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Low-cost differentiation and
competitive advantage: The case of
Southwest Airlines.

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Low-cost differentiation and competitive advantage: The case of Southwest Airlines.

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"Why are you afraid, O you of little faith?"

— *Matthew 8:26*

Abstract

This study complements Michael Porter's assertion that firms must choose between cost leadership and differentiation to achieve competitive advantage. It argues instead that a third business strategy is possible: low-cost differentiation. By analyzing the case of Southwest Airlines (SA), this study answers the following research question: *How low-cost differentiation influences competitive advantage?*

The research strategy adopted is case study research, combining primary data from interviews and secondary data from financial reports and websites. This study concludes that low-cost differentiation provided SA with sustainable competitive advantage. By eliminating non-essential service attributes and by maximizing critical service attributes, SA was able to provide a differentiated offer at a reduced cost. It thus complements Porter's dichotomy between a standard offer with a lower cost in cost leadership and a differentiated offer with a higher cost in differentiation. This third business strategy can thus be called low-cost differentiation.

Keywords: Low cost differentiation, Competitive advantage, Case study, Southwest Airlines, United States of America.

9659 words

Resumo

Este estudo complementa a afirmação de Michael Porter de que as empresas devem escolher entre liderança em custos e diferenciação para alcançar vantagem competitiva. Em contrapartida, argumenta que é possível uma terceira estratégia empresarial: a diferenciação de baixo custo. Através da análise do caso da Southwest Airlines (SA), este estudo responde à seguinte questão de investigação: Como é que a diferenciação de baixo custo influencia a vantagem competitiva?

A estratégia de investigação adotada baseia-se no método de estudo de caso, combinando dados primários provenientes de entrevistas com dados secundários retirados de relatórios financeiros e *websites*. Este estudo conclui que a diferenciação de baixo custo proporcionou à SA uma vantagem competitiva sustentável. Ao eliminar atributos de serviço não essenciais e maximizar os atributos críticos do serviço, a SA conseguiu oferecer uma proposta diferenciada a um custo reduzido. Deste modo, complementa a dicotomia de Porter entre uma oferta padronizada a um custo inferior, na liderança de custos, e uma oferta diferenciada a um custo mais elevado, na diferenciação. Assim, esta terceira estratégia empresarial pode ser designada por diferenciação de baixo custo.

Palavras-chave: Diferenciação de baixo custo, Vantagem competitiva, Estudo de caso, Southwest Airlines, Estados Unidos da América.

9659 palavras

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Abbreviations

USA – United States of America

CASM – Cost per Available Seat Mile

SA – Southwest Airlines

SDI – Service Disquality Index

Introduction

The strategic management literature has long been dominated by Porter's (1985) assertion that firms must choose between cost leadership and differentiation to achieve competitive advantage, as pursuing both leads to less performance — being characterized as “stuck in the middle.” This paradigm, rooted in the assumption of an inherent trade-off between cost reduction and value creation, has shaped decades of academic and practical discourse. However, emerging perspectives, such as Kim & Mauborgne (2015) Value Innovation concept, challenge this dichotomy by proposing that firms can simultaneously deliver superior value and lower costs through innovative business models. Despite these theoretical advancements, empirical validation of hybrid strategies remains sparse, particularly in industries characterized by intense competition.

SA, the low-cost pioneer in the aviation sector, presents a compelling case regarding this dichotomy: it has sustained profitability for decades by combining low-cost operations with a unique service, outperforming competitors on key attributes to customers. This raises important questions about the universality of Porter's trade-off and the viability of alternative strategic approaches. Southwest's success - often categorized as cost leadership - demonstrates that firms may achieve dual advantage by keeping low costs and outperforming competitors in essential service attributes.

Yet, academic literature lacks a systematic examination of how such strategies reconcile cost and differentiation without compromising performance. This gap limits practitioners' ability to innovate beyond traditional strategic trade-offs and underscores the need for a nuanced analysis of competitive advantage.

This study thus addresses the following research question “How low-cost differentiation influences competitive advantage?”. By analyzing SA' dual

advantage – a cost leader that simultaneously provides a unique service – this study complements Porter’s trade-off dichotomy. This study investigates the existence of low-cost differentiation strategy and explores its theoretical underpinnings.

This document is structured as follows. The first chapter provides a comprehensive review of traditional competitive strategy, focusing on Porter’s framework of generic strategies and competitive advantage. The second chapter details the methodology employed, including its research strategy, data sources, data collection, and data analysis. The third chapter delves into the case analysis, exploring SA’s success, identifying the mechanisms that enabled the firm to achieve both low-cost operations and differentiated service. The fourth chapter discusses the findings in the light of existing literature, comparing SA’s case to theoretical models and proposing five theoretical propositions to achieve low-cost differentiation. The final and concluding chapter summarizes the study’s findings, discusses its limitations, suggests avenues for future research, and anticipates practical implications.

Chapter 1

Literature review

1.1. Competitive advantage

Strategy constitutes a fundamental and dynamic concept in strategic management. It is commonly associated with the delineation of actions aimed at achieving organizational objectives and ensuring preparedness for future challenges (Drucker, 1986; Grant, 2022; Mintzberg, 1987). Despite extensive scholarly discourse, a universally accepted definition remains elusive.

Nevertheless, Mintzberg (1987) advocates for the coexistence of multiple definitions, contending that such a recognition facilitates both academic inquiry and practical application. The author states that strategy is inherently multifaceted, arising not only from intentional actions but also from emergent patterns and realized outcomes. He delineates various types of strategy, including intended strategy (preconceived courses of action), deliberate strategy (successfully executed intentions), unrealized strategy (planned actions that remain unimplemented), emergent strategy (patterns that materialize without explicit intent), and realized strategy (a synthesis of deliberate and emergent strategies).

In a contemporaneous view, (Grant (2022) emphasizes the role of strategy in facilitating decision-making, ensuring coherence across organizational initiatives, and navigating uncertainty. He further asserts that strategy is essential in three primary capacities: i) supporting informed decision-making, ii) coordinating organizational activities toward unified objectives, and iii) establishing future direction, motivating stakeholders, and addressing both present competition and future aspirations.

According to Grant (2022), strategy is observable and materialized in where and how a firm chooses to compete. The “where” – corporate strategy – defines the firm's scope in terms of industries and markets where it operates and competes. The “how” – business strategy – captures the way the firm competes within a particular industry or market and how it achieves competitive advantage. In this study, business strategy and competitive strategy are used interchangeably.

Porter (1980) defines competitive strategy as a framework for a firm to compete, its goals, and the policies required to achieve them. It combines the firm's objectives (ends) and the methods (means) to achieve them .

A firm's success thus relies on its ability to achieve competitive advantage. For the same reason, competitive strategy precedes corporate strategy (Grant, 2022). Even though the two types of strategy are interconnected, this study will only elaborate competitive strategy and its role on competitive advantage.

Competitive advantage lacks a unique definition. However, it is often referred to as a firm's ability to outperform its rivals and being superior in creating value for its stakeholders (Grant, 2022; Porter, 1985). This superiority can be achieved by offering equivalent benefits for a lower price or by providing unique benefits that justify a higher price (Porter, 1985). Additionally, sustaining competitive advantage requires that its competitors or potential competitors cannot implement the same value creation simultaneously as the firm (Barney, 1991).

For understanding competitive advantage and its sources, Porter (1985) suggests that we cannot just look at the firm as a whole, being necessary to analyze each discrete activity a firm performs. According to the author, each of these activities, as well as their linkages, contributes to a firm relative cost or differentiation.

Therefore, to identify the sources of competitive advantage, it is necessary to conduct a systematic overview of all activities performed by a firm and how

they interact (Porter, 1985). For doing so, Porter (1985) presents the Value Chain as a framework that decomposes a firm into its strategically significant activities, enabling the analysis of cost dynamics and the identification of existing sources of differentiation. According to the author: “a firm gains competitive advantage by performing these strategically important activities more cheaply or better than its competitors” (Porter, 1985 – p. 34).

By contrast, Barney (1991) shifts the focus inward, emphasizing a firm's internal resources and capabilities as the foundation for achieving and sustaining competitive advantage. According to the Resource-Based View, a firm can achieve competitive advantage by leveraging its unique internal resources and capabilities, which must be valuable, rare, imperfectly imitable, and non-substitutable (Barney, 1991).

Grant (2022) suggests that competitive advantage has a dynamic and not static nature, being created through internal or external changes. The author suggests that firms capable of responding effectively to external changes, through entrepreneurial agility or strategic innovation, can gain a significant competitive edge. Since competition erodes an established advantage, barriers to imitation must exist (Barney, 1991; Grant, 2022; Porter, 1985). Grant (2022) emphasizes the concept of "isolating mechanisms," which are barriers preventing competitors from imitating a firm's strategy. Porter (1985) complements this by asserting that sustainability requires creating and maintaining such barriers while simultaneously investing to stay ahead of competitors by presenting a "moving target" (Porter, 1985 - p. 12). Thirdly, Barney (1991) links sustainability to resource heterogeneity and immobility, in which only resources that are unique and not easily transferable across firms can create a sustainable advantage.

1.2. Generic strategies

Porter (1985) suggests two generic strategies: Cost Advantage and Differentiation, which are described below accordingly to his book “Competitive Advantage: Creating and Sustaining Superior Performance” (1985). Cost Advantage is the result of a firm’s ability to lower its cumulative cost of performing value activities compared to competitors, without sacrificing the value provided to customers (Porter, 1985).

To gain a cost advantage, firms must focus on controlling cost drivers - such as economies of scale, learning curves, capacity utilization, linkages between activities - or reconfiguring the value chain – by adopting new production methods or distribution channels for example. For instance, an important issue that must be considered when reducing costs is differentiation.

Firms may unintentionally undermine differentiation by reducing costs in areas that contribute to their unique value proposition (Porter, 1985). Although it can be strategically desirable, firms should take a comprehensive approach to cost reduction, carefully analyzing every activity in their value chain and ensuring that cost savings do not erode differentiation.

In contrast, Differentiation is the second type of competitive advantage a firm can achieve. A firm differentiates itself when it provides something unique to buyers beyond simply offering a low price (Porter, 1985). As a result, Porter explains that Differentiation allows the firm to command a premium price, to sell more of its product at a given price, or to gain equivalent benefits such as greater buyer loyalty during cyclical or seasonal downturns.

In addition, Differentiation extends beyond final product quality, aiming to create value throughout the entire value chain (Porter, 1985). Thus, any value activity from the value chain can be a source of uniqueness. Grant (2022) highlights that uniqueness to customers does not only mean quality, but can also be related to consistency, reliability, status, and innovation.

Differentiation typically incur higher costs, as firms must outperform competitors in value activities to achieve uniqueness. Nevertheless, firms can turn the cost of differentiation into an advantage by strategically managing cost and differentiation efforts. This involves: i) exploiting sources of differentiation that are low-cost, such as leveraging linkages between activities and ii) emphasizing differentiation methods where the firm has a sustainable cost advantage, such as scale-sensitive activities. Additionally, reducing costs in activities unrelated to buyer value can further offset the expenses associated with differentiation, ensuring a more competitive cost structure while maintaining distinctiveness.

Grant (2022) synthesizes the two types of Competitive Advantage proposed by Porter (1985) as: i) Cost advantage when a firm has a standard offer but with lower costs and a lower price as well as ii) Differentiation advantage when a firm provides unique offerings with higher costs and a premium price (Grant, 2022).

Porter (1985) concept of generic strategies emerged as a response to the question of how firms can achieve superior performance in competitive markets. These strategies are rooted in the understanding that a firm is required to make a choice among the generic strategies in order to achieve competitive advantage. The three generic strategies are two supply-side strategies - Cost Leadership, and Differentiation – as well as a demand-side strategy - Focus. For that reason, Focus complements either cost leadership or differentiation in terms of demand, that is, a narrow rather than a broad target, resulting in Cost Focus or Differentiation Focus.

Cost Leadership strategy aims to establish a firm as the lowest-cost producer within its industry. Achieving cost leadership allows firms to offer standard products at prices near or below industry averages while maintaining superior returns. This is possible because the cost leadership creates a buffer against price competition, enabling firms to sustain profitability even in intensely

competitive markets.

Porter (1985) alerts that a cost leader must guarantee parity or proximity on the offering relative to its competitors to be an above average performer. Achieving parity allows a cost leader to translate its cost advantage into higher profits than competitors, being the most profitable alternative, while keeping proximity ensures the maintenance of an acceptable market share.

Cost leadership requires an effort to exploit every available source of cost advantage, such as economies of scale, lean production, outsourcing, and offshoring. To sustain their position, cost leaders must prevent rivals from eroding their market share. Thus, it often involves pre-emptive strategies to deter competitors from entering the cost leadership space. Intense rivalry among multiple cost leaders can lead to margin erosion.

A differentiation strategy requires a firm to achieve uniqueness within its industry by offering products or services with attributes that are highly valued by buyers. This strategy involves identifying and prioritizing one or more dimensions perceived as significant by customers and aligning the firm's offerings to address these preferences distinctively. The firm is compensated for this increased cost through a price premium, reflecting the additional value delivered to customers.

To sustain above-average performance, it is imperative that the price premium gained from differentiation exceeds the incremental costs associated with delivering uniqueness. Consequently, a firm must also manage its cost position strategically, ensuring cost parity or proximity with its competitors by reducing and optimizing costs in areas that do not directly influence differentiation.

The focus strategy is distinguished by its emphasis on a narrow market segment. Unlike broader strategies, the focus approach involves targeting a specific segment or a group of segments and tailoring the firm's strategic actions exclusively to meet the needs of this target. By optimizing its operations for the

chosen segment, the firm seeks to achieve competitive advantage within that segment, even if it does not hold an advantage across the entire industry.

This strategy is categorized into two variants: i) cost focus and ii) differentiation focus. Cost focus involves pursuing a cost advantage within the target segment, while differentiation focus emphasizes offering unique value to meet the special needs of the segment's buyers. Successful implementation of these strategies requires the target segment to have distinct needs or to demand a production and delivery system that differs significantly from other industry segments. In essence, the focus strategy exploits the suboptimal performance of competitors in serving specific segments.

According to Porter (1985), to achieve competitive advantage, a firm needs to attain one generic strategy only. When a firm tries to engage in multiple generic strategies it is classified as "*stuck in the middle*" (Porter, 1985 – p. 16). According to Porter, in this positioning the firm tends to underperform, as it faces significant disadvantages compared to cost leaders, differentiators, and focusers.

The author defends that the pursuit of multiple strategies requires actions that are inconsistent with one another. For instance, cost leadership and differentiation paths are inconsistent (Porter, 1985). Usually, a cost leader demands strict cost control and standardization, while differentiation requires unique features and higher expenditures to sustain uniqueness. According to the author, even though a firm would be able to reduce costs while differentiating, when faced with capable competitors striving for cost leadership, it reaches the point where further cost reduction results in erosion of differentiation. At this moment, the firm must make a choice.

Nevertheless, Porter argues that there are three temporary conditions under which cost leadership and differentiation can be achieved simultaneously: i) competitors are stuck in the middle, ii) cost is strongly affected by share or interrelationships and iii) the firm pioneers a major innovation.

Firstly, when rivals lack a clear strategy, they cannot enforce trade-offs

between cost and differentiation, allowing a firm to achieve both. Secondly, when the cost position is heavily determined by market share, a big market share allows the firm to incur added costs in some activities and still maintain cost leadership. Additionally, when there are important interrelationships between industries that one competitor can exploit and others cannot, a firm can offset the higher cost of differentiation. Thirdly, technological advancements or new operational practices can reduce costs while simultaneously enhancing the product or service's uniqueness. This dual advantage is sustainable if the firm remains the sole innovator, but once competitors adopt similar innovations, the firm must decide between cost leadership and differentiation.

Hill (1988) complements Porter by presenting additional contingencies in which both advantages can co-exist. The author states that even if differentiation typically increases unit costs in the short term, long-term cost reductions can occur through mechanisms such as learning effects, economies of scale, and economies of scope. These cost declines depend on increasing production volume, which shifts the focus to the firm's ability to effectively stimulate demand.

According to Hill (1988), whether differentiation is compatible with achieving an overall lower cost position depends on two key factors: the extent to which differentiation expenditures increase demand and the potential for significant reductions in unit costs as volume expands. The ability to drive demand is influenced by three major contingencies: the firm's capacity to differentiate its product, the competitive dynamics of the market, and consumer loyalty to rival products.

Furthermore, cost reductions associated with differentiation depend on three primary sources: learning effects, economies of scale, and economies of scope. Learning effects emerge as production processes become more efficient over time, while economies of scale reduce per-unit costs as output increases. Thirdly, economies of scope allow firms to share resources across various

products, lowering the economic cost of production.

The author concludes that the coexistence of differentiation and cost advantage is primarily governed by major contingencies such as a firm capacity to differentiate, industry structure, economies of scale, economies of scope and learning effects. For instance, substantial economies of scale and scope enable firms to drive down costs while investing in product innovation. These conditions, coupled with secondary contingencies, such as robust brand loyalty and significant switching costs, reduce the intensity of price competition, thereby facilitating the simultaneous pursuit of low-cost and differentiation.

Other secondary factors, such as organizational learning, dynamic resource allocation, user and product characteristics, further support this strategic duality. By effectively aligning both major and secondary contingencies, firms can sustain a competitive advantage that leverages cost efficiencies without compromising the distinctive attributes that differentiate their offerings.

1.3. Blue ocean strategy

Since Porter's work, competitive strategy has emphasized outperforming rivals through incremental improvements in cost, quality, and differentiation. However, Kim & Mauborgne (2015) propose a paradigm shift with the Blue Ocean Strategy, which focuses on creating untapped market spaces - called "blue oceans" - free from competition and offering high growth potential.

Kim and Mauborgne introduce "Value Innovation" as the core of Blue Ocean Strategy. The concept consists of the creation of a leap in value for buyers, defending that firms can achieve both differentiation and lower cost simultaneously, unlike traditional strategies that assume a value-cost trade-off (Porter, 1985, 1996).

Value Innovation results in actions that favorably affect both the firm's cost structure and the value proposition to buyers. It optimizes cost structure by

eliminating and reducing industry-standard attributes while enhancing buyer value by creating and elevating attributes.

Kim & Mauborgne (2015) provide analytical tools to systematize Blue Ocean Strategy. Two key frameworks are: i) Strategy Canvas and ii) Four Actions Framework. The Strategy Canvas helps firms break away from competitive markets by mapping industry competition attributes and firm performance. It materializes in a graphic form, with the horizontal axis capturing the attributes the industry competes on and the vertical axis capturing the offering level that buyers receive across these key competing attributes. By plotting the offers of each firm, the value line of each firm emerges, which illustrates firm's relative performance.

The authors defend that firms need to reconfigure buyer value rather than just have better solutions than rival offers. Thus, firms should aim to implement a new value line in comparison to industry standards.

The Four Actions Framework guides firms in redefining industry standards by addressing four key questions. The first two questions lead to cost cut and cost reduction: i) which of the factors that the industry takes for granted should be eliminated? and ii) which factors should be reduced well below industry's standards? The last two questions aim to enhance buyer value, thus leading to cost creation and cost increase: iii) which factors should be raised well above the industry's average? and iv) which factors should be created that the industry has never offered? Finally, by answering and taking action on these four questions, a firm is able to design a new value line.

Kim & Mauborgne (1999, 2015) discovered six systematic patterns firms pursue to reconstruct industry boundaries and create blue oceans – see Annex 1. One of the patterns is illustrated by SA, the case firm analyzed in this study.

In summary, there are two streams of thought on the assumption that a

firm pursuing simultaneously cost advantage and differentiation advantage will be “stuck in the middle” and thus harm its performance (Grant, 2022; Kim & Mauborgne, 2015; Hill, 1988; Porter, 1985). This study aims, therefore, to answer the following research question: How low-cost differentiation influences competitive advantage? The following chapter presents the research strategy adopted in this study to answer such a research question.

Chapter 2

Methodology

2.1. Research strategy

This study adopts case study research to explore and understand one firm's strategic positioning. Additionally, the reliance on non-numerical data characterizes the study as qualitative (Denzin & Lincoln, 2000; Piekkari & Welch, 2004; Tesch, 1990).

The decision to pursue a case study was based on Yin (2003) framework for selecting research strategies. When the following conditions are met: i) the "how" and "why" compose the research question, ii) there is no requirement for control over behavioral events, and iii) the research focuses on contemporary events, a case study is appropriate (Yin, 2003).

In addition, this study aims to develop theoretical constructs and propositions from case-based empirical evidence, characterizing a "building from theory" approach (Eisenhardt, 1989). According to Eisenhardt & Graebner (2007), theory building from cases is an effective strategy when existing theories are insufficient to address significant research gaps. It leverages rich qualitative data to develop constructs and theoretical insights, making it particularly useful for exploratory research aimed at generating new theories.

