Southwest Airlines: 1993 (B)

On September 15, 1993, Southwest Airlines established a presence on the East Coast, initiating service from Baltimore Washington International Airport to Chicago Midway and Cleveland. Before Southwest's arrival, walkup fares ranged as high as $349 to Cleveland and $335 to Chicago Midway. A fare war involving USAir, Continental, and Southwest dropped fares to as low as $19 to Cleveland and $34 to Chicago. Within the first two months of service, Southwest's entry brought huge fare reductions and market growth—the pillars of the "Southwest effect."

Airlines across the industry were taking note of the "Southwest effect" and the airline became the object of close scrutiny. A U.S. Transportation study (see case (A), **Exhibit 12**) urged the government to encourage the entry of new, lower-cost carriers in domestic markets, creating competition to preserve the low-ticket prices offered by Southwest. The presence of such carriers would provide "a discipline for Southwest's pricing behavior in the future, and replace service of other major airlines that are scaling back service or exiting markets dominated by Southwest."[1]

Indeed, several U.S. majors were already considering plans to compete more effectively with Southwest. Continental Airlines' experimental airline-within-an-airline, CALite, took wing October 1 with a low-price, quick turnaround service that linked 14 cities in the Southeast. United Airlines was considering a two-tier airline, "U-2." This airline-within-an-airline would use compact Boeing 737s, skimp on meals, but still offer assigned seats and frequent flyer miles. Said Stephen Wolf, United's chairman and chief executive, "We realize we can't compete with Southwest. No one's at fault. No one's a dummy. It's just a fact."[2] Both USAir and Delta had been looking for ways to make its short routes more cost efficient.

Southwest management commented on the potential impact of the heightened competition on the airline. Said John Jamotta:

> New entrants may put more pressure on our growth strategy. Competition in our markets will bring new challenges in marketing. One of our strengths now is that we bring a new product to a market, and our customers associate low-cost, high-quality service with Southwest. However, the low-cost message doesn't work in markets where another low-cost provider is already there.

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[1] "U.S., Southwest at Odds on Pricing Strategy," *Aviation Week and Space Technology*, June 14, 1993, p. 47.

[2] "The Frugal Skies: Money-losing Routes Prompt Big Carriers To Mull Radical Steps," *The Wall Street Journal*, October 19, 1993, p. 1.

Research Associate Linda Carrigan prepared this case under the supervision of Professor Gary Loveman as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

McGlade commented on the Southwest model:

> There's a perspective that the industry should worship the Southwest model. There's a lot of models out there that work. For example, you could fly only 747s on long distance flights and redefine aircraft utilization. However, you can't try to do too many things, like some of the airlines are attempting to do with two-tier systems. I don't think you can be both a Christian and an atheist. The only difference at Southwest is the focus on low costs This I believe can only be maintained if the people are persuaded that this is important. And this only can be accomplished if the company pays attention to the individual through its corporate culture, convincing the people that their long-term success is connected to the company's success.

McGlade continued, addressing the ability of the new competition to compete with Southwest: "The other airlines all understand the cosmetics of Southwest, but I'm not convinced they understand the meat—what holds the Southwest model together."

Would the majors be able to launch a viable and sustainable competitive threat? Should Southwest change its expansion strategy to respond to the heightened competition and pursue a more aggressive, preemptive course? Would the entry of new low-cost competitors jeopardize the monopoly status that Southwest enjoyed in many of its markets? And what was the real basis of Southwest's competitive advantage now and in the future?