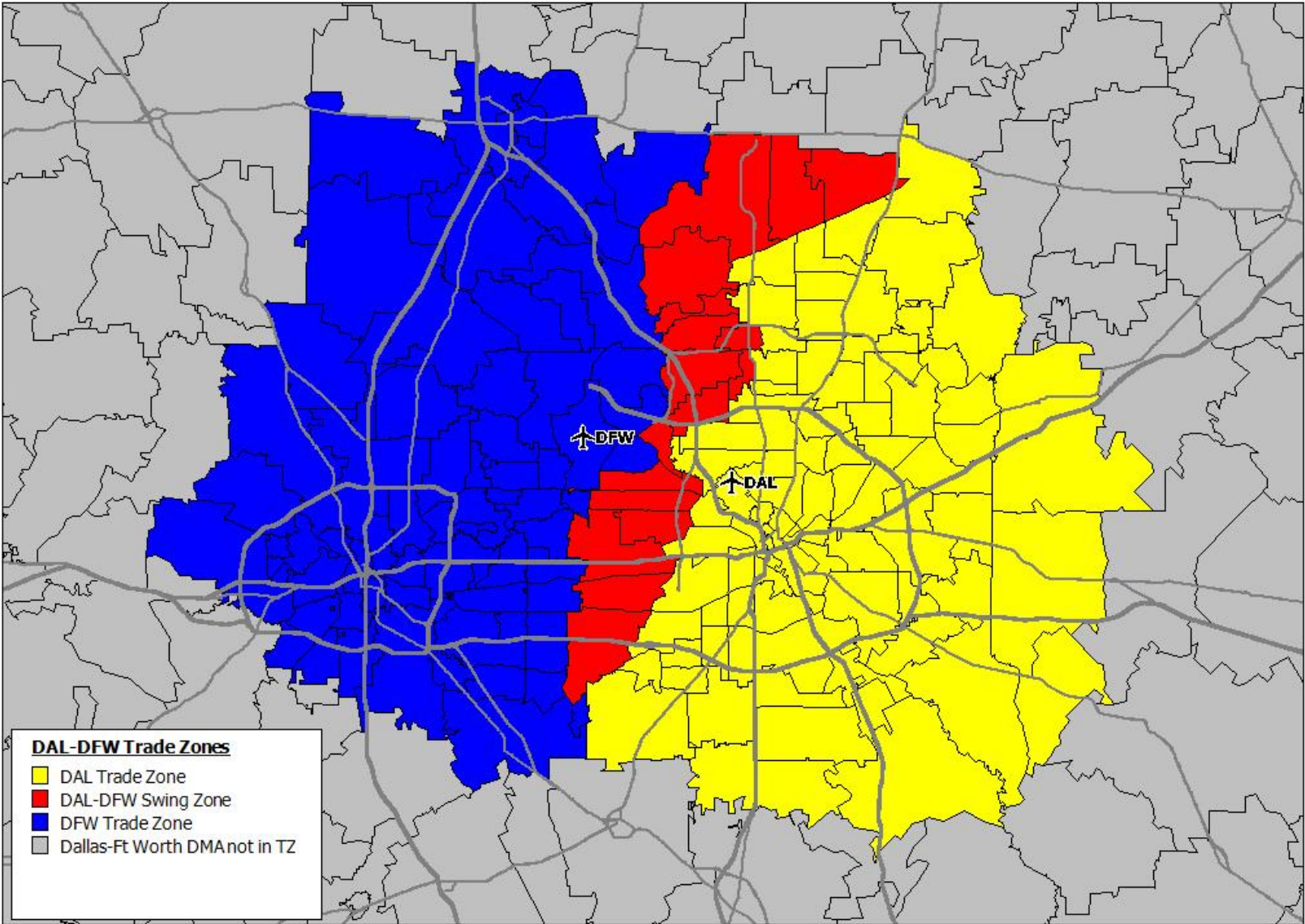


# LFMP scope of work

- The LFMP is a **\$519 million project** with initial funding by Southwest Airlines
- The LFMP **rebuilds and renovates an 892,000-square-foot facility** (255,000 square feet of renovated space and 637,000 square feet of new construction)
- Enabling projects, including roadway and fuel system improvements and \$70 million of apron pavement work, are also part of the program
- Corgan Associates is the Designer and Lead Architect
- Hensel Phelps Construction Co. is the Construction Manager
- Once completed, Love Field will **host one centrally located concourse for all airlines**, eliminating the original three concourses
- Love Field's Ticketing/Checkin and Baggage Claim will be **redesigned to increase travel efficiency**
- In 2013, the airport saw 4.2 million enplanements. The LFMP is expected to allow DAL to **handle upwards of 7 million annual enplanements.**