The firm selected to be analyzed was Southwest Airlines, an airline from the United States of America (USA). The choice of SA relied on two main reasons: i) SA is the first low-cost carrier, which has been independently successful until today (Voigt et al., 2017), and ii) SA case has already been studied by several strategic management authors (Grant, 2022; Kim & Mauborgne, 2015; Porter, 1996, 1985). There are, therefore, large amounts of secondary data available and sufficient literature to compare its findings with those of the current study.

2.2. Data collection and analysis

This study used both secondary and primary data. Secondary data is an unobtrusive source of information and enables access to precise and quantitative data (Creswell & Creswell, 2018; Yin, 2003). In terms of primary data, interviews have the advantage of providing access to information without direct observation, to discern the interviewee's perceived causal inferences (Creswell & Creswell, 2018; Yin, 2003).

In this study, secondary data included documents and archives, including institutional websites, online interviews, financial reports, newspaper articles, books, online publications, and case studies. One of the interview transcripts available online was from SA founder and former CEO, Herb Kelleher. The interview was recorded in 2017 and was conducted by Tom Gardner, Co-Founder and CEO of The Motley Fool, a financial services firm.

In terms of primary data, this study included interviews with SA managers and ex-managers. The interviews aimed to gather primary data from current and former SA professionals, offering valuable insights from active participants in the firm success.

To obtain a more rigorous sample of interviewees, a pre-judgement of their profile was conducted, prioritizing those with more experience at the firm (years) and more strategic decision-making power (hierarchical role).

Three interviews were held: i) two synchronous interviews with former SA Executives, and ii) one asynchronous interview with a current administration executive. In compliance with the consent forms sent beforehand (Appendix 1 and Appendix 2), the interviewees remain anonymous and were named as: i) Ex-manager A, ii) Ex-manager B and iii) Manager A, to safeguard their identity.

The questions of the interviews were open-ended but comparable due to a standardized interview guide (Appendix 3). The interviews were conducted between January 10th and February 07th, 2025. The interviewees were contacted

through social media platform LinkedIn, email, and through SA institutional media press contact. Both synchronous interviews were conducted online, via Zoom platform, with a semi structured format that combines prepared questions with flexibility to explore new topics based on responses that allowed deeper insights. The semi structured format is important for addressing complex issues, as probes and spontaneous questions help to explore, gain deeper insights, and clarify responses (Wilson, 2014).

For further analysis, the interviews were recorded and transcribed. This approach allowed the interviewer to concentrate fully on the interviewee, ask in-depth questions, remain less intrusive, and maintain neutrality when note-taking (Greenfield & Greener, 2016).

The third interview was asynchronous, in which the respondent answered each question of the guide by email. This interview had to be asynchronous because the interviewee was not available to meet online. An asynchronous interview does not allow follow-up questions and probes to find deeper insights, but it has some advantages, namely: i) the respondent has more time to think thoroughly about the answer, ii) there is no necessity of transcription, and iii) it is an alternative to availability mismatch between the interviewer and interviewee.

Following the transcription of the interviews, in order to categorize data and group it into other abstract categories, open coding was conducted (Kozinets et al., 2014). It was used the Taguette software to organize the material and connect it to the literature review (Bringer et al., 2006). The list of codes generated is available on Appendix 8.

The subsequent phases to find linkages between the themes and reach conclusions are depicted in Figure 1 below.

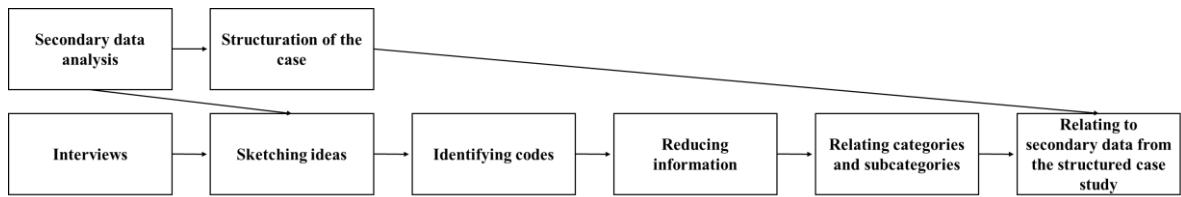


Figure 1: Data analysis process. Self-elaboration

Table 2 presents information about the interviewees. However, as stated on the consent form, the interviewee identity must be kept confidential.

Interviewee	Interview type	Experience at Southwest (years)	Position or former position level	Current at Southwest?
EX-MANAGER A	Synchronous	7	VP-Level	No
EX-MANAGER B	Synchronous	23	C-Level	No
MANAGER A	Asynchronous	33	C-Level	Yes

Table 1: Interviewees

Chapter 3

Southwest Airlines Case

Southwest Airlines (NYSE: LUV) is the second largest player in the US airline industry, with 17,3% market share, according to the Bureau of Transportation Statistics – United States Transportation Department (period of November 2023 to October 2024). The firm registered, in 2023, the record revenue of \$26Bn, with a fleet of 817 Boeings 737 aircrafts, serving 121 airports in 11 countries.

By implementing an innovative business strategy that focused on affordability, efficiency and customer satisfaction, SA was able to revolutionize air travel. Although other low-cost models existed at time it was founded (Pacific Southwest Airlines and Air California), SA is the first low-cost carrier to be independently successful until today (Voigt et al., 2017).

Founded in 1967 by Rolling King and Herb Kelleher, the firm began serving the three largest cities in Texas - Houston, San Antonio, and Dallas - by offering low fares, convenient schedules, and a "no-frills" approach that was completely contrary to the standards of the established airlines (Flynn & Devlin, 2022). After winning court decisions against its competitors that tried to preclude SA operations, the first flight took off from Dallas to Houston on June 18, 1971, (Southwest Airlines Co., 2021).

For the first two decades, the firm was considered an unconventional regional airline, based in Texas, well known for its customer service, prices and "LUV" culture (Gittell, 2003). After consolidating its success in the Texan intra-state scope, the firm expanded and grew to other states.

The Federal Airline Deregulation Act from 1978 (S.2493 - Airline Deregulation Act, 1978) removed US Federal Government control over fares, routes and market entry of new airlines, facilitating SA's interstate expansion. In

the 1980s, SA expanded outside Texas and launched service to several cities in the American Southwest and beyond, such as Phoenix and cities within the state of California (Southwest Airlines Co., 2021). According to SA 1989 annual report, at that time the firm served 30 destinations (vs 12 in 1979) and possessed 94 aircrafts (vs 18 in 1979). Additionally, in 1989, it officially became a major airline, with annual revenues exceeding \$1 billion (Flynn & Devlin, 2022).

Since SA disrupted the market and registered historical profit records since 1973, several authors aimed to explain the firm success and competitive advantage (Bunz & Maes, 1998; Donnelly, 2002; Freiberg & Freiberg, 1996; Gittell, 2003; Heskett & Hallowell, 1997; Inkpen, 2017; Mauborgne & Kim, 2015; Porter, 1996b, 1985c; Raynor, 2011; Smith, 2004; Voigt et al., 2017). Among them, it is consensual that SA differentiated itself through: i) cost structure & operations efficiency; ii) reliability, iii) customer service, and iv) culture & people.

However, it is important to highlight that SA success is a result of the integration of all these factors, and not each factor individually. SA's success involves a whole system of activities, in which activities fit and reinforce one another (Porter, 1996).

3.1. Cost structure & operations efficiency

SA low fares were due to a low-cost structure and high operations efficiency (Gittell, 2003; SOUTHWEST AIRLINES (A), 1995). In 1993 and 1994, SA's costs per available seat mile (CASM) averaged roughly on 7,1 cents, while the larger airlines had costs up 15 to 20% higher (O'Reilly & Pfeffer, 1995). Furthermore, in 2002, the Air Transport Association reported that other major airlines had CASM nearly 100% higher than that of SA (Donnelly, 2002).

Its low-cost structure is not due to low wages because its employees are more unionized than at any other major U.S. airline (Gittell, 2003). Rather, it is due to the highly productive use of its major assets - its aircraft, its people, and other strategic decisions (Donnelly, 2002; Gittell, 2003; Porter, 1996).

Firstly, the firm's fleet standardization, using only Boeings 737s, results in cost reduction with maintenance and staff training. By standardizing its fleet to a single aircraft model, SA allows the interchangeability of flight crews, the reduction of training complexity, and the streamlining of maintenance protocols, thus enabling faster turnaround times between flights (Gittell, 2003; Porter, 1996; Raynor, 2011). Additionally, by operating Boeing 737, SA gained an increased bargaining power towards its sole aircraft supplier (Voigt et al., 2017)

Secondly, serving frequent point-to-point short-haul flights between secondary airports is another key factor in reducing costs. By focusing on a point-to-point system rather than the traditional hub and spoke system, SA is able to avoid delays associated with connecting flights and minimize idle waiting time (O'Reilly & Pfeffer, 1995; Voigt et al., 2017). Its strategy to serve mainly secondary airports near major metropolitan areas and medium-sized cities led to lower landing fees and terminal costs, as well as to lower fuel costs of idle planes waiting for clearance to land (Raynor, 2011; Voigt et al., 2017).

Reducing congestion, minimizing idle waiting time and payment of lower terminal fees, contributed to allowing high frequent flights, thus, higher aircraft utilization. In 1993, SA aircraft spent an average of 11 hours/day in the air compared to an industry average of 8, and it averaged 10,5 flights per gate versus 4,5 for the industry (O'Reilly & Pfeffer, 1995). In addition, the reliance on secondary airports saved an average of 15% to 25% flight time, according to Jim Wimberly - 1985 Vice President of Ground Operations (Heskett, 1997). The high frequency of flights was crucial to keep the firm's profitability, since when a plane spends less time on the ground, it is able to earn more revenue per day (Gittell, 2003).

Thirdly, the elimination of frills and additional services, such as meals and seats assignments, is another contributor for cost reduction and increased operations efficiency. Serving no meals lowers expenses related to food preparation, storage, and waste management. The cost of serving meals for other

American carriers is approximately \$5,00/meal compared with approximately 20 cents for peanuts and soda provided by SA (Smith, 2004).

As a result of the above, SA was the industry leader on turnaround time. That, in turn, was crucial for the firm to increase flight frequency, keep on-time schedules, and stay profitable with low-fares.

In 1991, 70% of SA flights had 15 minutes ground time (O'Reilly & Pfeffer, 1995). In 1993, the airlines industry average turnaround time was 55 minutes while two out of three SA planes turned in 15 minutes or fewer (Heskett & Hallowell, 1997). Such a quicker turnaround of SA was performed with gate crew 50% smaller than its competitors (Inkpen, 2017).

3.2. Reliability

In addition to operational efficiency, SA has consistently proven itself one of the most reliable airlines, demonstrated by its multiple Triple Crown awards and historical records. The Triple Crown is awarded to airlines that excel in three critical areas: on-time performance, fewest lost bags, and fewest customer complaints. SA won this monthly award 24 times and became the only airline to win the annual Triple Crown for three consecutive years (1992-1994) (O'Reilly & Pfeffer, 1995).

In addition, a study performed by Waguespack & Rhoades (2014) analyzed the American airlines service quality for 25 years (1987-2012). The authors calculated the Service Disquality Index (SDI) of the main airlines during the period. The SDI is calculated using data from the US Department of Transportation Air Travel Consumer Report and it includes the following metrics: on-time flights, baggage reports, oversales, passenger complaints, and cancellations standardized by departures.

In other words, the SDI represents the total number of quality problems per departure for an airline, thus, the least value represents a more reliable service. Study results indicated that SA registered the lowest SDI value on

average over the entire period (0,381 vs industry average 0,505) and had the lowest SDI value on 12 years out of 25 (Waguespack & Rhoades, 2014).

Additionally, SA has maintained an impeccable safety record throughout history, standing out in the airline industry for never having experienced a fatality until 2018 (Flynn & Devlin, 2022). During the 1990s, the Federal Aviation Administration consistently rated Southwest as having the fewest pilot deviations per flight departure among major US carriers, further solidifying its reputation for safe and efficient operations (Gittell, 2003).

3.3. Customer service

SA has developed a compelling reputation for customer service, rooted in its commitment to creating a familial and fun atmosphere that engages both employees and passengers (Heskett & Hallowell, 1997; Inkpen, 2017). SA also adopts a service philosophy known as “positively outrageous service” which motivates employees to exceed typical service expectations (Inkpen, 2017).

Furthermore, the enthusiastic engagement of flight attendants plays a vital role in enhancing the travel experience. Crews are encouraged to integrate humor and light-hearted interactions into their service - with incorporation of onboard games - which contributes to a lively atmosphere at the aircraft and fosters a sense of community during flights (Harvard Business School, 1997; O’Reilly & Pfeffer, 1995).

3.4. Culture & people

SA’s culture has been considered a key factor for its success (Bunz & Maes, 1998; Freiberg & Freiberg, 1996; Gittell, 2003; Heskett & Hallowell, 1997; O’Reilly & Pfeffer, 1995). At the center of its people-culture lies the firm’s deep commitment to i) enhance an *esprit de corps*, ii) empower employees, and iii) recruitment process coherent with the firm’s values (Freiberg & Freiberg, 1996).

3.4.1. Esprit de corps

The culture at SA is heavily grounded in a "family spirit," where employees are encouraged to support each other and collaborate to achieve shared goals (O'Reilly & Pfeffer, 1995). As so, the promotion of *esprit de corps* - a French term that means a shared sense of loyalty, enthusiasm, and commitment within a group – is highlighted among SA employees (Freiberg & Freiberg, 1996).

According to Gittel (2023), the firm's most distinctive organizational trait is its ability to build and sustain relationships that are characterized by shared goals, shared knowledge, and mutual respect. These relationships enable the organization to maintain elevated levels of inter-department connections, increasing operational efficiency and customer satisfaction, as well as enhance employee engagement.

3.4.2. Employee empowerment

At SA, people are incentivized to take initiative and make decisions that would benefit customers, allowing them to break rules if necessary (Harvard Business School, 1997; Milliman et al., 1999). The firm recognizes and stimulates people to express their individuality, while emphasizing the liberty of expressing opinions and making suggestions (Bunz & Maes, 1998).

Related to the openness and liberty given, SA is a firm with a strong bias to action, by encouraging employees to generate ideas and try them, instead of waiting for time-consuming top management decisions. This, in turn, contributes to a higher sense of ownership and responsibility (Bunz & Maes, 1998; Heskett & Hallowell, 1997).

3.4.3. Recruitment process

SA' recruitment process is strategically designed to reinforce its distinctive corporate culture by prioritizing relational competence and the right attitude

over technical expertise (Bunz & Maes, 1998; Freiberg & Freiberg, 1996; Gittel, 2003; Heskett & Hallowell, 1997; Milliman et al., 1999; O'Reilly & Pfeffer, 1995). Its highly selective recruitment process emphasizes candidates teamwork and optimistic outlook. To ensure optimal cultural fit, SA employs rigorous interview procedures that involve multiple stakeholders, including peers and even customer evaluations, to gather comprehensive insights into a candidate's suitability (Heskett & Hallowell, 1997; O'Reilly & Pfeffer, 1995).

Chapter 4

Discussion

This chapter discusses the extent to which SA case confirms, complements or contradicts the insights from the literature review. The ultimate goal is to answer the research question: How low-cost differentiation influences competitive advantage?

Porter (1985) defends that the attempt to pursue both cost leadership and differentiation strategies without fully committing to one of them, is condemn to underperformance. The author argues that such firms are lacking a clear competitive advantage, which leaves them at a disadvantage compared to firms that position themselves clearly on cost leadership, differentiation, or focus strategies.

As a result, Porter (1996, 1985) considers SA a clear example of cost leadership strategy. According to the author, the firm achieved its cost leadership through the reconfiguration of the value chain (primary and support activities), aiming for lower costs. As stated on Porter (1985, p. 108), “no-frills airlines such as People Express and SA provide a striking example of strategies based on reconfiguring the value chain”.

For instance (Porter, 1985 - p. 108) highlights that low-cost carriers differentiate themselves by minimizing service complexity and operational costs across key areas. According to the author, they utilize secondary airports and terminals, eliminate traditional ticketing counters, and implement a first-come, first-served seating model. Their aircraft operations rely on used planes with high-density seating and smaller crews flying more hours per day. Onboard services are simplified, offering only snacks or no meals and charging passengers for food and drinks.

Additionally, Porter (1996) analyzed SA's activity system in order to

exemplify the firm's success. The author defends that Southwest's cost-based advantage comes from the way its activities fit and reinforce one another, that results in a lower cumulative cost when compared to competitors.

By distinguishing between trunk and no-frills carriers, the author is explicitly stating that the two offers are different rather than standard as it would be expected in cost leadership (Porter, 1985). Furthermore, the author fails to acknowledge that "very low-ticket prices" resulting from such differentiation could not be premium differentiation. In other words, a lower price from a different offer is neither cost-leadership from a standard offer nor a lower price from premium differentiation. In anything, it is a lower price from low-cost differentiation, which Porter does not acknowledge as a third strategy beyond cost leadership and premium differentiation.

While Porter (1985, 1996) provides a compelling analysis of SA's cost position, his interpretation of SA's offering appears to diverge from the present case study. For instance, the author asserts that the service provided by the airline is standard and does not present differentiation in comparison to competitors, as classifies SA's only competitive advantage as Cost. Yet this conclusion seems to overlook how the firm provided a unique service and how it achieved success on the essential attributes of an airline service.

Firstly, although SA did not provide frills on their offering, such as meals or seat assignment, their customer service has been distinguishable due to its fun, friendly and empathic approach (Heskett & Hallowell, 1997; Inkpen, 2017). Among the interviews conducted and collected, it was consensual that customer service was a differentiator of SA in comparison to competitors.

"Southwest has never given expensive snacks; they've never for 30 some years. Now you get a few uh protein bars, but that's it. But you don't come because of that. You come because people greet you with a smile when you leave. They say they were happy to have you. It sounds very simple, but to get it over and over again..."

EX-MANAGER A

"And probably as important as those two business models, was the people were nice, the people were friendly, and the flight attendants. And it was fun to fly. So, I think that people didn't... No, didn't find it at other airlines, this spirit and this fun environment, right, not really because you know, keep in mind that the rest of the airline industry was really trying to try to understand how to operate in a deregulated environment, and they really had a hard time competing with us."

EX-MANAGER B

Porter's (1996) activity system analysis mentions "limited customer service" which appears to neglect the fact that friendly and fun flight attendants are also an attribute of customer service. And that attribute alone, makes SA's offer different rather than standard, and even more premium on that attribute than premium legacy carriers.

Additionally, SA's employees have the freedom and autonomy to manage customers' problems the best possible, especially when there was a firm mistake. This empathy towards customers and employee empowerment to solve problems contributed to customer loyalty and proximity with SA. Ex-manager B supports this attribute:

"Southwest employees, we gave them the freedom to take care of the customers and make them happy without when things did, when things did go off schedule. We gave the employees the freedom to do whatever they needed to do with reason to make sure that those customers came back, especially when it was our mistake. And that type of leaning into customers, when you're dealing with a problem that you created, the rest of the industry didn't have that type of mentality necessarily with their customers when things went wrong. And, you know, people remember; they remember those kinds of service things."

EX-MANAGER B

Secondly, SA presents a record of the most reliable airlines in the USA, demonstrated by its unmatched achievement of 24 Triple Crown awards, highlighting excellence in on-time performance, baggage handling, and customer

satisfaction (Gittell, 2003; O'Reilly & Pfeffer, 1995). On the other hand, a 25-year analysis showed Southwest had the lowest Service Disquality Index (SDI) on average (0,381 vs. industry average of 0,505), reflecting the most reliable service among the airlines (Waguespack & Rhoades, 2014). Additionally, Southwest's impeccable safety record further reinforces its reliability, with no fatalities until 2018 and the fewest pilot deviations per flight departure during the 1990s (Flynn & Devlin, 2022; Gittell, 2003).

Summarizing the attributes mentioned above, the former manager synthesizes a couple of statements:

"People don't come because it's just low-cost, people come because it's low cost, it's safe, and safety is a huge issue with them, and in addition they're treated well."

EX-MANAGER A

"I believe that getting somewhere safely and on time and with a great spirit is critically important. I think Legacy airlines are trying to upgrade you to all these business-class and first class, and you pay a lot of money for it. And at that level, they do serve you better food and all kinds of other things. But that's never been the model for Southwest. The Southwest model has been, we're going to get you from point A to B very safely, and you're going to have fun doing it."

EX-MANAGER A

Finally, Southwest differentiates itself through the convenience provided to customers. Such convenience is mainly explained by the high frequency of flights provided, allowing customers several options to choose. Providing such a higher frequency of flights in comparison to the legacy airlines, illustrates how Southwest outperforms even the "premium airlines" in specific aspects, such as convenience.

According to ex-manager B, convenience was a major attribute of Southwest service:

"... Southwest business model was that we offered a lot of flights every day, so there was convenience. If you had a business meeting in New Orleans in 1980 and there were four airlines to choose from, and you didn't know what time your meeting was going to be over with in New Orleans, you'd probably pick Southwest because we had the lowest fare, but we'd have flights every two hours in between those two cities. And that was, other airlines might have three flights a day, and we'd have 20. So, the convenience, yeah, at one point between Dallas and Houston, which is an hour flight, it's 240 miles, there were 70 flights a day. Like every 30 minutes, every 15 minutes, every 30 minutes. That's impressive. Well, so people really didn't have to think, it was almost like, you know, you're hailing a cab. You know, it's not like you had to make a reservation, and you just go to the airport, and you knew there'd be another flight in less than an hour, and the fares were the lowest. So, it really built up a loyal and a large customer base, just because of the convenience of the operation."

EX-MANAGER B

In conclusion, Southwest differentiates among competitors due to i) fun and friendly customer service, ii) higher punctuality, iii) safety and iv) convenience. Thus, despite charging "very low ticket prices" (Porter, 1996, p. 49), SA provides a different and not standard service attributes, some of which are more premium than premium legacy carriers.

On the hand, it has been claimed by Kim & Mauborgne (2015) that SA is an example of a Blue Ocean Strategy, highlighting the firm's value innovation. The authors describe the firm strategic value line, with some of the attributes clearly above those of premium legacy carriers, such as friendly service, speed, and frequent point-to-point departures, while secondary attributes – such as lounges, hub connectivity, meals and seating choice – clearly below other airlines. In summary, Southwest abdicates providing frills on its offering, such as seating class choices, hub connectivity, lounges, and meals, but it delivers a better performance than premium legacy carriers on other relevant attributes for customers, such as friendly service, speed, and frequent point-to-point departures.

The literature (Grant, 2022; Porter, 1985, 1996) considers SA a cost leader by attributing its ability to offer low prices to a more efficient activities system. Such a focus on the value-chain instead of the value line of SA overlooks the fact that the offer is not as standard as the activity system. In other words, SA may be

more efficient than its competitors on standard backstage operations, but its offering is far from standard.

The case of SA thus refutes: i) Grant's (2022) dichotomy between low cost standard offer and high cost different offer. As a result, the competitive advantage of SA cannot be attributed to cost advantage (its offer is not standard) nor to premium differentiation advantage (its price is not high and its offer is not premium on all attributes).

This assertion is reinforced by Herb Kelleher, SA founder and former CEO. Kelleher contends that the firm successfully overcame the traditional value-cost trade-off and the prevailing paradigm in strategic management. Instead, SA embraced both approaches simultaneously, challenging conventional strategic frameworks.

"A friend of mine, recently wrote a paper that he sent to me, and in it he said: "corporations are always succumbing to the tyranny of not rather than the genius of yes." And what he was pointing out is that people sit down and say, well, "we can either have low cost and lousy customer service, or great customer service and high costs", and we said, no, you can have low costs and great customer service, and guess what, we're not offering you less for less fare, we're offering you more for less fare."

HERB KELLEHER

In other words, SA is a case of a low-cost differentiation advantage: offering a better service in essential attributes while keeping low cost and low fares due to cost cuts on eliminated non-essential attributes.

This study thus suggests the following propositions:

P1: Charging lower prices than competitors is a necessary but not sufficient condition to achieve low-cost differentiation advantage.

P2: Outperforming competitors on essential attributes is a necessary but not sufficient condition to achieve low-cost differentiation.

By contrast, existing literature, with the exception of the concept of Value Innovation (Kim & Mauborgne 2015), does not acknowledge the possibility for simultaneous cost savings and differentiation. Porter (1985) argues that cost leadership and differentiation are usually incompatible but can coexist under three rare conditions: (i) when competitors are “stuck in the middle”; (ii) when a firm's strong market share creates a cost position that offsets higher differentiation costs; and (iii) when a breakthrough innovation simultaneously reduces costs and enhances uniqueness. He maintains that these conditions are temporary and that firms should focus on one strategy for a sustainable competitive edge.

Hill (1988) contends that while differentiation may initially raise unit costs, increased demand - stemming from product or service uniqueness - can enable economies of scale, scope, and learning effects that lower costs over time. To achieve this, Hill emphasizes the need for: (i) the firm's ability to differentiate its offering; (ii) favorable market conditions, such as high growth and fragmented markets; and (iii) low consumer loyalty to rival products and low switching costs.

Such boundary conditions imply that neither Porter (1985) nor Hill (1988) acknowledge cost cuts resulting from the elimination of attributes. By contrast, Kim & Mauborgne (2015) acknowledge the elimination of attributes, but label it blue ocean strategy thus implying that cost savings result from economies of scale, that is, cost reductions rather cost cuts.

Porter states that the conditions for conciliation are temporary and vulnerable, in which, inevitably, a firm becomes “stuck in the middle” and underperforms in the long term. SA, by contrast, has an incredible and consistent profit record since its’ beginnings, being the only airline to register profit for 47 consecutive years since 1973 until the COVID-19 pandemic in 2020 (Singh, 2024), and by becoming the second largest airline in terms of market share, accordingly to the Bureau of Transportation Statistics – United States Transportation Department (period of November 2023 to October 2024).

Porter argued that SA superior performance is due to the fact that it is a cost leader and thus not “stuck in the middle”. By contrast, this study demonstrates that SA is not a cost leader because its offer is not standard and its cost savings do not result from cost reductions, but cost cuts instead due to the elimination of non-essential attributes.

SA case also refutes the three specific conditions proposed by Porter (1985). Firstly, its competitors were not stuck in the middle because the so-called Legacy Airlines (American Airlines, United and Delta) pursue premium differentiation, namely by investing in premium seats options and premium lounges. This is supported by Kim & Mauborgne (2015) value curve of the average airlines.

Secondly, Porter argues that a firm with a significant market share or unique interindustry relationships can incur in added cost from differentiation. SA differentiation, by contrast, has been achieved through added costs on essential attributes, but also cost cuts on non-essential attributes. In addition, SA did not benefit from scale economies in the beginning of its service.

Thirdly, SA new business model in the airline industry did not involve any major innovation that simultaneously enhances the product or service's uniqueness as well as reduce costs. One could consider the low-cost differentiation advantage the innovation itself, but Porter was referring to all attributes being premium rather than just the essential ones.

Fourthly, Porter assumed that competitive advantage is sustained only as long as the firm remains the sole innovator. SA, by contrast, sustained its competitive advantage after being imitated by competitors such as Pacific Southwest Airlines, People Express Airlines, and JetBlue Airways.

SA also challenges Hill's (1988) framework for reconciling cost leadership and differentiation, which is contingent on high demand over the long term. According to the author, this alignment becomes feasible only after the firm benefits from economies of scale, economies of scope, and learning effects, while

in the short term, differentiation is expected to increase unit costs. By contrast, SA achieved the coexistence of low cost and differentiation from the outset, before attaining significant scale.

SA thus contradicts the conditions where low cost and differentiation can coexist proposed by Porter (1985) and Hill (1988) - see figure 2.

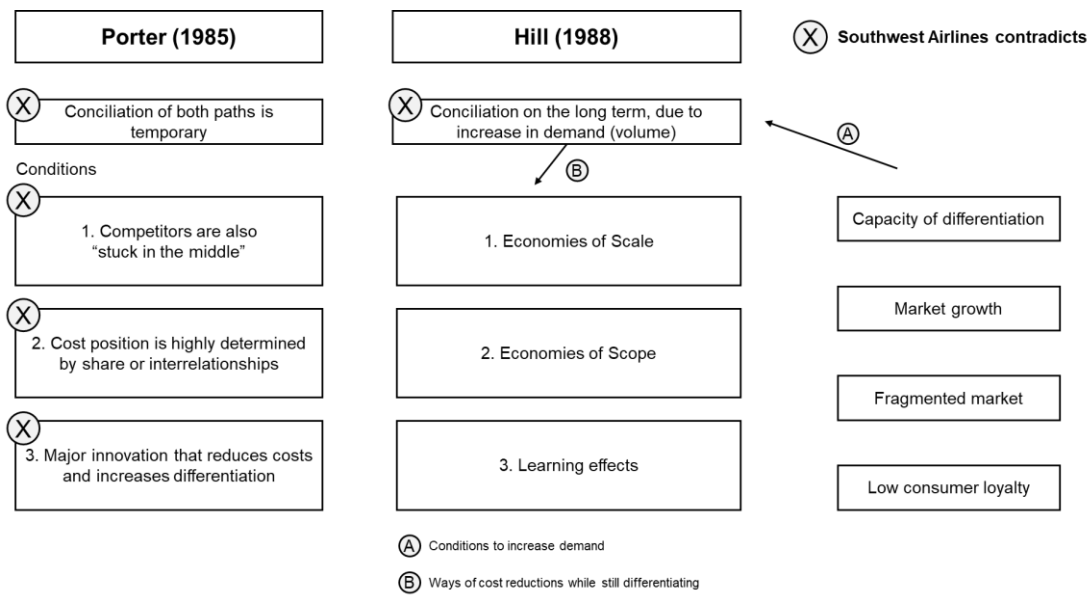


Figure 2: SA Case contingencies refutation (Self Elaboration)

Consequently, SA's ability to reconcile low cost and differentiation does not coincide with the rare and temporary conditions described in the literature. Instead, it demonstrates that such a dual strategy can be achieved under standard conditions, similar to the attainment of solely cost advantage or premium differentiation.

By defending the alternative competitive advantage that conciliates cost and differentiation, it is important to introduce suggestions about a generic strategy to achieve it, as Porter demonstrated with the Three Generic Strategies (Porter, 1985). For instance, Kim & Mauborgne (2015) introduces the concept of Value Innovation.

Value Innovation consists of creating a leap in value for buyers and the firm, through the offering of new products or services that deliver new benefits

to buyers at lower costs. The authors contend that cost cuts and cost savings, respectively, are realized through the strategic elimination and reduction of one's product or service attributes. Buyer value is enhanced through the introduction and elevation of one's product or service attributes.

To support managers on implementation, Kim & Mauborgne (2015) introduced a tool, called Four Actions Framework that guide managers to achieve Value Innovation. When applying this framework to SA , it is clear that the firm eliminated and reduced secondary attributes for customers, such as meals, lounges, seat assignments, baggage transfers, connections with other airlines and limited use of travel agents. On the other hand, it raised performance on essential attributes such as reliability, safety, and customer service, and created new attributes to the industry offering, such as the high frequent point-to-point flights system in detriment of hub connectivity.

For instance, MANAGER A when asked about the Value Curve proposed by Kim & Mauborgne (2015) agreed to the attributes analysis.

Do you agree with the value line above representing the attributes of the service provided by Southwest Airlines?

ANSWER: Yes, the chart shows that there is higher worth placed on attributes of strength in our brand, such as friendly service and frequent, point to point departures, and less on lounges and meals (neither of which we provide).

MANAGER A

Additionally, EX-MANAGER A and B clarifies Southwest's focus on essentials attributes, rather than frills:

"But I don't have to have an assigned seat. And I know I'm not going to get any food whatsoever except peanuts or coffee or something. But it's just that it feels comfortable flying them. I know it's safe. I know that they usually, unless it's a very critical thing like they had a couple years ago when their technology was outdated and they really screwed up at Christmas two years ago, their flights are not cancelled. They complete flights. And that's what the business carrier, business flyer wants. We've got to be at point A to B when we're supposed to be there."

EX-MANAGER A

"We didn't have assigned seating; we didn't have meal service; we didn't have real fancy seats; we didn't have basic equipped boarding services; and we didn't have terminal buildings and gates, and it was—we had plastic boarding passes, you know, rather than a reservation system for an assigned seat there's... You know, there's a lot of costs associated with those types of systems. The other airlines were paying for it, and we didn't."

EX-MANAGER B

Consequently, it can be inferred that the elimination and reduction of secondary attributes, while focusing on essential attributes of the service, contributed to Southwest achievement of low cost differentiation.

Thus,

P3: The elimination of secondary attributes of the service is a necessary, but not sufficient condition to the adoption of a low-cost differentiation advantage

P4: The reduction of secondary attributes of the service is a necessary, but not sufficient condition to the adoption of a low-cost differentiation advantage

In addition, implementing a Do-It-Yourself (DIY) approach is important for firms seeking to achieve low-cost differentiation. By shifting certain operational responsibilities to customers, firms can significantly reduce internal resource allocation, lower costs, and concentrate their efforts on core value propositions. This strategic focus not only enhances cost efficiency but also allows the business to deliver a streamlined and more effective performance on the most valuable attributes of the service.

For instance, SA exemplifies the DIY principle in several steps of the service. Firstly, customers are responsible for checking in via automated kiosks

and printing boarding passes. Secondly, usually there is the necessity of walking from gate to plane. Finally, by eliminating assigned seating, the airline passes the responsibility of boarding order and seat selection onto its customers, simplifying operations and reducing the need for complex boarding procedures. This delegation of tasks minimizes operational complexity and reinforces the firm's commitment to efficiency.

In addition to seating, the airline extends its DIY approach by eliminating in-flight meal services. Customers who desire a more substantial dining experience are responsible for bringing their own food onboard. This measure reduces the expenses associated with catering services and further simplifies the in-flight experience, ensuring that operational costs remain low.

In essence, the more a firm integrates DIY practices into its non-essential attributes, the stronger its low-cost differentiation position can become. DIY serves as a pivotal lever in building a competitive, cost-effective business model that meets customer needs – by focusing on the essential attributes - while maintaining a lean operational structure.

Thus, complementing P1, P2, P3, and P4:

P5: Transferring the execution of eliminated attributes to customers through DIY approach is a necessary but not sufficient condition for the adoption of a low-cost differentiation strategy.

Furthermore, SA has been identified by Kim & Mauborgne (2015) as an example of a Blue Ocean Strategy. While it indeed exemplifies Value Innovation, classifying SA within the broad category of Blue Ocean strategies appears inappropriate. This is primarily due to the overly expansive nature of the Blue Ocean concept, which encompasses low cost differentiation at a lower price as well as premium differentiation at a premium price.

Secondly, the Blue Ocean framework assumes that the creation of new

market spaces renders competition irrelevant until rivals eventually imitate the innovation (Kim & Mauborgne, 2015). This scenario can be partially observed in SA. During the first 7 years, before the deregulation act, SA was the only firm with freedom to operate, not being obligated to follow Federal Government rules.

Thus, during the first years, by providing only intra-state short haul flights, SA main competition was considered the car. This assumption is supported by (Kim & Mauborgne, 2015), by defending that SA took the path of “Looking through alternative industries”, as the airline have the price and flexibility of car travel to create the blue ocean of short-haul air travel. Additionally, Ex-manager B supports:

“So, they really didn't think about competition with other airlines; they were trying to keep their costs low so they could charge prices that were less than if you had to drive. And really, that's kind of fundamental—that really was the business model of the airline. And for a long time, the competition was the car.”

EX-MANAGER B

However, this initial competition irrelevance was mainly due to government regulation that limited existent airlines' retaliation or challenge to the new Texan entrant. Additionally, after the deregulation in 1978, SA has consistently faced and actively engaged with competition, operating in a market with strong competitive pressures.

Consequently, due to broadness of Blue Ocean concept, as well as local rather than global competition-free ecosystem – due to government restrictions - SA categorization as a Blue Ocean strategy is open to discussion.

Chapter 5

Conclusions

5.1. Conclusions

In summary, even with several cases and theoretical frameworks, such as Kim & Mauborgne (2015), the current literature does not recognize an alternative competitive strategy that conciliates both low cost and differentiation. Through the case study analysis of SA, this research suggests that it can be possible to pursue a Low-Cost Differentiation strategy, not only on rare, specific, or temporary conditions, as the literature defends (Hill, 1988; Porter, 1985), but yet on standard competitive conditions.

The Low-Cost Differentiation path requires an approach that eliminates or reduces attributes that are unnecessary or secondary to customers, respectively, while leveraging and out-performing competitors on attributes that are essential to the buyer. The first actions contribute to decreasing the cost position, while the second actions enable us to deliver a unique offering. SA achieved its success through a low-cost and highly efficient service, with a distinguishable offering - mainly due to convenience, reliability, safety and customer service - thus, representing a case of Low-Cost Differentiation.

Based on the findings, the implementation of isolated actions is insufficient to achieve Low-Cost Differentiation. The propositions (P1–P5) are interdependent and mutually reinforcing, forming a cohesive system for achieving Low-Cost Differentiation. For instance, eliminating secondary attributes (P4) and transferring their execution to customers (P5) directly enable lower prices (P1) by reducing operational costs. These cost savings, in turn, free up resources to invest in outperforming competitors on essential attributes (P2). Figure 3 illustrates the relationships between propositions.

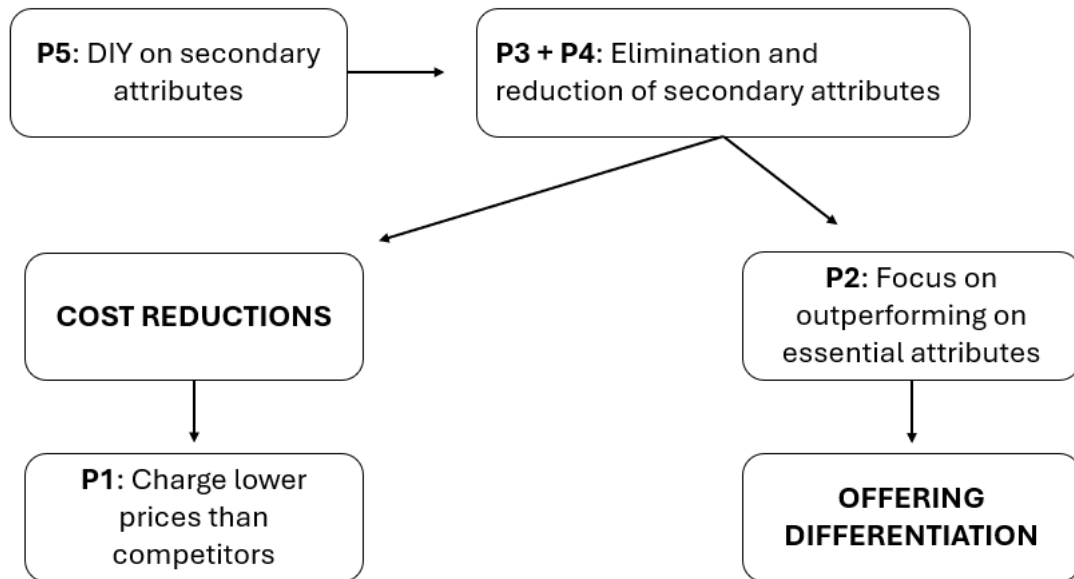


Figure 3: Propositions Connections (Self Elaboration)

Crucially, none of these propositions can operate in isolation: differentiation without cost discipline (P2 without P1) would fail to achieve the “more for less” positioning. Thus, Low-Cost Differentiation emerges not from isolated tactics but from the systemic alignment of the propositions.

Overall, this study suggests that an alternative strategic approach which pursues both Low Cost and Differentiation should be recognized or at least considered for investigation and discussion among the strategic management literature.

5.2. Limitations

This study has drawbacks that should be acknowledged. First, the formulation of study propositions was based solely on a single case study - SA. While this approach allows for an in-depth exploration of the firm's strategic choices, it inherently limits the generalizability of the findings, since it only encompasses one industry and one organization.

Second, the scarcity of literature on Low-Cost Differentiation posed a significant constraint. Most existing studies focus on traditional strategic

frameworks, such as Porter's Generic Strategies and value-cost dichotomy, with limited academic discussion on their possible reconciliation. The absence of prior research explicitly supporting the concept of Low-Cost Differentiation restricted the theoretical foundation available for this study, emphasizing the need for further academic inquiry into this strategic approach.

Finally, the limited ability to conduct a large number of interviews with individuals directly involved in SA posed a constraint on data collection. Geographical distance from the US and restricted access to key decision-makers made it challenging to obtain a large number of firsthand insights. Incorporating more primary data through direct interviews would provide more detailed evidence, ultimately strengthening the study's findings.