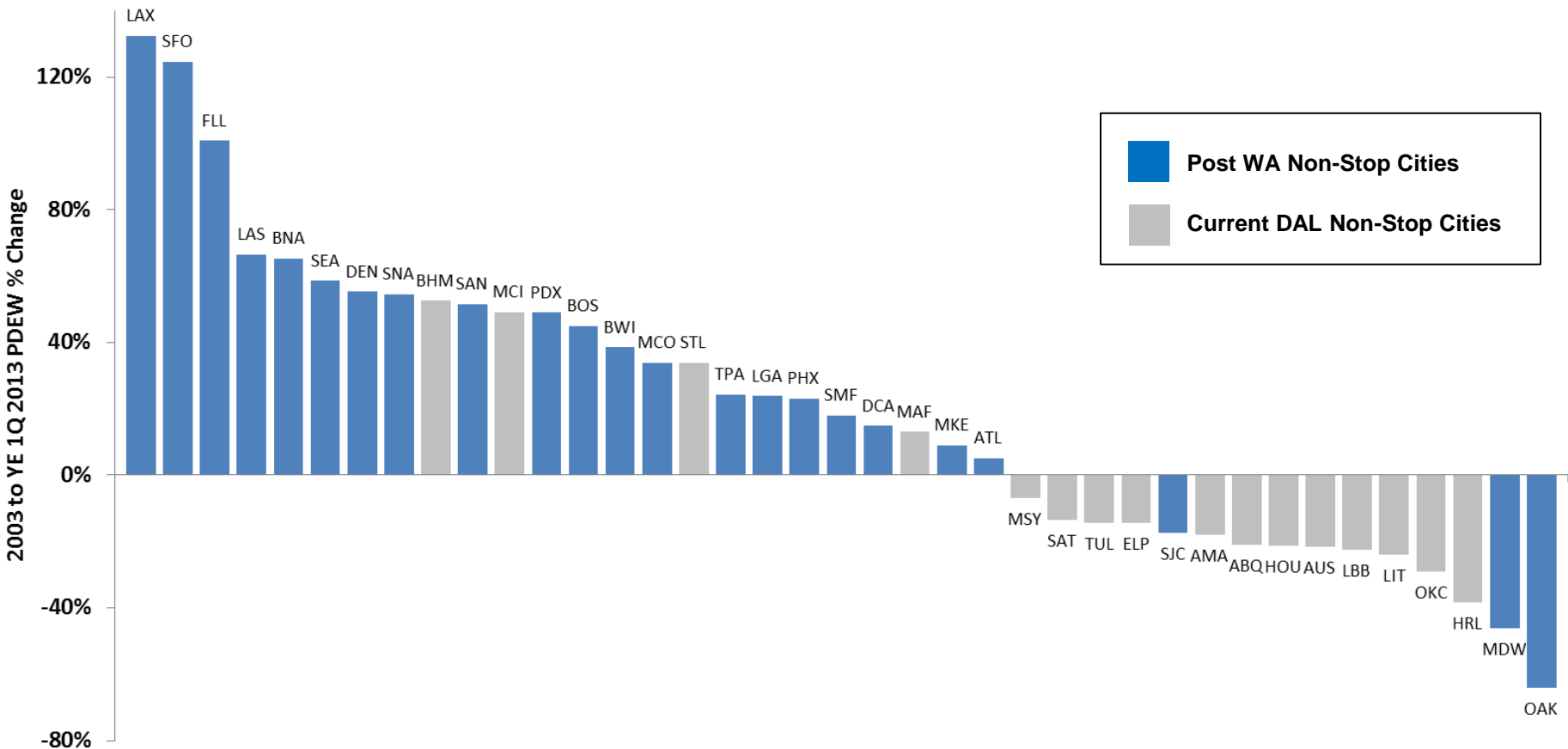


# Dallas Love Field Customer development plan



# DFW and DAL traffic change since 2003

Over the last 10 years short haul traffic out of Dallas to current Southwest non-stop cities has primarily decreased while new long-haul post Wright Amendment routes have seen higher growth rates.