5.3. Suggestion for future research

Future research should seek to expand the scope of this study by incorporating additional cases across different industries and geographical contexts. Analyzing firms that operate under varying market conditions, regulatory environments, and competitive landscapes would provide a more comprehensive understanding of Low-Cost Differentiation and its applicability beyond the airline industry. A comparative approach could also help identify common patterns and critical success factors that contribute to the effectiveness of this strategic positioning.

Additionally, a more extensive literature review and in-depth theoretical investigation are necessary to assess whether Low-Cost Differentiation should be considered a distinct alternative within the framework of generic competitive strategies. Given the current gap in academic research on this topic, future studies should critically examine its conceptual foundations, evaluate its differentiation from traditional cost leadership and differentiation strategies, and explore its implications for strategic management theory. Establishing a solid theoretical basis would enhance the academic legitimacy of Low-Cost

Differentiation and provide clearer guidance for both scholars and practitioners.

5.4. Practical implications

The findings of this study offer valuable insights for both practitioners and academics. For managers and entrepreneurs, the concept of Low-Cost Differentiation provides a strategic framework for optimizing resource allocation while maintaining a competitive edge. By eliminating non-essential attributes and reducing secondary attributes, while excelling in essential attributes, firms can achieve cost efficiency while simultaneously offering a unique value proposition. This strategic reflection allows firms to refine their positioning and maximize the impact of their differentiation efforts within cost constraints.

From an academic perspective, this study raises important questions about the theoretical conditions put forward under which cost leadership and differentiation can be reconciled. Future academic research can explore the recognition and legitimacy of Low-Cost Differentiation as a distinct strategic path. By examining its theoretical underpinnings and real-world applications, scholars can contribute to the ongoing development of strategic management literature and provide clearer guidance for businesses navigating competitive trade-offs.

Declaration of generative AI and AI-assisted technologies in the writing process

During the preparation of my dissertation, Low-cost differentiation and competitive advantage: The case of Southwest Airlines, the Chat-GPT tool was used for summarizing insights from articles and formatting interview transcripts, while the Clipto AI tool was employed for transcribing audio to text. The prompts used for these tasks are listed at the List of Prompts section.

Following the use of these tools, I reviewed and edited the content as necessary and assume full responsibility for the final work presented. Furthermore, I declare that I am aware of and adhere to the Artificial Intelligence Code of Conduct of Católica Porto Business School.

List of Prompts:

Chat-GPT:

a. Summary of articles main insights

“Based only on the attached document, what are the main insights of the article?”

b. Format transcriptions

“Context: The interview is about Southwest Airlines history and success.

Desired format:

1. [QUESTION FROM INTERVIEWER]

A: [ANSWER FROM INTERVIEWEE]

I will need to organize the document on the previous format. I need the original and full answers for each question. You can only edit spelling or punctuations.”

Clipto AI

There was no prompt, audio files were uploaded and the software returned the transcription.

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Annexes

Annex 1: Six paths framework (Kim & Mauborgne, 2015)

Path	Explanation	Examples
Look across alternative industries	Involves examining how customers fulfil the same objective using different industries. It identifies opportunities for value innovation by analyzing trade-offs customers make between alternatives that serve the same purpose but differ in form and function. By focusing on the key factors that lead buyers to trade across alternative industries and eliminating or reducing everything else, firms can create a blue ocean of new market space	Southwest Airlines (USA) provides the speed of air travel at the price and flexibility of car travel to create the blue ocean of short-haul air travel. Page: 57
Look across strategic groups within industries	Involves identifying and bridging the competitive gaps between groups of firms within an industry that adopt distinct strategic approaches. With firms narrowly focusing on outcompeting peers within their group, often there are overlooked opportunities across groups. By analyzing factors that drive customer decisions to trade up or down between groups, the firm needs to integrate the	Curves, a Texas-based women's fitness firm, built on the key advantages of two strategic groups in the US fitness industry, traditional health clubs and home exercise programs— and eliminated or

	distinctive strengths of multiple strategic groups while eliminating or reducing aspects that do not appeal to a broader customer base.	minimized other factors. Pages: 58 - 62
Look across the chain of buyers	Involves questioning the conventional focus on a single target buyer group within an industry, recognizing that purchasing decisions are influenced by multiple buyers - purchasers, users, and influencers - who may hold distinct definitions of value. By identifying these groups and shifting focus to overlooked buyers, firms can uncover new value opportunities.	Novo Nordisk shifted focus from doctors to diabetes patients, developing NovoPen, a user-friendly insulin delivery device, transforming the insulin market and becoming leader. Pages: 64 - 65
Look at complementary product and service offerings	Involves expanding the product or service offering by considering the broader context in which it is used, addressing related pain points before, during, and after usage. Firms can identify untapped value by examining complementary products or services that influence the overall customer experience, beyond the industry's traditional boundaries.	Philips transformed the British teakettle market by adding a filter to remove lime scale from tap water, enhancing tea quality and addressing a complementary issue for the user convenience. Pages: 70 - 71
Look across	Involves challenging entrenched norms	QB House (JAP)

<p>functional or emotional appeals to buyers</p>	<p>of industries' specific basis of appeal— either functional (focused on price and utility) or emotional. Firms can redefine industry norms and unlock latent demand by two ways: a) Functionalization of Emotional Industries, removing extra cost that do not enhance core utility or b) Emotionalization of Functional Industries, infusing emotion into their products to create aspirational value.</p>	<p>disrupted the traditional barbershop model by focusing on speed, simplicity, and efficiency. By eliminating unnecessary services like shampooing and luxury amenities, they reduced costs while delivering value through quick, high-quality haircuts.</p> <p>Pages: 72 - 74</p>
<p>Look across time</p>	<p>Involved analyzing how the latest trends could transform customer value and business models, rather than merely adapting incrementally. Finding insights into trends that are observable today, firms can identify key changes needed today to unlock new market spaces,</p>	<p>Apple leveraged the growing trend of digital music consumption to create iTunes in 2003. By addressing customer frustrations with CD purchases and free downloads, iTunes offered affordable,</p>

		high-quality, and user-friendly song downloads. Pages: 78 - 80
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Appendices

Appendix 1: Synchronous interview consent form

The following information is provided to ascertain whether you wish to participate in the interview for this study or not:

1. You are allowed not to take part in the interview and do not have to answer any questions if you don't want to, and this will have no effect on your connection with the researcher Gabriel Fonseca
2. The goal of this study is to distinguish Cost Advantage strategic approach from a Low-Cost Differentiation approach, that conciliates cost and value. To discover findings, in addition to a thorough case study analysis about Southwest Airlines, interviews with ex-managers and managers from the company will be conducted. The result will be presented in a master thesis.
3. The advantages of being involved are the chance to take part in a qualitative research and have access to the conclusions of the study.
4. The interview will be recorded, so that all the specifics of your input are retained. The recording will only be listened to and converted by the researcher Gabriel Fonseca to a transcript in a word document. Your identity will be kept confidential.
5. Everything mentioned in the interview, as well as any summary interview information or excerpt will be anonymous so that you cannot be recognised.
6. To our knowledge, there are no hazards or inconveniences linked with this study.

Signature: _____

Date: dd/month/year



Appendix 2: Asynchronous interview consent form

The following information is provided to ascertain whether you wish to participate in the interview for this study or not:

1. You are allowed not to take part in the interview and do not have to answer any questions if you don't want to, and this will have no effect on your connection with the researcher Gabriel Fonseca
2. The goal of this study is to distinguish Cost Advantage strategic approach from a Low-Cost Differentiation approach, that conciliates cost and value. To discover findings, in addition to a thorough case study analysis about Southwest Airlines, interviews with ex-managers and managers from the company will be conducted. The result will be presented in a master thesis.
3. The advantages of being involved are the chance to take part in a qualitative research and have access to the conclusions of the study.
4. The answers of the interview will be recorded on a word document. Your identity will be kept confidential.
5. Everything mentioned in the interview, as well as any summary interview information or excerpt will be anonymous so that you cannot be recognised.
6. To our knowledge, there are no hazards or inconveniences linked with this study.

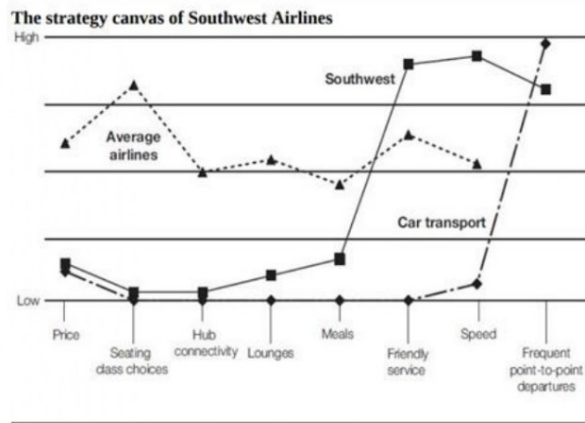
Signature: _____

Date: dd/month/year



Appendix 3: Interview guide

Interview Guide



Source: (Mauborgne & Kim, 2015)

1. Do you agree with the value line above representing the attributes of the service provided by Southwest Airlines?
2. Can you identify direct competitors of Southwest Airlines?
3. Do you think Southwest Airlines is offering a standard service, that is, identical to the service of competing airlines?
4. If not, which attributes of the service provided by Southwest Airlines are different from the service of competing airlines?
5. If you mentioned different attributes, which, if any, are above the service of competing airlines?
6. If you mentioned different attributes, which, if any, are above the service of premium airlines?
7. If you mentioned different attributes, which, if any, are below the service of competing airlines?
8. If you mentioned different attributes, which, if any, are present in the service of competing airlines but absent from the service of Southwest Airlines?
9. Are any other attributes in the service of Southwest Airlines that allow for cost cuts or cost reductions compared to competing airlines?

Appendix 4: Interview – Ex-manager A

1. How does Southwest differentiate itself from other airlines' service?

A: It's really a culture of high productivity. They have fewer people per aircraft than anyone-the last number I saw was something in the 80s, whereas the closest one is like Delta at 125. I mean, all the numbers are better with Southwest or have been typically. It might be a little bit different because they've just gone through some tough negotiations with the pilots who want a lot more money, of course. But generally, they have been really more productive, and they turn planes faster. You probably saw that they turn planes very quickly, which of course allows them to have more flights per day than other carriers. They typically used to turn a plane in 28 minutes and then when they started going to the east all of a sudden it became closer to 40 minutes but that's okay because the others it's an hour and 25 minutes. So, everyone knows all the productivity numbers too. Every day everyone is told what the numbers are just like they are at Jet Blue. Three of the five of us came out of the Southwest to start Jet Blue, so we aren't as good as Southwest at the numbers, but we are very good about productivity is a key.

2. Would you say that the main attribute that allows Southwest to have both low fares for its customers and a good service is the high productivity.

A: The main attribute is recruitment people who get it. It's very difficult to hire in this country now, but it was even more difficult for Southwest. It takes time. Used to take and I haven't seen the numbers lately, but as late as last year, it took 28 people for every one they hire. And the reason is that they look at people who have a history of delivering great customer service, but who also have a history of working and working hard. They don't hire people that haven't had a like retail. We love McDonald's, we love any retail environment where it is busy. Those are the types of people they want to hire.

The pilots they hire are all about their three values: one of the values is warrior spirit and that warrior spirit is all about doing things quickly but well. They hire pilots who care about saying hello to the customers and being customer service oriented rather than ones that are arrogant and sit in the cockpit, and don't turn around and say hello. They'll stand at the door if you notice. Southwest captains a lot of times are at the door when you leave and when you come back. So, it's a spirit with the three values that are so critical to them, and more your spirit being one of the best. The other one is the golden rule. So, they're taught from the day they start to treat customers as they would want to be treated, and that's a critical part of their success.

They will let someone go not having the right attitude and not having the right spirit, and a lot of places are afraid to do that, but they aren't, and they never have been. They've been criticized for it before, Herb Kelleher, who was the original founder and who was one of my favorite people ever, he was a great leader, and he cared. He said: "It doesn't mean that you can't be great with customers because we have fewer people for aircraft and because our numbers are better. You still have to be great with customers so they will come back". People don't come because it's just low cost, people come because it's low cost, it's safe, and safety is a huge issue with them, and in addition they're treated well. Southwest has never given expensive snacks; they've never for 30 some years. Now you get a few uh protein bars, but that's it. But you don't come because of that. You come because people greet you with a smile when you leave. They say they were happy to have you. It sounds very simple, but to get it over and over again...

You've been on airlines where they act like they don't care that you're there and they're rude, and at Southwest they aren't. The way Southwest does use a sense of humor, and that sense of humor has served them very well. They hire people with a sense of humor. One of the questions they ask is: "Give me an example of a time when you had to use your sense of humor in a difficult customer

situation". If you can't give examples of this kind of behavior, you will not be hired.

3. Fun is an attribute Southwest focuses on?

A: Yes, fun is one of their values and it's very rare Southwest had fun as a value long before other firms did and now you see it in a lot of firms. Because what they found out is that people who want to want to work in an environment like that, where they're relaxed and they're respected, where they feel good about coming to work. If you were in Southwest Headquarters, you would see people coming in laughing all the time. It's just so much fun because people just enjoy coming to work there and that matters because you get higher productivity, you get better retention.

People understand customer service is important because without it, you're not going to be there, and it actually ensures that you keep a job right. A lot of airlines started and did not do well, and they're no longer with us. Southwest has been around, I think 50 years is their anniversary this year.

4. So, as I understood, the base for everything is the people and the culture?

A: Attitude, let's say yes if you have. If you have read any of the original interviews from Herb Kelleher, he talks about it in every interview. Yes, he said, we hire the right people, put them in the right spot, and we get the right results. And it is because he hires the right people who care about delivering on the model which includes fun, warrior spirit, and golden rule. Those are the three values and the behaviors associated with those values, that really represent the brand.

5. And do you see that this attribute is unique for Southwest in comparison to other airlines?

A: If it has ever been another similar, I think many of us tried to copy them so

JetBlue has fun as a value because three of us came out of Southwest. We tried to get the same productivity numbers but never quite achieved them, and we always blamed it on being in New York, but that's an excuse, right? But we think others have tried to emulate Southwest, but again it's all about recruitment, and if you don't have the right people, I don't see how you can deliver on the promise. So having the right people is what you know about Southwest. I heard this number last year they had over 200,000 people waiting to be interviewed when others were dying deaf people wanting to be interviewed. We always paid below market, but we had such great applicants we didn't have to worry about it. With the advent of all the unions and all of that, then of course the costs have gone up to where they are competitive in terms of salary, but that was not the original case. In fact, Herb asked me to come and build a recruitment model because he felt they weren't recruiting the right people. That was 30 years ago. They were about they were like four or five thousand when I got there, and when I left there were 26,000. Now they have 40, some thousand, but honestly, people were lined up to come and work even though they didn't leave us for a higher salary, you know, and that is not true of most airlines. Our turnover was single digits rather than double digits, and again when you look at it in the whole picture and you see that that was true even though they weren't paid above market, that's very unusual. That's it's all about wanting to be there, you know what I still contend that's true. My firm now goes into firms, and we build values-based firms like Southwest, but I will tell you we try to get lower turnover. And we do, in most cases, when it's values-based and behavioral-based behaviors matter. And when I ask large groups: "So if you fly Southwest, what is the value you see?" Every one of them says "fun". So obviously they've done a good job of it, yes. And have continued to do it for five decades.

6. You mentioned that JetBlue tried to emulate Southwest.

A: It's very much like Southwest, it is in New York, so it's a bad one, but you know. That's kind of where we are, that's where we had about 20 of our teams are, but I will tell you the people are great, we have low turnover and we use the Southwest model because of the three of us and there are people there today that believe in that same value set, fun is a value. JetBlue too and our numbers have always been good and they're always on the list of best places to fly or JetBlue, Southwest, and now Delta is the third one. Delta is a very good airline, so is Singapore Air. I don't know if you've ever flown them, but they're great. But all of them, the similarities are the people. They all go out of their way to hire people that have great customers and understand the value of taking care of the customer. That's the commonality in the great airlines to me; is they hire the right people because that's the only way you can deliver on your promise.

7. Would you say that this excellent customer service, that is a result of the right people from a good recruitment, is the main characteristic that, apart from the low fare, that differs Southwest from the legacy airlines, for example American, Delta, United?

A: Yes. If you ever fly American or some of the others, I honestly notice the people don't seem happy. And you get on Southwest and they're laughing and smiling. And I know Delta has gotten better. So, they are very much, I think they're happier because they've got a great CEO a few years ago who changed and started recruiting the right people and also incorporated more fun and relaxing, a fun environment, great culture.

So, culture to me is a collection of behaviors of an organization. And when you know that, then you know that if everyone behaves alike and they're all having fun, people want to stay there and work. And if you ever go to the headquarters of Southwest in Dallas or you ever get on a Southwest plane, they're playing with each other. They're having fun. When you get on and off, they are having fun.

And even when they're serving you and when they make their announcements, they're really fun. And that's by design. They hire people with a sense of humor, and they make sure that people treat people well. Herb used to say: "if you tell an employee to treat a customer well, you better be treating them well.". It starts with the leaders treating the employees well, and then they reciprocate by treating the customers well. And it's such a given. It's such a basic promise. And if every leader understood that you can't ask people to treat people in a way that is better than how they're being treated, you can't. It doesn't work. It certainly doesn't work in the long term.

8. How do you evaluate the impact of strong leadership, as Herb had, to allow this culture? And do you imagine it would be possible without Herb?

A: I think it's hard to follow a guy like Herb Kelleher. They originally hired someone who did not do well, but he had been inside. And then they replaced him in a year. And they replaced him with Gary Kelly, who stayed for 20 some years. They did find someone who had been brought up by Herb and acted like him. But there was no replacement. And I don't know if that's what you're asking him exactly because he just was one of those irreplaceable people. But he had put in place a culture that was so strong that people still continue to have fun and still relax. So he was, Gary was not the same as Herb, but he was a good leader. Now they have a new one that I don't know as well. He's been there a couple of years.

And I know they've had some concerns, some of the employees, but you should see what will happen because we'll see what happens with the new leadership. He was a great leader that wasn't brought up inside Southwest. He worked there for years, but he wasn't one that Herb had shoulder tapped. So, we'll see. That's sort of the, how do we watch leadership? And leadership changes are so darn

hard when you have to follow a great leader. It's really hard.

9. Do you agree that Southwest customer service is even better than Premium Airlines, for example?

A: I believe that getting somewhere safely and on time and with a great spirit is critically important. I think Legacy airlines are trying to upgrade you to all these business class and first class, and you pay a lot of money for it. And at that level, they do serve you better food and all kinds of other things. But that's never been the model for Southwest. The Southwest model has been, we're going to get you from point A to B very safely, and you're going to have fun doing it. And so, for that reason, I mean, I've been on most of their flights right now are sold out and they've raised the prices. So, they're not just the lowest carrier all the time anymore, but they're still sold out. And I believe that people care about, again, these are shorter flights, though now they are going overseas and to Mexico and to Canada. So, you will see probably a different type of service.

They've even talked about doing more of a business class service. I don't know if they're going to do that. They've just talked about it. The press has talked about it. I believe that I would fly Southwest, and I do, even if it's a little bit higher than an American or some of the other legacy carriers, because I like knowing that I'm going to be serviced with a smile and knowing I don't care that I get peanuts, frankly. The airline food is not very good anyway. If you want to pay \$5,000 and be in business class, maybe, but I would just assume. The other thing you should know about Southwest is they're one of the safest airlines in the world.

They take off and land more, and takeoffs and landings are where you have most of your accidents. And they have taken off and landed more than any airline, I believe, in the world still. But I believe they still hold that record. And that's

because they have shorter flights. Safety is huge. And they take care of their aircraft. I think they've had two, I mean, we're talking 50 years. I think they've had two major accidents. One was with the Boeing aircraft with the door going off, and the other one was a person who was killed on the aircraft because the window flew off. I happen to know her. She lives in Albuquerque where I live. And Jennifer Reardon was her name.

That was the only accident where they lost someone. So, they have a great safety record. And I think people care about that a lot. Now, some people always want to sign up for seats. And I think they're looking at whether they should do that. So, they're not staying completely away from some of the offerings that they have with the legacy carriers. They're now looking at it. JetBlue assigned seats because when we talk to passengers in New York, they would not fly us without it. Now Southwest is there, and they fly Southwest without having assigned seats. But the answer to your question really is, I always care that I get somewhere safe.

But from point A to B, for a value-priced airline, I think you're always going to get, if you get great service and you feel comfortable and you get there and you aren't canceled, like so many of the legacies, cancel so much. I just think as, and I'm a business traveler, I think as a business traveler, I'd rather take Southwest.

10. The legacy airlines also compete with Southwest on short haul flights?

A: Sure. From here to, for example, from Albuquerque to Phoenix, American flies it, United fly it, others all fly it. And typically, sometimes American will be slightly less to compete with Southwest. But I chose Southwest anyway. And really no assigned seats. I board early. I picked that board early premium I can get. But I don't have to have an assigned seat. And I know I'm not going to get any food whatsoever except peanuts or coffee or something. But it's just that it feels comfortable flying them. I know it's safe. I know that they usually, unless

it's a very critical thing like they had a couple years ago when their technology was outdated and they really screwed up at Christmas two years ago, their flights are not canceled. They complete flights. And that's where the business carrier, business flyer wants. We've got to be at point A to B when we're supposed to be there.

11. You mentioned business travelers, but you see that most Southwest customers are business travelers?

A: I think the majority are going on vacation, going to see family. They're not business travelers. We used to try to get more business travelers. We used to have 20%. I don't know what the number is now. A business traveler is willing to pay more because the firm pays for it. So, we tried to get more business travelers. I think that's one reason they're looking at assigned seats now, because you can get a premium price for those. And so that's probably what they're looking at right now. Okay. They'll still have a smile. They'll still have customer service. But in addition, you may pay a little more to get an assigned seat. Okay.

12. Is there any attribute on Southwest service that is worse compared to other airlines?

A: No. The attributes that I look for are: are we going to take off on time? Are we going to land on time? Are we going to have at least some minimum service because you usually want water or something on a flight? I think that the culture has slightly changed over time. So, while I always see people having fun still, it's not quite the level they were at before, but that's okay because they're still better than anybody else. Or I think they are anyway, in my opinion. They're very good. And the people they hire are extremely personable. If you go to a gate, they'll kid you. They'll play with you. They'll have fun. And I think that means they're probably doing very well in terms of retention, which matters.

I think they can get to know you. Customers love it because when I go to Albuquerque, I usually know the names of the people. They've been there a long time. I just had my guy who checks my baggage, and he said, "I'm finally retiring after 30 years, but I'm not sure I want to". Because see, one of the things Southwest has done, which you should know, is if you're a baggage guy and you've been there 25 years loading those planes, and you have the only thing you get is profit sharing-you don't get a retirement profit sharing. They always pay their employees first, not the shareholders. And you are a millionaire today, a baggage guy of 25 years that's been in the Southwest if he's kept it in stock and hasn't sold any of it to buy a house or anything else. He will have a million dollars, and that's what my guy told me. He said he is doing extremely well, but he thinks he's going to leave it to the kids because he may stay at work. It's great.

13. You mentioned recruitment, the attitude and what you just mentioned about profit sharing. Do you see the latter as a differentiator?

A: Let's say well it's really interesting for pilots they're used to retirement, so they just want to be guaranteed x dollars when they retire. When we first started having problems recruitment at Southwest it was because pilots came out of the military and they were used to a regular retirement and they started seeing our profit sharing because our shares were going up, was very valuable but it took a while to convince them, so we almost had a pilot shortage. But I think as people see it and as they learn that the stock does well if they do well, and the firm does well. Now all the airline stocks are in the tank right now they aren't doing well so some of the people that had a lot of money may not have as much anymore they're trying to come back that's why they're looking at all kinds of different things to do but ever since covid there's the airline stocks because they were closed down haven't done as well at all as they were doing so they're trying to make up for that and now I think they're giving profit sharing plus cash. So, we're

trying to make up for it a little bit.

But I believe that it is a differentiator for people who understand the value, and who want to work in a place where they enjoy coming to work, so that's the differentiation. It's not a place where command and control are alive. It's a place where leadership is very servant-leadership driven; that's their model. That started with Herb Kelleher. I really believe that the servant-leadership model was defined by Herb Kelleher. He used to talk about, 'I'm really a servant to my employees because if they do well, we do well. But I'm certainly not going to live in a command-and-control environment. We want participation and collaboration.'"

He was a huge collaborative guy, he would always come to ask your opinion, but he was funny when we were interviewing flight attendants. He would come walk through the walk-through room and say, wow, you guys are great, he'd hug every one of them and it was really fun. He just always enjoyed it. I think he loved people, and it showed.

Do you know that on Thanksgiving, he would come to the ramp of one of the cities and shoulder tap a guy and say: "I'll do the bags for you today, you go home with your family". And he would sling the bags every single Thanksgiving in the days before. That's unique, very fun, very personable. He gave away his shares to his employees, his stock. He was very caring. People trusted him, I think. Trust and he inspired people, a lot of the leaders at Southwest went on to do great things at other organizations because they had the right model, they learned the model from him.

He's so fun, many times he would kid me, and we would kid each other in meetings, we would go to give speeches. He made fun of himself and everybody else all the time. It was really fun, and this inspired the rest of the firm also to have fun. He had such a sense of humor that he made everybody else laugh all the time. So, then you tend to do it. If you ever walk through the building, you'll

still hear him laughing all the time. They tell me that it's that part hasn't ever changed. And that's part of his legacy. He created a very fun. He said: "We don't have money to pay people the most we should pay them. So therefore, I want them to enjoy work and enjoy coming and learn a lot because they will get respect, and they'll get ability."

85 percent of our promotions were internal. That's unheard of. People had the ability to move up very rapidly and we were growing very fast. And so, he wanted us to try to find people inside for all the jobs they could move up. He was very much a proponent of supporting his people.

14. What would you say were the most important attributes that allowed Southwest to keep the low cost and low fares for customers?

A: The attributes helped everyone understand what the values were and be held accountable. So, warrior spirit. So, you didn't put in your budget each year, you didn't ask for more people. You tried to figure out a better way to do something. You didn't try. You didn't try to emulate. For instance, when we had a frequent flyer program, we didn't try to emulate all the other airlines who we knew we had to do something for people to reward them for flying us. But it would have cost us one million dollars in '95. We looked at a frequent flyer program, we said "Oh, my God, that's going to cost us millions of dollars, not one million, but millions of dollars to implement." Let's just make it simple. Let's just give them X points for Y travel length. So, we made it so simple. So, trying to be simple and implement things and try to kill the bureaucracy. We didn't have levels of management.

Now, I imagine they have more. But at the time, we did not. We didn't have senior VPs. We didn't have lots of directors or lots of managers. We had more people per manager than other airlines. And I think it's because everyone worked together. And the other thing was they got the rewards and profit sharing. So, giving people the profits first rather than the shareholders, I think, says a lot

about a program where people really get rewarded for their efforts.

15. Would it be “less is more”?

A: Yeah. Less is more. Having less bureaucracy, having less levels of management, having fewer people, more people would report to a manager. But that was fine. And getting everyone involved in solutions. Because every time there was a problem, we ended up asking the people who actually had to work with it, right? So, people at all levels were helping us get better at what we did. And that's really participative management. That's a servant leader model. And I think by everyone is trying to resolve the issue, they get involved in making sure it happens. Whatever the solution is, they help you with the solution.

I also think one of the issues with recruitment is knowing what behaviors you want and using a behavioral recruitment model. So, it was always asking questions about past experience, because past experience will tell you how someone will behave in the future. So, make sure that people know that if you have a recruitment model, make it very specific around that. And the behaviors you want, because that's how you build the brand so that every time anyone interacts with one of the 50,000 employees or 40 some thousand, they get the same experience. And that's the Nordstrom model, that's the Southwest model and that's the great organization's model. If you go into an Apple store, if it's in Portugal or it's in Albuquerque, you're going to get that same experience. They're well-trained, they're personable, and they know the solution, right? So, Southwest was one of the first to start what was called behavioral recruitment, which is known as the behaviors you want and then hire to those behaviors.

It's over 90% predictive. So, their hires were good. It took 28 resumes to get one, but their hires were good. And the other thing we did was we had the people that were going to work with the people hire them. So, we went to pilot recruitment with pilots, flight attendants, recruitment flight attendants, operators and baggage guys, hire the guys that work with them. Do you know what they do

then? They make them successful. They make sure their hire isn't bad. Because they'll catch all kinds of hell for it with their peers. So, all those little things being put in place make the model work. And as a result, we have better people, more motivated people, better service. Yes. And still at a low cost.

And they start as a team, because they hire their team members. It really works. And it really is a model that a lot of firms try to emulate today. But Southwest was one of the first ones to use it. And it started in World War II. When they were trying to find out why the Air Force was performing well, it was called Air Corps, and some pilots always hit their targets, and some didn't. The ones that always hit their targets, guess what they did? They always walked the aircraft for safety. And they always did a checklist. So, there were things they did every single time. So, they tried then at Southwest, we took our pilot recruitment and said, okay, we want to use those same behaviors. We want every pilot to do a checklist. And today everybody does it. Emulating the right behaviors gets you the right outcomes. But you have to know what those are. So, you have to look at your A players to figure out what those behaviors are. Then you hire them and then you get consistency of brand. And they execute in a way that's much more productive because they're consistently behaving the same. So, it's not like you have a bunch of people trying to do different things. They all have the same goal.

Appendix 5: Interview – Ex-manager B

1. **Southwest is well recognized and distinguished by its low cost and low fares. But in your opinion, do you see that Southwest's service, the service it provides to customers, is standard—like identical to other competitors—or different?**

A: Well, you know, when Southwest first started flying in 1971, there really was no competition in the airline business because all of the other American certificated airlines were governed and regulated by the federal government, and so the government in the early '70s told every airline where they could fly, how much they could charge, how many flights a day they could operate between cities, how many first-class seats they could have, whether they could serve meals—I mean, every part of the competitive atmosphere was controlled by the Civil Aeronautics Board, by the federal government.

So, when Southwest started flying in 1971, the original government approval of Southwest to start was granted by the state of Texas, not by the federal government, so Southwest didn't have to comply with all the federal regulations that the rest of the airlines did. As a result—and you probably know all this history—from 1971 to 1978, Southwest operated with really no direct competition because the airline was playing off of a different business model than everyone else. They could charge any fare they wanted; they weren't required to get approval from the government about how many flights they flew. It was a really interesting time in the airline industry in the United States because Southwest was just so different, and the other airlines didn't know how to compete until 1978 when they were deregulated.

When the playing field became more level between Southwest and all the other airlines—but the other airlines, you know, from the beginning, they had been told exactly what they could and couldn't do—so it was quite a change in, like,

October 1978 when they could start playing by the same rules or do whatever they wanted to do like Southwest had been doing for the previous seven years. So, Southwest had, you know, a seven-year head start competitively to really operate differently than anyone else. And I think the best way to think about what Southwest was charging and the business model they had was that they thought their competition was the car—the automobile—no other airlines. I say "they," but I say "we" all the time. I still feel like I'm, you know, a part of the firm. I was there for so long and was so close to it. But they were charging fares that were less than what it would take to drive between Dallas and San Antonio, and Dallas and Houston, and Houston and San Antonio.

So, they really didn't think about competition with other airlines; they were trying to keep their costs low so they could charge prices that were less than if you had to drive. And really, that's kind of fundamental—that really was the business model of the airline. And for a long time, the competition was the car.

2. But the competition like on these first seven years that you mentioned before deregulation. I think it was clear that Southwest's main competitor was the car. But after the deregulation act and the years following in which the other airlines could do whatever they want as mentioned, their competition still the main competitor still remains the car or other airlines enter the game?

A: It's a good question. Within the original markets within Texas, the competition was still the car. Okay, but after 1978, you know, the first out-of-state destination was New Orleans, Louisiana. So, when they started going outside the state of Texas, they were competing with other airlines. Okay, and then it became more service focused. What kind of service could you offer? How many flights a day could you offer and still offer a lower fare? So, the fare basis was still kind of the core but had to recognize that we were also competing against a lot of airlines

flying between Houston and New Orleans, and they were offering a lot of flights between Houston and New Orleans, and they were offering meals and assigned seats, but they didn't... Another part of what the original Southwest business model was that we offered a lot of flights every day, so there was a convenience. If you had a business meeting in New Orleans in 1980 and there were four airlines to choose from, and you didn't know what time your meeting was going to be over with in New Orleans, you'd probably pick Southwest because we had the lowest fare, but we'd have flights every two hours in between those two cities. And that was, other airlines might have three flights a day, and we'd have 20. So, the convenience, yeah, at one point between Dallas and Houston, which is an hour flight, it's 240 miles, there were 70 flights a day. Like every 30 minutes, every 15 minutes, every 30 minutes. That's impressive. Well, so people really didn't have to think, it was almost like, you know, you're hailing a cab. You know, it's not like you had to make a reservation, and you just go to the airport, and you knew there'd be another flight in less than an hour, and the fares were the lowest. So, it really built up a loyal and a large customer base, just because of the convenience of the operation. And the fares were low. And probably as important as those two business models, was the people were nice, the people were friendly, and the flight attendants. And it was fun to fly. So, I think that people didn't... No, didn't find it at other airlines, this spirit and this fun environment, right, not really because you know, keep in mind that the rest of the airline industry was really trying to try to understand how to operate in a deregulated environment, and they really had a hard time competing with us. And at the same time trying to charge fares they couldn't match our fares because our operating costs were so low, and they had all these legacy and historical facilities and gates and airplanes that they had to keep paying for it, and we were, you know, we just had one kind of airplane and a real efficient operation, and from a cost standpoint, they just couldn't, our costs were probably 50 less than the rest of the industry, so if they didn't want to compete with us and offer 20 flights a day between Houston and

New Orleans, they lose it, they lose so much money because their operating costs were so high.

3. And you mentioned the operating costs and the efficiency that Southwest had throughout those years. What are the main factors you mentioned, for example fleet standardization, just Boeing 737 for example, but which other factors or attributes allowed Southwest to have such an efficient operation that made it possible to have such frequent flights among cities?

A: Yeah, that's a really important question, and a lot of the answer, the answer a lot comes from just having one type of airplane because you know every pilot, mechanic, flight attendant, anybody could operate, could work on any airplane. The cost and the experience to maintain the airplanes was less because the mechanics, just, and you know parts, mechanics—all those costs were lower because you just had to take care of one, one type of airplane. We didn't have assigned seating; we didn't have meal service; we didn't have real fancy seats; we didn't have basic equipped boarding services; and we didn't have terminal buildings and gates, and it was—we had plastic boarding passes, you know, it was rather than a reservation system for an assigned seat there's... You know, there's a lot of costs associated with those types of systems. The other airlines were paying for, and we didn't. But I think most importantly though, really low per-flight cost. If it, just say on an average day, you fly 100 flights and you do that with a certain number of people, and you have to buy fuel, if you can beat payroll and buy fuel, you can operate an airline pretty inexpensively. And other airlines might get 30 flights a day with that same number of people, but they just didn't fly the same number of flights. So, we were able to keep our per-flight operating costs very low because we flew a whole lot of flights with the same number of people and it was basically two shifts a day. We flew from 6 in the morning until 10 at night and then from 10 at night to 6 in the morning, we maintained the airplanes. And at 6 o'clock in the morning you start over again. And most of the

time during the event, I'm not sure what it is today, Gabriel, but in most of the time when I was at Southwest just to give you kind of a productivity measure, the rest of the airline industry had about 125 employees per airplane. We had 75 employees per airplane. Well, you know, so, you know, when you end with labor as your number one cost, if you can, if you can keep that kind of cost formula intact with that few employees per airplane compared to competitors, it's not hard to, it's not hard to be profitable. Yes, that's really impressive. This big difference between the Southwest and other legacy airlines in terms of people or workers per flight.

4. And you mentioned that, so my interpretation is Southwest delivers a cheaper service, low fare service to the customers, but with no frills, right? No meals, no seat assignments, no lounges, for example. While the legacy airlines, they offer all of those frills, but with a higher cost and also higher fare. But still, many people prefer Southwest as we see that we have more flights with more people in the case of Southwest. And my question is, do you think that this, I would say, preference for Southwest would be just because of the fare aspect, just because of the fare that is low or something else?

A: I think the convenience of having many flights per day without any type of change fees. And the friendly people, and if something did go wrong, and what you know, the airline business is very difficult to operate without something going on in your system every day. Either air traffic control issues, weather issues, airplanes break, you know, the FAA says, here's the rules when you can safely fly an airplane. So there's, you know, every day there's something that goes wrong. And the Southwest employees, we gave them the freedom to take care of the customers and make them happy without when things did, when things did go off schedule. We gave the employees the freedom to do whatever they needed to do within reason to make sure that those customers came back, especially

when it was our mistake. And that type of leaning into customers, when you're dealing with a problem that you created, the rest of the industry didn't have that type of mentality necessarily with their customers when things went wrong. And, you know, people remember; they remember those kinds of service things. I, you know, I had, you know, I was responsible for almost the whole airline. And I would always tell a lot of our employees, you know, take care of the customer and we'll take care of you. One, one night we had a, I mean, it sounds, it sounds simple, but sometimes it's hard to execute. We had a flight one night that was going from El Paso, Texas down to Houston. And there was a lady who was, it was the last flight of the night. And she was going to see her mother who was dying in Houston, a cancer. And she, she tripped and sprained her ankle in the jet bridge, you know, that, that connects, you know, that connects the terminal to the airplane. And it was our jet bridge. It was our fault. She missed the flight and she was going to see her, you know, her, her mother who was gravely ill. So that was on a Sunday night, Monday morning, the manager in El Paso called me and said, Hey, I just want to let you know what happened last night and what I did to take care of this lady. I had to go see her mother before she died. And I said, Hey Rudy, whatever, that's fine. He said, well, I chartered a jet and I flew her to, I flew her to Houston. So she could be with her mother. And I said, good job. And then I said, I'm just curious. How much was it? He said, I was about \$6,000. And I said, you know, way to go, Pat, pat on the back. He did, he did the right thing. But at the time, our average ticket price was \$50. But I just give that as an example. And our employees did that. They had the freedom and the latitude every day to do what they needed to do to make sure our customers came back when it was clearly our mistake. So, the fare was a big deal. It was a big deal. The destinations we served, the convenience with the flight schedule of many flights a day, and just really friendly people to be on board an airplane with. And we just wanted to get you to your destination on time and with your bags. And it was really simple. We just kept it simple.

5. With Southwest's success and proven success throughout the years, we have many attempts to copy or emulate Southwest's model, and some of them fail. For example, Midway, Morris. But why do you think that even if some firms try to emulate and copy Southwest's model, why has nobody still got it exactly as Southwest and surpassed Southwest? What makes it unique?

A: In some ways, there's an easy answer to that. There's a complicated, more complex answer to that. And the more difficult answer is Southwest. Yeah. There is a simple, you know, informed, and it is because we have to make sure our elevation strategy is very, very clear. Yes. And more so, that's new. You, Paul. And we were and we got our approval from the state of Texas. It's not from the federal government. And so that. That to get the, you know, that we were in court for almost 5 years before we ever flew 1 flight. So that, we call it that warrior mentality was a part of the fabric of the firm before we ever started flying was, you know, we were fighting, we had to, we wanted to survive. We had to do things that no one else did. We had to be persistent. We had to be, you had to get angry. You wanted to win. And the other airlines didn't have that same environment the way they were creating the way Southwest did. And so that's, I think that's the complex answer is just that. That moment in time, the late sixties and early seventies when the idea to create Southwest took a whole lot of work and a lot of individual contributors working for free in order to get the airline started. The other part, it's not quite as complicated as to why Southwest survived and the other ones didn't is that we were doing one thing that started in the pre-deregulation environment. So, we had seven years to learn how to operate with one type of airplane. They were able to operate with a very efficient, very high-cost airplane. A network that was very efficient, low cost, and high productivity, and employees enjoyed coming to work every day. The rest of the industry, the rest of the startup carriers, like Midway or Morris,

or, you know, there were so many airlines that tried to do what we did. They, because of us, when they started, they immediately were in the, were being aimed at by the big boys. Midway is a good example. You know, they wanted, you know, a huge market, Chicago. And when they started, American Airlines was like, we're not, we don't want Southwest to get away from us. We're not going to Midway Airlines. It's this little Midway airport. We're going to do whatever we, we can do legally to make sure they don't succeed competitively. So, and that was really the case with a lot of other startup low-cost carriers. The big boys, the Americans, Deltas, United. You know, once they saw another Southwest kind of firm, they got started, well, they just, they just put them in the crosshairs and started, they overlapped their schedule. They flew the same routes as Midway. They charged lower fares, they lost money just to keep those carriers from becoming successful over a longer period of time like Southwest did. I think a lot of it had to do with; they didn't want to know the Southwest in their backyard. It's a vicious business, yes?