# All of this integrated planning enables new flights from coast to coast out of Dallas Love Field

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Where We Fly

Wright Amendment

Rapid Rewards<sup>®</sup>

Why Fly



## HELLO NEW NONSTOPS.

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# LFMP achievements

- The LFMP has **exceeded its commitment goals**, established by the City of Dallas' Business Inclusion and Development (B.I.D.) Program, of working with Minority and Women-Owned Business Enterprises (M/WBEs)
- On September 1, 2011 was **recognized by President Obama's Job Council** for the private/public partnership to build the new airport
- In October 2012 the Dallas Regional Chamber **recognized Southwest Airlines for Total Job Growth in Dallas** much of it due to the LFMP project
- The Love Field Modernization Project is **worth over \$1.2 billion dollars to North Texas**, and has brought **more than 9400 jobs to Dallas**
- While the City requires public buildings to have an art program, Love Field's program is a very cost-effective one and is integrated as part of the design of the building. Some pieces are stand-alone, but many of the \$3.25 million program are integrated into the terrazzo floors, or window treatments and walls.



## A few final thoughts...

- In 2014 we are on plan to **achieve record profitability** and surpass 15% ROIC for the full year
- Our 2014 focus will continue to be on **delivery** (complete AirTran integration, launch Southwest international service, start reservation system replacement) and **performance** (financial, operational, Customer)
- Strengthening our low-cost advantage while enabling new capabilities will continue to **enable profitable growth** the back-half of the decade (2020 strategic plan)
- We are well on our way to **realize our vision** of becoming the World's Most Loved, Most Flown, and Most Profitable Airline
- If you haven't already, come out and try the **New Dallas Love Field** with new long haul flights starting on October 13<sup>th</sup>



# Questions



**10.13.14**  
**MORE LOVE IS COMING.**



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## Other notable items

- Completed **WiFi** install across fleet
- Announced **Amadeus** as provider of our domestic reservation system
- Continue modernizing our fleet (**Evolve** interior and **737-800**)
- **All-New Rapid Rewards** continues to outperform
- Launched **Mobile Boarding** system wide
- Partnership with **Dish Network** for free streaming TV
- Opened new state of the art **NOC** (Network Ops Center) and **Training facilities**



# LFMP Factsheet

## THE OLD LOVE FIELD AIRPORT

- The City of Dallas owns and operates Love Field.
- The current Love Field was constructed to host 32 gates and 3 individual concourses to support all airlines. Love Field is currently served by Southwest Airlines, United Airlines, and Delta Air Lines.
- Love Field serves as the front door to Dallas for approximately 7 million passengers each year.
- Love Field offered more than 120 daily flights to 17 nonstop destination, with additional direct or connecting service to approximately 60 markets.

## THE NEW LOVE FIELD AIRPORT

- Aging facilities will be replaced with a modern 20-gate concourse, new Ticketing/Checkin and Baggage Claim area.
- Terminal design respects the unique history of Dallas Love Field, preserving treasured features such as the World Map and Texas Ranger Statue.
- Expanded curbside and roadway will provide efficient passenger pickup and drop-off.
- Passengers will have a higher quality selection of food and retail concessions that include local and popular eateries upscale dining, a wine bar, and finer clothing stores and travel shops.
- The Terminal will be constructed to achieve Leadership in Energy and Environmental Design (LEED) Silver Certification.



# LFMP business partnership

- The Five Party Agreement limited how much the city could spend in capital improvements to **\$250 million**
- Once project scope was solidified the cost was greater causing Southwest Airlines and the City to agree to a **higher capital project if the airline could control the project's schedule and budget**
- Under this arrangement, Southwest Airlines became an agent of the City and **undertook management of the improvements to Love Field**
- The City created a local government corporation, which issued debt that was used to finance the LFMP. Southwest Airlines, “in true partnership,” pledged its corporate credit as the backstop on the debt, making the **airline responsible for the debt service.**



## LFMP business partnership (cont...)

- Additionally, the City **executed a revenue credit agreement** whereby the city collects fees and revenues necessary to make the debt service payment and then transfers those funds to Southwest Airlines
- A steering committee, **with joint decision-making power**, was also part of the agreement. Both the City and Southwest Airlines had motivation to agree. There were no other large committees allowing for quick decisions.
- All project payments are **signed off by both the City and Southwest Airlines**
- Thanks to the partnership between the City of Dallas and Southwest Airlines, the City estimates the project **saved two years on construction** and approximately **50 percent of the overall project cost** because of the private sector's flexibility