And at least in the United States, and I think it depends on other countries too, but in the United States, it's against the law, it's against federal law to charge what's called predatory fares that are less than what it costs you to operate a flight. And that's what a couple of the airlines that originally went after Southwest in the early days, they were found guilty in federal court of predatory prices. They were charged, they were matching our fares and they did it to run us out of business, but they couldn't make money by matching our fares. And they ultimately were all found guilty in federal court. Yes. And in the long term, they would also, uh, be at a net loss, right, in the long term, if they kept, if they kept, uh, with those, those prices. And in the early days, you know, otherwise, they were operating globally, globally, airlines, and so they had a lot of other opportunities to charge higher fares, you know, between Miami and London, you know, they could, they could earn enough money on some of their

larger international routes to help offset the few flights that they would be competing with Southwest losing money. It's a complicated legal case to try to prove because airlines usually don't, they don't break down their costs, their revenue structure. On a per-flight basis, or they do between the cities. I mean, they know how much it costs to fly between Phoenix and Los Angeles. But when you look at the entire route system every day, it's hard to prove that they were, they were targeting a startup airline with predatory pricing to try to put that. Yeah. They were targeting a startup airline with predatory pricing to try to put that. But they did, and most of them were ultimately found guilty.

6. Why are those low-cost airlines, including Southwest, having more difficulties to come back now after COVID-19?

A: Well, you probably have learned this in your research, but Southwest is the most heavily unionized airline in the United States. 80%, 86% of all employees belong to different unions, and those union contracts usually are from 23 to 5 years in duration. In the years leading up to the pandemic in 2020, Southwest, the management of Southwest, got behind in negotiating new contracts with all those different unions. And I think that, you know, as I said before, that's the number one cost to an airline is labor. You know, fuel is number two, but your operating costs for people, and they're typically highly paid. You know, they're highly paid folks for the most part. So, Southwest, I think, made a mistake in not diligently negotiating new contracts with all their employees, even 10 years before the pandemic. And I think morale-wise, the employees felt like, well, because historically, I've negotiated, I don't know how many union contracts. In the past 10 years or so, that priority of whatever, before a union contract expired, you know, we'd sit down with the union and hammer out a new deal, and everybody's happy, and everyone feels, well, not everybody's happy. But, you

know, at least contracts didn't go years after they expired without having a new compensation package for the employees. And I think over time, the employees felt like the firm didn't care as much as it used to. So, when you book right before the pandemic, and given the pandemic, a lot of these contracts that had not been renegotiated became stagnant, particularly with the pilots and the flight attendants. And the pilots went almost 4 years without a new contract. And so, by the time we finally got a deal, they had to, the firm had to pay the same amount, or basically the same salaries to pilots as American had already negotiated a new contract, Delta did, and United. And they were really expensive pilot contracts. So, Southwest was the last one, and now Southwest 737 captains are by far the highest paid pilots in the domestic U.S. airline business.

What happens to operating costs when this occurs? They start going up. Yeah. And they're high, and they're high. It's totally opposite of the beginning of the airline. When we were 50% lower for labor costs. Now we're 15, 20, 25% higher. So, you have to start charging higher fares, and the flight attendants were the same. We didn't do the same thing. The flight attendant union contract was approved right before the new pilot contract. So, you're dealing with two large employee groups, pilots and flight attendants, right before the pandemic and during the code. A new contract created some very expensive labor rates. And the only way to keep the airline profitable was to start charging higher fares. Mm-hmm. And the rest of the industry. How does Southwest compare with its competitors today? So, Southwest, Southwest really is, their competition today is American and Delta. And, you know, those four airlines, I'm sure you've seen, you know, they fly 85% of the domestic traffic in the United States are those four airlines. But the rest of the, you know, the other three competitors, you know, they offer meals on almost all flights. Wow. Meal service, assigned seating, more legroom, more destinations, TVs in the seat back, you know, with Wi-Fi and entertainment systems per seat. Southwest has none of that. And we have to

charge higher fares because the labor costs are so high. So, that's their problem today. They're competing with the other three large airlines, and they don't have the amenities, and they're working on it. But I flew Delta last week, and, you know, it was so different. It was a market that Southwest served as well. And, you know, what I got for a lower price on Delta with all those things, I mentioned, why would you pick Southwest? Because the people are friendly? No. Because they have more flights? No. If they're going to my destination, it's a better product at a lower price. And Southwest can't offer that today. They're working on it. But it's been probably a five-to ten-year deterioration in the cost advantage that Southwest has had. And the rest of the industry offering a lot more amenities and things on flights that Southwest hasn't been offering. Southwest got lazy. They got lazy, and they lost. Not been lazy. They took their eye off the ball of keeping their costs low.

7. How do you evaluate the impact of Herb's absence on Southwest's performance since, well, he left the firm?

A: Herb was one of my best friends. And we worked closely together. We first met in 1977. And we worked together for 40 years. And. He had a. He had a larger impact on employees, just because of his personality that can't be duplicated. And when he, when he retired, he was still around after he officially left the firm in 2008. He was still, he was still hanging around a lot. And he was still, he still had an impact on morale and employees. Uh, but, you know, he was. He was a one in a 1 in a 1 billion. And. And. You know, the leadership and Gary, Gary Kelly is a good friend of mine. The leadership team that followed him, her, and Colleen. They, they, they continue to take care of employees, but it just wasn't the same. Okay. And it's a pure personality thing. She's as much as part of the Southwest story this part. Colleen Barrett. She was the heart of the airline. Herb was the brains and Colleen was the heart. So, I would encourage you to, and if you want

to set up some time, I can tell you more about Colleen. She just died last year, and I was a part of her funeral in Dallas, and you need to do some, if you have time, if it fits with your schedule, to get a really accurate composite picture of SA, you have to learn about Collin and Barrett as well. She had systems set up for employee recognition, for feedback to employees, keeping the employees informed about what we were doing. All employees got birthday cards signed on, there's just hundreds, probably thousands of things that Collin was doing internal to the firm to keep the morale up and to keep employees happy.

What was Colleen's role in the firm? Make people looking forward to coming to work every day. That was her job. She was to make sure 50,000 employees felt respected, they felt loved, and it wasn't just talk. I mean, it showed up in a lot of different ways in the culture that firms; it was really a unique cultural and business model that Southwest had for. For 40 years before they retire, before we retire, and I was very blessed and fortunate to have done a part of those; those; those years when it was; it would have been impossible to not make my money. And airlines just can't say that, but yes, it was a real magical, magical time. I, with the culture and the business model and, you know, people just enjoy getting on and coming to work and following me.

It's pretty simple, you know, it's, it is; we just try to treat each other the way you want to be treated, keep your costs low and, and, uh, you know, keep an eye on the bank account, you know, you don't want to spend money you don't have. Mm-hmm. The Wall Street analyst. For years, they used to, they used to just crucify Southwest because we didn't have enough debt. You know, they said, because they were comparing this to the other airlines who had, you know, 60, 70, 80% debt-to-equity ratio. Our was 20. And they would say, you know, you guys need to go out and borrow more money and fly to more destinations, buy more airplanes. And we were financially disciplined. As far as, you know, capital expenditures and, and spending money over, over the years, we were happy with

an 8% return on invested capital that was 8 to 10% return on all of our capital. And we made a whole lot of money, and the firm was solvent and safe for decades by just having a, a, a really disciplined and successful economy. Almost boring financially. About the horrible year after year as far as sending money borrowing money. And not spending stuff, not spending money on things that didn't generate revenue.

Many years ago, I don't remember the exact year, but. The city of Dallas. That. They built a new arena for the Dallas Mavericks basketball team. And it was right in the middle of downtown. It was 10 minutes from Love Field in our office. And they came, the developers came to us and said we want to name this SA Arena. It would be a great branding opportunity to have our name. And so, you know, we met the city of Dallas and the developers of what is now the American Airlines Center. But they offered us the naming rights first. And Herb said, "Well, tell me how much money it's going to make us. Because you had to buy it. They wanted an investment. A big investment to buy the name, the arena.

And he said, show me how that would be. A good investment for Southwest. He said, you know, we could buy three 737s for the price of having our name on a basketball court. Which is today still the American Airlines Center. They went to American next and American said, yeah, we'll take it. But unless you could show that getting caught up in the hype and the business popularity or the world popularity. I mean, your name everywhere, we weren't interested.

8. And I saw an interview from Herb that he said something that was like Southwest. They were well managed in good times. So, they were cautious and didn't make expenditures for low returns in good times. So, when there are bad times, they don't feel as much as other airlines feel, for example, so

they have solid balance sheets to keep solid and steady throughout the bad times also...

9.

A: And those bad times, no matter when they happen, whether it was in the '90s when the Gulf War started and fuel prices tripled, and I suspect you've seen some of those studies where, you know, over a month's time, the price of our jet fuel tripled. Well, you know, when that's your second highest operating cost, you just can't sustain those kinds of cost increases for a long period of time. 9/11. That was another example. You know who would have ever thought about that? But we had credit, we had a solid balance sheet, and when that happened, we were in a position to continue to operate over a longer period of time and not lose money. We didn't make as much money, but we didn't start losing money, and the rest of the industry did because we had a savings account, and we didn't have a lot of debt.

I learned a lot about how to manage my own home, you know, with, you know, the same principles apply to individuals as well as to firms.

Yeah. Can I go out and buy an airplane right now? Yeah. Would that be a smart move? No, especially since I can fly Southwest for free. Anyway, I digress. I'm sorry.

Appendix 6: Interview (asynchronous) – manager A

- 1. Do you agree with the value line above representing the attributes of the service provided by SA?**

A: Yes, the chart shows that there is higher worth placed on attributes of strength in our brand, such as friendly service and frequent, point to point departures, and less on lounges and meals (neither of which we provide).

- 2. Can you identify direct competitors of SA?**

A: Southwest's direct competitors include all the US domestic carriers, United, American, Delta, Frontier, JetBlue, Spirit and Alaska as well as a few others on a lesser scale such as Allegiant, and some Mexican carriers to the extent that our route networks overlap flying from US Gateway cities to key cities in Mexico, like Cabo San Lucas, Puerto Vallarta, and Cancun.

- 3. Do you think SA is offering a standard service, that is, identical to the service of competing airlines?**

A: No. To date, Southwest has offered a single-class cabin (so no business or first-class seating); no airport lounges; no onboard meals; and no assigned seats or extra legroom seating options. Effective last Fall, the airline did announce it would be moving to assigned seating (for sale) in mid-2025 and offering an extended legroom seating option beginning with operations in early to mid-2026. That will help Southwest compete more directly for business travelers domestically.

- 4. If not, which attributes of the service provided by SA are different from the service of competing airlines?**

A: Answered above.

5. If you mentioned different attributes, which, if any, are above the service of competing airlines?

A: Competing airlines have business and first-class seats, onboard meals on some flights, and assigned seating and extra legroom seating options. Most also operate airport lounges.

6. If you mentioned different attributes, which, if any, are above the service of premium airlines?

A: Premium airlines with extensive international route networks have widebody aircraft which operate European, Asian, South American, African and Canadian routes while Southwest does not. Southwest is pursuing offering its customers broader international options than it can operate with its narrowbody aircraft via codeshare or interlining agreements. The first of which was recently announced with Icelandair.

7. If you mentioned different attributes, which, if any, are below the service of competing airlines?

A: Our current, open seating operation is unlike any other airline; we're currently the only airline in the US to operate this way. That will change with the product changes being made now that will be for sale later this year and operational early to mid-2026.

8. If you mentioned different attributes, which, if any, are present in the service of competing airlines but are absent from the service of SA?

A: Answered above.

9. Are there any other attributes in the service of SA that allow for cost cuts or cost reductions compared to competing airlines?

A: We believe that a single fleet type (We fly the Boeing 737 narrowbody jet) allows for cost efficiencies when it comes to operational training of our Pilots and Flight Attendants, mx parts inventories and aircraft mechanics training and manuals. Having a single fleet type allows for some simplicity in our operating model that other airlines who fly multiple fleet types do not have.

Appendix 7: Interview – Herb Kelleher

Herb Kelleher at an interview for The Motley Fool in 2019

Motley Fool is a financial services firm that reaches millions of people every month through investing solutions, free guidance and market analysis on Fool.com, top-rated podcasts, and non-profit The Motley Fool Foundation.

The interview was conducted by Tom Gardner, Co-Founder and CEO of The Motley Fool.

Transcription

From minute **00:00:40 to 00:09:33**, the interview topic was about Herb Kelleher's personal life. Therefore, the transcription of this period was discarded, since it didn't add value to the research.

[00:09:33]

Tom Gardner – Interviewer

And then what happened at St. Anthony's Club?

Herb Kelleher - Interviewee

Roland and I might have discussed the formation of SA at the St. Anthony Club.

Tom Gardner – Interviewer

And how did you know Roland at that point, and why did that conversation come up?

Herb Kelleher - Interviewee

Well, the conversation came up because Roland became a client of mine. And so, I represented his little airline, Twin Beach, operating short haul out of San Antonio. And he got into a squabble with a partner, and I got that straightened out for him. And then he became a law client of mine on a regular basis. And his banker was John Parker at the Alamo National Bank. And he was talking to John one day, and John had just gotten back from California. And John said, "You

know, for \$11. 43, I flew from San Diego to San Francisco on Pacific Southwest, later PSA. And he said, why don't you think about starting something like that in Texas? Because Texas had the basis for that. Large state. Large metropolitan areas, far enough apart to justify flying. You know, and so at first, I was kind of skeptical and said to Roland, you know, I'm not so sure this is a good idea. But then I spent time researching PSA in California, and I said, hey, this could really work.

Tom Gardner – Interviewer

What did you learn from PSA?

Herb Kelleher - Interviewee

Well, they were a low-fare, low-cost airline. And they also had a certain, I guess you would say, panache with respect to the way that they talked to passengers and made jokes on the airplane and, you know, wore hot pants. Things of that nature. And so, they served as kind of a role model, and they actually came in and said, Lamar Muse was our operating president by that time, and said, we want to sell you our operating manuals, you know, and Lamar said, I've already stole them. You know?

Tom Gardner – Interviewer

What happened to Pacific SA?

Herb Kelleher - Interviewee

They were bought by U. S. Air.

Tom Gardner – Interviewer

I mean, that ultimately would have been a great merger for the two of you, right?

I mean, the airlines.

Herb Kelleher - Interviewee

It would have been. As it turned out, we became big rivals because we went into Phoenix, and PSA ran an ad saying, SA, Phoenix belongs to PSA. And I said, 'Let's run an ad saying, PSA, we'll meet you at the OK Corral.'

So, we were really turned into adversaries, but we saw their costs getting higher

and higher, their fares getting higher and higher, and finally decided it was time to get into California. And within a relatively short period of time, we became the largest carrier of passengers-and intrastate passengers in California.

Tom Gardner – Interviewer

So, I want to talk about cost containment in a second, but before doing that, I want you to tell me for the 1,000th time, the beginning of Southwest. For somebody that's never heard the story of injunctions, litigation, all the effort that had to be put in, that seems almost preposterous today, and maybe even a little bit about the Wright Amendment and the battle for Love Field. You left them to almost go bankruptcy. I mean, maybe not bankruptcy for you. But certainly, you had no income, right? I mean, Southwest was on the verge of bankruptcy as it was trying to make its way to really get its first plane in the air.

Herb Kelleher - Interviewee

Well, what happened was the incumbent carriers were not exactly warm and welcoming and hospitable. So, they contested our application before the Texas Aeronautics Commission. We were an intrastate carrier, not under the CAB, as a federal carrier. And that litigation went on for – For four and a half years before we could fly. And I had to go to the Texas Supreme Court.

Tom Gardner – Interviewer

Where did the original money come from in the last four and a half years?

Herb Kelleher - Interviewee

We raised it.

Tom Gardner – Interviewer

And were you just going, you were like, we'll probably be up in a year. And then when you weren't, you went back and raised another round?

Herb Kelleher - Interviewee

Well, we had to raise another round. But at that time, we did something different because the board said in '69', we're going to have to shut down because we've run out of money. And we can't afford this litigation anymore. And I said, well,

how about if I do it for nothing and pay the costs out of my own pocket? Tough to turn that down. And then if we ever get started, you know, you can reimburse me. And they said, well, that sounds okay. And then after we got into the air, the other carriers continued their— suits. Energetic. Energetic. And it's competitive against SA.

Tom Gardner – Interviewer

And the basic reason they're coming after you is they know you have a great game plan.

Herb Kelleher - Interviewee

Well, that may have been part of it. But we were intent on democratizing the skies, because only a very small percentage of adult Americans had ever been able to afford to fly. Well, we produced a lot more passengers for us and them. But, of course, their fare yields went down. Because it was a lower price than accomplished that. And then after we got started, they did all kinds of things to try to put us under. And they wound up getting indicted, two of them, by the Justice Department. I didn't know that. Oh, yeah. For violation of the federal antitrust laws.

And they would try to keep us out of cities that we were interested in serving by calling upon the Chamber of Commerce. The city council opposed us, you know, and basically with the threat of the Southwest coming in, we'll withdraw. And then we got into a big war with them over the Noise Act of 1990, where they contended that you could only comply with the new quieter airplane standard by, you know, bringing in new airplanes. They're old. Old ones. In other words, trying to prevent us from expanding was the purport of it. And so, we got that cured. The Congress came to our rescue, and the Aviation Subcommittee said, that's not what our statute means.

You can comply either way, bringing in new airplanes, you know, but not to replace old airplanes, just as long as you get to a fleet level of quietness. Then they proposed changing the tax laws. Guess what? So, the short haul, low fare

carriers paid \$240 million more in taxes a year, and guess what? The big seven, as we called them then, Mirabel Dick II, Tom, their taxes were reduced by \$240 million a year. Amazing, isn't it? Going to war there. Isn't it amazing? Anyhow, that war went on for four years.

Tom Gardner – Interviewer

Do you think it was imperative for Southwest to survive and succeed that one of their founders had legal training?

Herb Kelleher - Interviewee

Yes, yeah, and it wouldn't necessarily be me, but it was imperative that you have legal training. And the political training didn't hurt either because they were constantly attacking us in the Texas legislature and the United States Congress. So, it was going on before the administrative agency. The battle was being waged in the courts. It was being fought in Congress. It was being waged in the legislature of Texas. And I call it the 30 years' war. I think that was the Punic War, if I remember correctly. But anyhow, it went on for 30 years. History classes, I'm disappointing my history teacher by not really having the information on the Punic War.

Tom Gardner – Interviewer

So now you're flying up and you're going to go to New York. Would you say that?

Herb Kelleher - Interviewee

Well, let me just sum up all that we've been talking about. Over a period of four or five years, I was involved in maybe six years. Well, they also tried to force us out of Love Field. But three trips to the United States Supreme Court, which is rather unusual. You know, General Motors, U.S. Steel and Ford hadn't been up there that often during that period. A period of time. And three trips to the Supreme Court.

Tom Gardner – Interviewer

And how many planes do you have flying then? Or what's the size of Southwest

as you go through those three? Just to give you context for GM and Ford.

Herb Kelleher - Interviewee

We probably had 12. Okay. Yeah. Something like that. Yeah, that's incredible. And then they tried to push us out of Love Field when they opened DFW Airport. So that litigation, quite separate, went on for six or eight years.

Tom Gardner – Interviewer

What is the significance of Love Field today for somebody who's not been to Dallas? I mean, what does it mean to Dallas? Why is it important to have?

Herb Kelleher - Interviewee

It's a close-in airport, which provides a lot more convenience for the people who are located in the city of Dallas and the business community in downtown Dallas. And when they opened DFW in the Dallas area as a compromise, between the cities of Fort Worth and Dallas, who had fought each other for years over airport location, and when they closed Hobby Airport and created Intercontinental, I was interviewed by Texas Monthly.

And they said, "Well, why are you doing this? And I said, because people want to fly from Dallas to Houston and Houston to Dallas. They don't want to fly from Grapevine, you know, to some other outlaw. They want to fly to a flying city on the Houston end of it.

Tom Gardner – Interviewer

So, in the early stages of the definition of Southwest strategy, I do wonder when you talk about your mother and what she taught you around the dinner table or into the wee hours of the morning about respecting other people.

Herb Kelleher - Interviewee

Absolutely. And even the energy or the dynamic of flying shouldn't just be for people who are wealthy. It should be available to everyone. The egalitarian nature. She was very egalitarian.

And in that respect, she was a great teacher because she told me that I should not necessarily pay obesity to position or title because she said, 'Pay attention to the

individual. The individual may have a grand position or title but have feet of clay, you know, which I think all of us have to agree can be the case. And she also encouraged me to read very widely. And unusual adult books, you know, for someone my age. And she stimulated my curiosity in a whole lot of things that I probably never would have gotten into. And curiosity, I think, is one of the great things that can be very, very helpful to you because you're always looking for something different and how it might fit in, you know, to what you're doing. So, I've never adhered to the philosophy that curiosity killed the cat. I look at it as curiosity informed the cat.

And also, you know, the political aspects of it, very helpful having that experience, fighting these battles in the Congress and in the Texas legislature.

Tom Gardner – Interviewer

Why do so many airlines go bankrupt and why have SA never laid off a single employee? I mean, those are, they're so extremely opposites. The industry. We know. You know, it has created very little economic value in aggregate going back to its inception. And yet SA has created, has been, well, certainly during your time, it was the best performing stock on the S&P 500. And since then, it's been a wonderful stock as well, all the way through, no layoffs. Why?

I mean, for a layperson that's sitting out there saying, 'I have no idea why this airline's successful and all the other ones continually failed, went through bankruptcy, came back, went bankrupt again, et cetera.'

Herb Kelleher - Interviewee

Some of them three times. Well, first of all, and I think this has something to do with history and learning something about history. I was well aware that the airline industry was a very difficult industry. As you pointed out at one point, it had a net loss from its inception, which means it's fairly difficult, you know, fairly scary. And I said, you know, you hear about, you know, regression to the mean and I'm not quarreling with that as a formula. But how long is it going to take to regress? You know, is it five years, 25 years, 38 years? And so, what we're going

to do is we are always going to be very, very strong from the balance sheet standpoint number one. We were once for a long time; we're the only airline that had an investment grade rating from the financial community. We're going to have lots of liquidity and my mantra was we want to manage in good times so that we do well in bad times and there you get into the no furlough policy. Because if you if you just hire a bunch of people willy-nilly doing good times, guess what you're doing? You're firing them bad times. So, we were always well set up to ride through the bad times.

Market share was not our focus. I compared market share to elephantiasis. I was trying to say: size in and on itself is unimportant. I would rather have 4% of the market and be profitable than have 24% of the market and lose money. So, we're not going to talk about market share at all, it was verboten.

Tom Gardner – Interviewer

I don't know if you've read Peter Thiel's book "Zero to One" or know about Peter Thiel, he said basically from an investor standpoint, when people pitch firms to him, when they talk about how large their market is, he said I want to know the smallest piece that you're going to dominate.

because I know off that and you have the opportunity to grow. So, the other airlines weren't doing that, they were trying to get as many routes.

Herb Kelleher - Interviewee

They were at war with each other who had the most airplanes and who gets the most routes from the CAB, and that sort of thing, and we just chewed all that. And we opened a lot of secondary airports, satellite airports, and people initially said, 'Oh, you'll never make a success out of the satellite airport.' While the other airlines were trying to get as many routes as they could. I said, 'Well, there's Hobby, there's Love Field; you know, I can run through about five or six more of them.' And of course, they were much more efficient to operate from no backups, they were a lot closer and more convenient for an awful lot of people. And so, we did things unconventionally that way, and we tried to keep our work rules very

simple to promote the efficiency of the airline, and kind of you know operated on the philosophy that airplanes don't make money on the ground, they only make money in the air. Passengers don't pay just to sit, they pay you to fly, so we're very high on utilization and productivity.

Tom Gardner – Interviewer

What would be a gap in fairness between you and the competitor at any point in history, I mean you could name one today or go back 25 years and say we flew from point A to point B for X, and they did it for two X or whatever the gap was.

Herb Kelleher - Interviewee

Yeah, some of those contrasts are really amazing. Do you have time for one that's kind of please? It's kind of like a burlesque plenty of the time we went into uh BWI right and uh US Air was the leading carrier there and the round-trip fare to Cleveland from BWI was like I don't know 340 dollars or something like that and we reduced it to 56 dollars. You know that's a considerable drop and then US Air found out we had a friends fly free program, so they went matched out it was 24,50. They matched that, that's right. Then on the friends fly free basis. Then we went to 19 between BWI and Cleveland, so that's a pretty big saving, you know? \$19 instead of \$349 and the traffic increased by 1.500% in the first year of service, that's an exaggeration but most markets we went into. The popularity of flight increased enormously, enormously I'm talking 100%, 200%, 300% within a year.

Tom Gardner – Interviewer

So, presumably some of the ways that you hold those costs down for passengers is efficiency, hard work of everyone who's coming to work

Herb Kelleher - Interviewee

Exactly

Tom Gardner – Interviewer

Probably not the highest salaries in the industry. I don't know whether that's true or not, you can tell me, but how can you have cost containment and balance sheet management and a great corporate culture, I mean those things we see that we

think there's a big tension there and why isn't there at Southwest?

Herb Kelleher - Interviewee

A friend of mine, recently wrote a paper that he sent to me, and in it he said: "corporations are always succumbing to the tyranny of not rather than the genius of yes." And what he was pointing out is that people sit down and say, well, "we can either have low cost and lousy customer service, or great customer service and high costs", and we said, no, you can have low costs and great customer service, and guess what, we're not offering you less for less fare, we're offering you more for less fare. And part of that, of course, was our culture, first of all, the warrior spirit of our employees who pitched in in every battle. Secondly, the fun and warmth and hospitality that our people provided to our passengers. Thirdly, the kind of culture that was upbeat. We didn't ask people to change and become robots or automatons when they came to work. We kept telling them, look, "we hired you because you're you".

Tom Gardner – Interviewer

Did anyone take that so far? I'm Herb, I'm not going to wear clothes to work today.

Herb Kelleher - Interviewee

When we had somebody who did something extraordinary, we didn't put in new rules pertaining to the whole firm or one of its departments. We just sat down with them individually and talked to them, saying "you cannot do that". But if every time there's a sort of anecdotal incident, a new policy, you put in a new policy, you're gradually strangling yourself with bureaucracy. As a matter of fact, when I saw a ticket agent in San Antonio after I became CEO, trying to answer a customer's question by going through these two loose-leaf manuals, looking for page 73, capital A, small I. We burn them; we burn them, and what we said was, "we have a substitute, it's called guidelines for leaders" and the first sentence was "these are just guidelines, feel free to break them". We were unleashing our people to be themselves with the customer and Colleen Barrett of course played

a great role in that and she called it her flexibility policy and basically, she was saying “look we work like crazy to hire the right people with the right attitudes positive, generous caring and so just unleash them”.

Tom Gardner – Interviewer

I think many people would guess that that works when you have 100 employees, or you have 400 employees. How many people work at SA today and is it still true today that its guidelines and feel free to break them and we hire people that know how to thrive in this type of ecosystem?

Herb Kelleher - Interviewee

Yeah, it's still basically the same, we're much larger but the key to that is, and everybody else in the airline industry kept saying that to me, it's a little Camelot now you know. But where do you get 500 employees? And then they'd say where do you get 5, 000 employees? Then they'd say oh where do you get 15, 000 employees and my response always was “if it's job one, if it's the most important thing that you do to maintain that esprit de corps that culture, then you can do it instead of putting it on the back burner, as opposed to a lot of other things that come up as you get bigger”. Basically, SA has retained that sort of attitude, you know. Hire for attitude, training for skills, what kind of person are you? That's what we want to know about.

Tom Gardner – Interviewer

You mentioned Colleen Barrett. When did you get to know Colleen and what's her journey at Southwest?

Herb Kelleher - Interviewee

Well, her journey Southwest is let's see. She joined uh the law office I was in before I helped to start my own firm in probably 1966 or 67, and then when I started the new firm, she joined it. And within a relatively short period of time, without anybody's ever sitting down and discussing it, she managed the whole firm. And all us Palookas are walking around thinking, “Well, I think HR are moving well. You know, yes sirree!”. I had a great idea the other day, while

Colleen, in the meantime, was doing it all. Then she got into the cataclysms that we faced the litigation and so on. And proved to be a very able uh lobbyist uh with the legislature, really valuable at trials because she always knew who was lying, about what you know when I was cross-examining, yeah! So, and then of course she came to SA full-time and was actually on the payroll here before I was, yeah! On the Southwest, I was still representing Southwest and, on the board, and general counsel, but she was actually on the payroll. So, I guess you'll have to say that we've been collaborating with SA for a period of about 50 years now.

Tom Gardner – Interviewer

And how do you work together today?

Herb Kelleher - Interviewee

Well, she tells me where to go, what to do, how to say things, and you know what, and I go where she tells me, and I do what she tells me, and I say things the way she says tells me to say them, so it's working out beautifully.

Tom Gardner – Interviewer

As one of the best performing CEOs in American history. You never wanted to be CEO, that's just interesting.

Herb Kelleher - Interviewee

No. It was not me. I'd love practicing law, and practicing law, you know, you have a lot of latitude as to How do you live the other parts of your life? I mean, I'd work till two in the morning, then go home, get some sleep, come back at 11 o'clock in the morning, you know that sort of thing. Working for SA, I didn't leave my law office, eat or sleep for two full days and then I went home, showered, and went to a fundraiser for SA. And I'm sure I was most engaging.

Tom Gardner – Interviewer

What would you guess is your average number of hours of sleep a night since the founding of Southwest?

Herb Kelleher - Interviewee

Oh, it was four or five, for 30, 35, 40 years.

Tom Gardner – Interviewer

Are you napping in the afternoon or at four or five is fine for you?

Herb Kelleher - Interviewee

No, no, four and five were fine, yeah.

[00:36:24]

From minute 00:36:24 to 00:41:20, the interview topic was about Herb Kelleher personal life and other non-related topics. Therefore, the transcription of this period was discarded, since it didn't add value to the research.

[00:41:20]

Tom Gardner – Interviewer

How do you invest?

Herb Kelleher - Interviewee

You know, artfully.

Tom Gardner – Interviewer

What would be some examples of one or two success stories in your investment career?

Herb Kelleher - Interviewee

Well, SA. That's been pretty good. But, Tom, I always turn down what the consultants recommend. I always said, "No, that's too big. This is too much stock. I really did. Yeah, one of our directors stood up at a shareholder meeting one day, one year, and said "you know, I think Herb just gave up about \$50 million worth of compensation".

Tom Gardner – Interviewer

You were turning down the stock grants that the firm was offering you.

Herb Kelleher - Interviewee

Yes.

Tom Gardner – Interviewer

Because you viewed them as too, the compensation consultants, that were advising the Southwest Board on how to provide compensation to you, were

suggesting grants that were too large in your opinion. And so, you turned them down. Even though most of your cap and most of your wealth has been accumulated through stock options and stock at Southwest.

Herb Kelleher - Interviewee

Yeah, but through stock that had no value. Based on, you know, my contracts at the time. And later on, it became very valuable. For everybody.

Tom Gardner – Interviewer

Well, I want to talk a little bit about the profit share plan in a second. But so, for you, when it came time for the board to accept the consultant's guidance on how much equity you should be granted, you said that's too much. There were occasions where you said that's too much.

Herb Kelleher - Interviewee

The bonus is too big, the salary is too big, and there are too many stock options involved. Long-term incentive stock options. And so, what I would do basically is look at the consultant's report. And I would say “well I'll put myself in the 37th percentile. Okay?”. Even though we were more profitable than other airlines.

Tom Gardner – Interviewer

37th percentile of bankrupt airlines.

Herb Kelleher - Interviewee

Right. Yeah, right. Well, I did get a kick out of it. I did get a kick one time because somebody pointed out to me that the then chief of another airline, which was teetering on the edge of bankruptcy, was paid three times as much as I was.

And I said, that's the way I want it. That's part of leadership. You know, I want the people to know that I'm for them. I'm not here for me. You know that sort of thing.

Tom Gardner – Interviewer

If you had, let's say, two or three leadership principles. If you had to boil them down to two or three. Maybe you've just sort of touched on one of them. But I hate to just try and get a little sound bite. But what would be your top two or

three principles as a leader?

Herb Kelleher - Interviewee

I would say that number one, you have to look for the well-being of others more than you do for your own. Number two, that you have to really rejoice in your people and their accomplishments and praise them and recognize them all the time for what they have achieved. And be humble, I think. Be humble. Never think you've done something so great, you know, that now you're at the top of the pyramid because that's when the pyramid starts to collapse. You know and never be complacent.

Tom Gardner – Interviewer

How about two or three principles of business strategy that might apply more broadly than just the airline industry for an entrepreneur or a CEO that's looking at their game plan and that maybe is overlooked, the responsibility of having a strong balance sheet so that you can be resilient in a down period? Or maybe two or three strategic principles.

Herb Kelleher - Interviewee

Well, first of all, if one of your principles is that you're not going to furlough. That in and of itself is an incentive to stay lean, even when times are really good. You know, it's a discipline and a valuable one, I think. Number two, particularly with respect to young entrepreneurs, including myself, their optimists, Tom. And I think, and that optimism is needed, you know, to be an entrepreneur, year one. I ought to be interviewing you. But sometimes you don't realize how long it's going to take and how much capital it's going to take to bring it to realization. And so, you don't raise enough money at the beginning. And sometimes, with the young people, I have found, representing young people who want to start up their own businesses, I've found that they think they're just having the idea is all they have to do. And I keep telling them, no, there's a lot of sweat that goes into it. You know, you just don't announce your idea, and suddenly golden coins start raining down from heaven like manna on you. And there's a hell of a lot of lonely

work to do to make it come to pass and to be successful. But the thing that I have always emphasized is culture, because I think that's the most important thing. It's the most powerful competitive weapon that you can have because it's intangible. It's spiritual. You can't buy it. You know, other airlines can buy airplanes. They can lease space. But if they don't have the kind of outgoing, participative, happy, devoted culture that you have, you're going to have the edge on them. I always told our people that the intangibles are more important than the tangibles.

Tom Gardner – Interviewer

Is there a single story that comes to you right now, and maybe not across all of Southwest history, about the employee or teammate of yours at SA that did something remarkable for somebody else on their team or for one of your passengers?

Herb Kelleher - Interviewee

Well, I'll tell you what. I've got several stories that just jumped into my mind. There are thousands of them. But these will serve as, you know, exemplars with respect to what you asked. And one of them is that, you know, a lady had a flat tire in the parking lot at a terminal, air terminal. And our station manager stops and says, let me change that tire for you. And she said, "Well, I don't think you should because, you know, I didn't fly with SA. He said, "that doesn't make any difference. I just want to help you change your tire no matter who you flew on". And we honor people for the great things they do outside SA, not just inside. But the great things they do in society in general and hold them up as role models. And another one, this was really sad, but this father was taking his son on a hunt and had bought him a new shotgun for the occasion. So, of course, you know, the teenager was all excited and we misplaced the shotgun. Okay? So, our station manager says, you've got enough time. Hold on. I'll be back. And he goes home, gets his own shotgun, and brings it back and says, "Use this on your hunt." That kind of thing. And our people do that all the time. They will find somebody who's kind of been abandoned or neglected at the airport for one reason or another, and

they will provide them with lodging, give them money for food, and drive them to their homes.

You know if they're bereft of any funds. And they just do that continually because of the great people that they are. You know, Colleen has always said, it's very simple. Just follow the golden rule, you know, and forget everything else. And it's been very successful, I think.

Tom Gardner – Interviewer

So, when I, as an investor, look over the landscape of business and have been taught by both of our parents, but probably our dad a little bit more, about business and investing and the game of business and investing. One of the things I've observed, which I think we've talked about in the past, is the incredible performance of public firms in aggregate. There are obviously failures or there's fraud in some of these cases. But the incredible performance of businesses where the founder is the CEO. Why?

Herb Kelleher - Interviewee

Well, I think, you know, there are some situations where some of the gurus of academia have said in the past, Tom, that, you know, you're not going to be able to do it. The founders can't run firms that they found because they don't have the discipline. That's not so. When I took over SA as an example, two of the analysts, sell-side analysts in New York said, "Sell SA stock because he's a lawyer and lawyers don't know how to run firms."

Well, we did pretty well despite that, you know, and maybe my not knowing much about it was helpful in some ways. Fresh eyes, exactly. And I don't think that's true at all. I think founders have the passion, you know, that you need. Now they have to succumb to some disciplines, I understand that. You know, you can't run it like a one-man show when you've got 10,000 people. But I don't think that should be a general rule. There was one in Texas where it wasn't, you know, the rule. In essence, he founded three successful firms. Big, successful firms got kicked out of all of them, you know, because he was a creative genius.

But he didn't want to go beyond that, and he just wanted to continue coming up with ideas for new firms. So, I don't think there's any rule. I mean, it's just like people have said when I sat down as CEO, you know, they said, well, I was chairman of the board for eight years thereafter. A good many academicians said, "no founder, no former CEO should ever remain at a firm after he steps down in effect." And the problem is that he and the incoming CEO launch a struggle for attention, et cetera, et cetera, and enter into a competition. Well, I instantly said no. Gary, it's yours, don't pay any attention.

Tom Gardner – Interviewer

Navy ship.

Herb Kelleher - Interviewee

Don't pay any attention. Right, Navy ship. Beautiful comparison. Don't pay any attention to me whatsoever. I won't be going out among the people the way I used to. That hurts me more than anything else, emotionally. But it's just total hands off. And I remember what C.R. Smith, founder of American, wrote when his successor took over, and it was hilarious. And it was a letter, which this guy found on his desk after C. R. had stepped down. And he opened it up and it said, "I have five suggestions for you. One, two, three, four, and you know what the fifth was. "Never pay any attention to my suggestions." That's the way to do it. So, Colleen and I immediately got a low profile, as we should. And you know, if people at Southwest Taylor Airlines want to come talk to us or ask us to come talk to them, we're available, but we never push ourselves on anybody. And Gary's a great friend and he's been a superb CEO. And I don't think he ever feels any pressure or unease about, you know, the two of us being around.

Tom Gardner – Interviewer

My last two questions. These are actually two relatively short in there. And one of them is, what was it like on 9-11 at SA? What was the experience of running a business? Was it an airline during that? And what did you see emerging in the culture? And yeah, what was the day like? Or the days around it?

Herb Kelleher - Interviewee

It was, of course, a horrible shock when we realized that it was a terrorist attack. And I immediately got hold of the board of directors and told them this was a huge emergency and that we were going to have to take a lot of action quickly and spontaneously to respond. But I would keep them informed of what we were doing. I just didn't have time to convene board meetings every day, you know. And then we went into an officer's meeting, and I announced that I thought the airline world had just changed, not just for the day or the week, but for the future. And Gary Kelly said the same thing. And we worked out a plan as to how we're going to keep the firm afloat. And we instantaneously set about bringing in all the available money that we had, not knowing whether people were going to allow us to do that or not. But they came through. The banks came through. We immediately had to set about taking care of all our crew because they had to land in places that we didn't serve. You know, FAA, you got an hour, you're down. So, there's another example of our spirit, the spirit of our people and how they like to serve. We're trying to get hold of this captain who's in an off-line airport, and we called the hotel, and they said "well he's not here right now. He just took all the passengers to a movie." We called another one and said, "Well, we need to talk to you and find out how your passengers are doing. And the guy who was there said, "Well, they're not here because your pilot bought them all tickets on Amtrak to get home. That kind of volunteer spirit, you know, is absolutely invaluable. And so, we always tried to encourage that in all of our folks. And it's one thing that really helped us to buoy us up and carry us through that disastrous period after 9-11. Because nobody was sure what the aftermath of that was going to be.

Tom Gardner – Interviewer

How long was it before you were flying again?

Herb Kelleher - Interviewee

Let's see. We came back up on the 14th. And our first flight out of Love Field was

out of Love Field. And the whole general office was out by the fence crying and singing "God bless America" as the first flight of ours took off. But it was a very harrowing time. And there were a lot of things to be worked out on an entirely new platform. You know, the new security platform. And I was appointed as one of the people for the airline industry, along with a fellow from America and one from Northwest. I must say that working with the FAA and then the TSA and then the Department of Homeland Security was a very rewarding experience. Because they don't operate things, you know. They don't operate airlines. They don't operate airports. We're the ones that process passengers. And they were very agreeable to the suggestions that we had. It was not like; I suggested this and therefore it's sacrosanct. They were very agreeable and very open. And so, it was a great, great relationship for the most part. But there were tremendous hurdles that had to be overcome. We had to change our whole technology because of the new security requirements. We had to change the processing of passengers. That was done very quickly and very effectively.

Tom Gardner – Interviewer

The last question, you talked about being a founder and the number of hours of sleep you've got on average, the decades that you've put into it. I know that you don't really have probably any regrets. But why don't you? You've given so much of your life to one organization. Do you have any sense of, gosh, I wonder if I'd taken five years of my life and I'd gone and done that. My life might have had this. So how do you view your commitment to a single ship that you've been sailing on for 50 years?

Herb Kelleher - Interviewee

I have no regrets whatsoever because if a father has a daughter or a son, I believe that father is going to commit himself to a single ship for as long as that ship is afloat.

And so, I've always said, you know, I'm so fortunate because my vocation is simultaneously my vocation. So, there's no challenge. There's no tension. There's

no hostility between the two. I'm doing what I love to do for a firm I love and help to create and for people that I adore. And what could be more rewarding, more enjoyable than that? I refer to our people as my fountain of youth. I said, you know, Ponce de Leon was in the wrong place looking for the fountain of youth in Florida. He should have come to work for SA. That's where you find your Fountain of Youth from our people.

Appendix 8: List of codes

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)
Southwest service differentiation	Customer Service	Empathy	"And I would always tell a lot of our employees, you know, take care of the customer and we'll take care of you. One, one night we had a, I mean, it sounds, it sounds simple, but sometimes it's hard to execute. We had a flight one night that was going from El Paso, Texas down to Houston. And there was a lady who was, it was the last flight of the night. And she was going to see her mother who was dying in Houston, a cancer. And she, she tripped and sprained her ankle in the jet bridge, you know, that, that connects, you know, that connects the terminal to the airplane. And it was our jet bridge. It was our fault. She missed the flight and she was going to see her, you know, her, her mother who was gravely ill. So that was on a Sunday night, Monday morning, the manager in El Paso called me and said, Hey, Jim, I just want to let you know what happened last night and what I did to take care of this lady. I had to go see her mother before she died. And I said, Hey Rudy, whatever, that's fine. He said, well, I chartered a jet and I flew her to, I flew her to Houston. So she could be with her mother. And I said, good job. And then I said, I'm just curious. How much was it? He said, I was about \$6,000. And I said, you know, way to go. Pat, pat on the back. He did, he did the right thing. But at the time, our average ticket price was \$50. But I just give that as an example. And our employees did that. They had the freedom and the latitude every day to do what they needed to do to make sure our customers came back when it was clearly our mistake." (EX-MANAGER B)
			"And another one, this was really sad, but this father was taking his son on a hunt and had bought him a new shotgun for the occasion. So, of course, you know, the teenager was all excited and we misplaced the shotgun. Okay? So, our station manager says, you've got enough time. Hold on. I'll be back. And he goes home, gets his own shotgun, and brings it back and says, "Use this on your hunt." That kind of thing. And our people do that all the time. They will find somebody who's kind of been abandoned or neglected at the airport for one reason or another, and they will provide them with lodging, give them money for food, drive them to their homes. You know, if they're bereft of any funds. And they just do that continually because of the great people that they are. You know, Colleen has always said, it's very simple. Just follow the golden rule, you know, and forget everything else. And it's been very successful, I think." " (HERB KELLEHER)
		"And when I ask large groups: "So if you fly Southwest, what is the value you see?" Every one of them says "fun". So obviously they've done a good job of it, yes. And have continued to do it for five decades." (EX-MANAGER A)	
		"And probably as important as those two business models, was the people were nice, the people were friendly, and the flight attendants. And it was fun to fly. So, I think that people didn't... No, didn't find it at other airlines, this spirit and this fun environment, right, not really because you know, keep in mind that the rest of the airline industry was really trying to try to understand how to operate in a deregulated environment, and they really had a hard time competing with us." (EX-MANAGER B)	
	Reliability	No Flight Cancellation	"But it's just that it feels comfortable flying them. I know it's safe. I know that they usually, unless it's a very critical thing like they had a couple years ago when their technology was outdated and they really screwed up at Christmas two years ago, their flights are not canceled. They complete flights. And that's where the business carrier, business flyer wants. We've got to be at point A to B when we're supposed to be there." (EX MANAGER A)
			"People don't come because it's just low-cost, people come because it's low cost, it's safe, and safety is a huge issue with them, and in addition they're treated well." (EX MANAGER A)
		Service consistency	"And the behaviors you want, because that's how you build the brand so that every time anyone interacts with one of the 50,000 employees or 40 some thousand, they get the same experience. And that's the Nordstrom model, that's the Southwest model and that's the great organizations' model. If you go into an Apple store, if it's in Portugal or it's in Albuquerque, you're going to get that same experience. They're well-trained, they're personable, and they know the solution, right? So, Southwest was one of the first to start what was called behavioral hiring, which is known as the behaviors you want and then hire to those behaviors." (EX-MANAGER A)
	Safety	Safety	"Southwest is they're one of the safest airlines in the world. They take off and land more, and takeoffs and landings are where you have most of your accidents. And they have taken off and landed more than any airline, I believe, in the world still. But I believe they still hold that record. And that's because they have shorter flights. Safety is huge. And they take care of their aircraft. I think they've had two, I mean, we're talking 50 years." (EX MANAGER A)

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)	
Southwest service differentiation	Convenience	High quantity of frequent flights	"... Southwest business model was that we offered a lot of flights every day, so there was a convenience. If you had a business meeting in New Orleans in 1980 and there were four airlines to choose from, and you didn't know what time your meeting was going to be over with in New Orleans, you'd probably pick Southwest because we had the lowest fare, but we'd have flights every two hours in between those two cities. And that was, other airlines might have three flights a day, and we'd have 20. So the convenience, yeah, at one point between Dallas and Houston, which is an hour flight, it's 240 miles, there were 70 flights a day. Like every 30 minutes, every 15 minutes, every 30 minutes. That's impressive. Well, so people really didn't have to think, it was almost like, you know, you're hailing a cab. You know, it's not like you had to make a reservation, and you just go to the airport, and you knew there'd be another flight in less than an hour, and the fares were the lowest. So it really built up a loyal and a large customer base, just because of the convenience of the operation." (EX-MANAGER B)	
		Secondary Airports with convenient locations	"And we opened a lot of secondary airports, satellite airports, and people initially said, 'Oh, you'll never make a success out of the satellite airport.' While the other airlines were trying to get as many routes as they could. I said, 'Well, there's Hobby, there's Love Field; you know, I can run through about five or six more of them.' And of course, they were much more efficient to operate from no backups, they were a lot closer and more convenient for an awful lot of people." (HERB KELLEHER)	
	No frills, only the essentials	No meals, no assigned seats and no lounges		"Southwest has never given expensive snacks, they've never for 30 some years. Now you get a few uh protein bars, but that's it. But you don't come because of that. You come because people greet you with a smile when you leave." (EX MANAGER A)
				"We didn't have assigned seating; we didn't have meal service; we didn't have real fancy seats; we didn't have basic equipped boarding services; and we didn't have terminal buildings and gates, and it was—we had plastic boarding passes, you know, it was rather than a reservation system for an assigned seat there's... You know, there's a lot of costs associated with those types of systems. The other airlines were paying for and we didn't." (EX-MANAGER B)
				"Our current, open seating operation is unlike any other airline; we're currently the only airline in the US to operate this way." (MANAGER A)
				"...the chart depicts that there is higher worth placed on attributes of strength in our brand, such as friendly service and frequent, point to point departures, and less on lounges and meals (neither of which we provide)." (MANAGER A)

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)	
Southwest Low Cost	Aircraft fleet	Single type aircraft	"...the answer a lot comes from just having one type of airplane because you know every pilot, mechanic, flight attendant, anybody could operate, could work on any airplane. The cost and the experience to maintain the airplanes was less because the mechanics, just, and you know parts, mechanics—all those costs were lower because you just had to take care of one, one type of airplane." (EX-MANAGER B)	
			"We believe that a single fleet type (We fly the Boeing 737 narrowbody jet) allows for cost efficiencies when it comes to operational training of our Pilots and Flight Attendants, mx parts inventories and aircraft mechanics training and manuals. Having a single fleet type allows for some simplicity in our operating model that other airlines who fly multiple fleet types do not have." (MANAGER A)	
	Destinations & Routes	Secondary Airports	"And we opened a lot of secondary airports, satellite airports, and people initially said, 'Oh, you'll never make a success out of the satellite airport.' While the other airlines were trying to get as many routes as they could. I said, 'Well, there's Hobby, there's Love Field; you know, I can run through about five or six more of them.' And of course, they were much more efficient to operate from no backups, they were a lot closer and more convenient for an awful lot of people. And so, we did things unconventionally that way, and we try to keep our work rules very simple to promote the efficiency of the airline..." (HERB KELLEHER)	
	No frills, only the essentials	No meals, no assigned seats and no lounges		"Southwest has never given expensive snacks, they've never for 30 some years. Now you get a few uh protein bars, but that's it. But you don't come because of that. You come because people greet you with a smile when you leave." (EX MANAGER A)
				"We didn't have assigned seating; we didn't have meal service; we didn't have real fancy seats; we didn't have basic equipped boarding services; and we didn't have terminal buildings and gates, and it was—we had plastic boarding passes, you know, it was rather than a reservation system for an assigned seat there's... You know, there's a lot of costs associated with those types of systems. The other airlines were paying for and we didn't." (EX-MANAGER B)
				"Our current, open seating operation is unlike any other airline; we're currently the only airline in the US to operate this way." (MANAGER A)
		"...the chart depicts that there is higher worth placed on attributes of strength in our brand, such as friendly service and frequent, point to point departures, and less on lounges and meals (neither of which we provide)." (MANAGER A)		

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)
Southwest Low Cost	High Productivity	Quick turn around times	"But generally, they have been really more productive, and they turn planes faster. You probably saw that they turn planes very quickly, which of course allows them to have more flights per day than other carriers. They typically used to turn a plane in 28 minutes and then when they started going to the east all of a sudden it became closer to 40 minutes but that's okay because the others it's an hour and 25 minutes. So, all the productivity numbers everyone knows too." (EX-MANAGER A)
		More time on the air, less on the ground	"I think most importantly though, per day really lowered the per-flight cost. If it, just say on an average day, you flew 100 flights and you do that with a certain number of people, and you had to buy fuel, if you can beat payroll and buy fuel, you can operate an airline pretty inexpensively. And other airlines might get 30 flights a day with that same number of people, but they just didn't fly the same number of flights. So we were able to keep our per-flight operating costs very low because we flew a whole lot of flights with the same number of people and it was basically two shifts a day. We flew from 6 in the morning until 10 at night and then from 10 at night to 6 in the morning, we maintained the airplanes. And at 6 o'clock in the morning you start over again." (EX-MANAGER B)
			"And so, we did things unconventionally that way, and we try to keep our work rules very simple to promote the efficiency of the airline, and kind of you know operated on the philosophy that airplanes don't make money on the ground, they only make money in the air. Passengers don't pay just to sit, they pay you to fly, so we're very high on utilization and productivity." (HERB KELLEHER)
		Less employees per aircraft	"...just to give you kind of a productivity measure, the rest of the airline industry had about 125 employees per airplane. We had 75 employees per airplane. Well, you know, so, you know, when you end with labor as your number one cost, if you can, if you can keep that kind of cost formula intact with that few employees per airplane compared to competitors, it's not hard to, it's not hard to be profitable. Yes, that's really impressive. This big difference between the Southwest and other legacy airlines in terms of people or workers per flight." (EX-MANAGER B)
			"It's really a culture of high productivity. They have fewer people per aircraft than anyone-the last number I saw was something in the 80s, whereas the closest one is like Delta at 125. I mean, all the numbers are better with Southwest or have been typically." (EX-MANAGER A)
		Hiring the right people	"The main attribute is hiring people who get it. It's very difficult to hire in this country now, but it was even more difficult for Southwest. It takes time. Used to take and I haven't seen the numbers lately, but as late as last year, it took 28 people for every one they hire. And the reason is that they look at people who have a history of delivering great customer service, but who also have a history of working and working hard. They don't hire people that haven't had a like retail. We love McDonald's, we love any retail environment where it was busy. Those are the types of people they want to hire." (EX-MANAGER A)
			"Southwest was one of the first to start what was called behavioral hiring, which is known as the behaviors you want and then hire to those behaviors. It's over 90% predictive. So, their hires were good. It took 28 resumes to get one, but their hires were good. And the other thing we did was we had the people that were going to work with the people hire them. So, we went to pilot hiring with pilots, flight attendants, hire flight attendants, operators and baggage guys, hire the guys that work with them. Do you know what they do then? They make them successful. They make sure their hire isn't bad. Because they'll catch all kinds of hell for it with their peers. So, all those little things being put in place make the model work. And as a result, we have better people, more motivated people, better service. Yes. And still at a low cost." (EX-MANAGER A)
		Motivated employees	"Because what they found out is that people who want to want to work in an environment like that, where they're relaxed and they're respected, where they feel good about coming to work. If you were in Southwest Headquarters, you would see people coming in laughing all the time. It's just so much fun because people just enjoy coming to work there and that matters because you get higher productivity, you get better retention. People understand customer service is important because without it, you're not going to be there, and it actually ensures that you keep a job right." (EX-MANAGER A)
			"Our turnover was single digits rather than double digits, and again when you look at it in the whole picture and you see that that was true even though they weren't paid above market, that's very unusual. That's it's all about wanting to be there, you know what I still contend that's true." (EX-MANAGER A)
			"And as a result, we have better people, more motivated people, better service. Yes. And still at a low cost." (EX-MANAGER A)

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)
Southwest above average performance throughout years	Low Cost and Differentiation conciliation	Less for More	"The destinations we served, the convenience with the flight schedule of many flights a day, and just really friendly people to be on board an airplane with. And we just wanted to get you to your destination on time and with your bags. And it was really simple. We just kept it simple." (EX-MANAGER B)
			"And what he was pointing out is that people sit down and say, well, "we can either have low cost and lousy customer service, or great customer service and high costs", and we said, no, you can have low costs and great customer service, and guess what, we're not offering you less for less fare, we're offering you more for less fare." (HERB KELLEHER)
	Culture	Value-based culture	"But the thing that I have always emphasized is culture, because I think that's the most important thing. It's the most powerful competitive weapon that you can have because it's intangible. It's spiritual. You can't buy it. You know, other airlines can buy airplanes. They can lease space. But if they don't have the kind of outgoing, participative, happy, devoted culture that you have, you're going to have the edge on them. I always told our people that the intangibles are more important than the tangibles.-" (HERB KELLEHER)
	Warrior Spirit		"...one of the values is warrior spirit and that warrior spirit is all about doing things quickly but well."(EX-MANAGER A)
			"...you know, that we were in court for almost 5 years before we ever flew 1 flight. So that, we call it that warrior mentality was a part of the fabric of the company before we ever started flying was, you know, we were fighting, we had to, we wanted to survive. We had to do things that no one else did. We had to be persistent. We had to be, you had to get angry. You wanted to win. And the other airlines didn't have that same environment the way they were creating the way Southwest did." (EX-MANAGER B)
			"...we said, no, you can have low costs and great customer service, and guess what, we're not offering you less for less fare, we're offering you more for less fare. And part of that, of course, was our culture, first of all, the warrior spirit of our employees who pitched in in every battle." (HERB KELLEHER)
	Employees' Motivation & Attitude	Golden Rule	"The other one is the golden rule. So, they're taught from the day they start to treat customers as they would want to be treated, and that's a critical part of their success." (EX-MANAGER A)
			"He said: "It doesn't mean that you can't be great with customers because we have fewer people for aircraft and because our numbers are better. You still have to be great with customers so they will come back". (EX-MANAGER A)
	Fun value		"Yes, fun is one of their values and it's very rare Southwest had fun as a value long before other companies did and now you see it in a lot of companies. Because what they found out is that people who want to want to work in an environment like that, where they're relaxed and they're respected, where they feel good about coming to work. If you were in Southwest Headquarters, you would see people coming in laughing all the time. It's just so much fun because people just enjoy coming to work there and that matters because you get higher productivity, you get better retention." (EX-MANAGER A)
			"Secondly, the fun and warmth and hospitality that our people provided to our passengers." (HERB KELLEHER)
Profit sharing & rewards		"And the other thing was they got to the rewards and profit sharing. So, giving people the profits first rather than the shareholders, I think, says a lot about a program where people really get rewarded for their efforts." (EX-MANAGER A)	

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)	
Southwest above average performance throughout years	People Management	Hiring Process	"The main attribute is hiring people who get it. It's very difficult to hire in this country now, but it was even more difficult for Southwest. It takes time. Used to take and I haven't seen the numbers lately, but as late as last year, it took 28 people for every one they hire. And the reason is that they look at people who have a history of delivering great customer service, but who also have a history of working and working hard. They don't hire people that haven't had a like retail. We love McDonald's, we love any retail environment where it was busy. Those are the types of people they want to hire." (EX-MANAGER A)	
			"Thirdly, the kind of culture that was upbeat. We didn't ask people to change and become robots or automatons when they came to work. We kept telling them, look, "we hired you because you're you". (HERB KELLEHER)	
		Empowerment	"Southwest employees, we gave them the freedom to take care of the customers and make them happy without when things did, when things did go off schedule. We gave the employees the freedom to do whatever they needed to do within reason to make sure that those customers came back, especially when it was our mistake. And that type of leaning into customers, when you're dealing with a problem that you created, the rest of the industry didn't have that type of mentality necessarily with their customers when things went wrong. And, you know, people remember; they remember those kinds of service things." (EX-MANAGER B)	
		"We were unleashing our people to be themselves with the customer and Colleen Barrett of course played a great role in that and she called it her flexibility policy and basically, she was saying "look we work like crazy to hire the right people with the right attitudes positive, generous caring and so just unleash them"" (HERB KELLEHER)		
	Sustainable Management	Strong and controlled balance sheet		"what we're going to do is we are always going to be very, very strong from the balance sheet standpoint number one. We were once for a long time, we're the only airline that had an investment grade rating from the financial community. We're going to have lots of liquidity and my mantra was we want to manage in good times so that we do well in bad times and there you get into the no furlough policy." (HERB KELLEHER)
				"It's pretty simple, you know, it's, it is; we just try to treat each other the way you want to be treated, keep your costs low and, and, uh, you know, keep an eye on the bank account, you know, you don't want to spend money you don't have. Mm-hmm. The Wall Street analyst. For years, they used to, they used to just crucify Southwest because we didn't have enough debt. You know, they said, because they were comparing this to the other airlines who had, you know, 60, 70, 80% debt-to-equity ratio. Our's was 20. And they would say, you know, you guys need to go out and borrow more money and fly more destinations, buy more airplanes. And we were financially very disciplined. As far as, you know, capital expenditures and, and spending money over, over the years, we were happy with an 8% return on invested capital that was 8 to 10% return on all of our capital. And we made a whole lot of money and the company was solvent and safe for decades by just having a, a, a really disciplined and successful economy. Almost boring financially. About the horrible year after year after year as far as sending money borrowing money, And not spending stuff, not spending money on things that didn't generate revenue. Many years ago, I don't remember the exact year, but, The city of Dallas. That, they built a new arena for the Dallas Mavericks basketball team. And it was right in the middle of downtown. It was 10 minutes from Love Field in our office. And they came, the developers came to us and said, we want to name this Southwest Airlines Arena. It would be a great branding opportunity to have our name. And so, you know, we met the city of Dallas and the developers of what is now the American Airlines Center. But they offered us the naming rights first. And Herb said, well, tell me how much money it's going to make us. Because you had to buy it. They wanted an investment. A big investment to buy the naming, the arena. And he said, show me how that would be. A good investment for Southwest. He said, you know, we could buy three 737s for the price of having our name on a basketball court. Which is today still the American Airlines Center. They went to American next and American said, yeah, we'll take it. But unless you could show that getting caught up in the hype and the business popularity or the worldly popularity. I mean, your name everywhere, we weren't interested." (EX-MANAGER B)
			"I was trying to say: size in and on itself is unimportant. I would rather have 4% of the market and be profitable than have 24% of the market and lose money. So, we're not going to talk about market share at all, it was verboten." (HERB KELLEHER)	

Category	Sub-category	Coding	Interview Excerpts (primary and secondary)
Southwest above average performance throughout years	Decentralized organization	Few bureaucracy	"So, trying to be simple and implement things and try to kill the bureaucracy. We didn't have levels of management. Now, I imagine they have more. But at the time, we did not. We didn't have senior VPs. We didn't have lots of directors or lots of managers. We had more people per manager than other airlines. And I think it's because everyone worked together." (EX-MANAGER A)
			"Less is more. Having less bureaucracy, having less levels of management, having fewer people, more people would report to a manager." (EX-MANAGER A)
			"...we didn't put in new rules pertaining to the whole company or one of its departments. We just sat down with them individually and talked to them, saying "you cannot do that". But if every time there's a sort of anecdotal incident, a new policy, you put in a new policy, you're gradually strangling yourself with bureaucracy." (HERB KELLEHER)
		People empowerment	"Southwest employees, we gave them the freedom to take care of the customers and make them happy without when things did, when things did go off schedule. We gave the employees the freedom to do whatever they needed to do within reason to make sure that those customers came back, especially when it was our mistake. And that type of leaning into customers, when you're dealing with a problem that you created, the rest of the industry didn't have that type of mentality necessarily with their customers when things went wrong. And, you know, people remember; they remember those kinds of service things." (EX-MANAGER B)
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