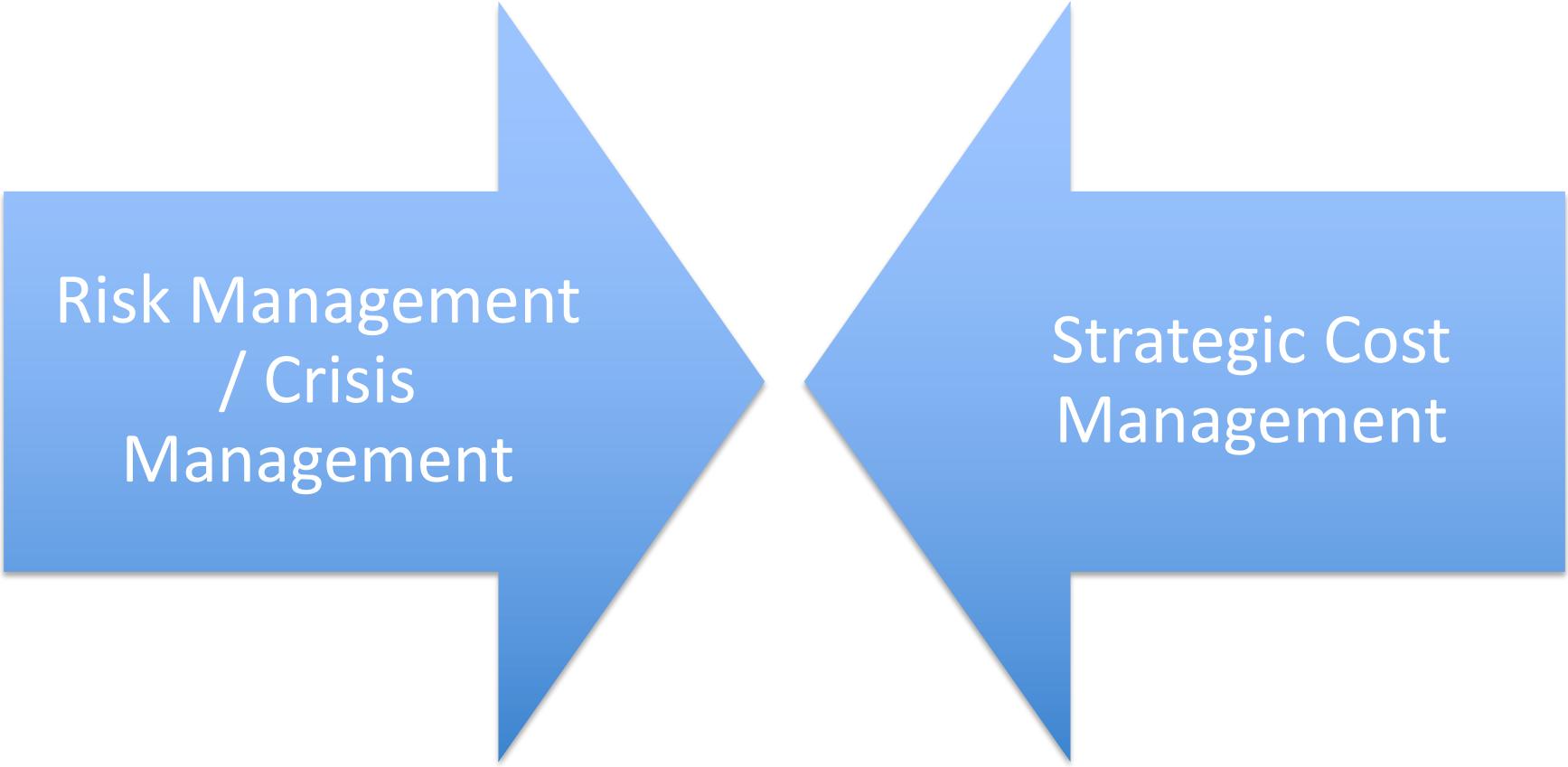


An Effective Response

Smoldering Crisis and
Strategic Cost Management

Risk and Crisis Management

Structural and Executional Cost Drivers



Risk Management
/ Crisis
Management

Strategic Cost
Management

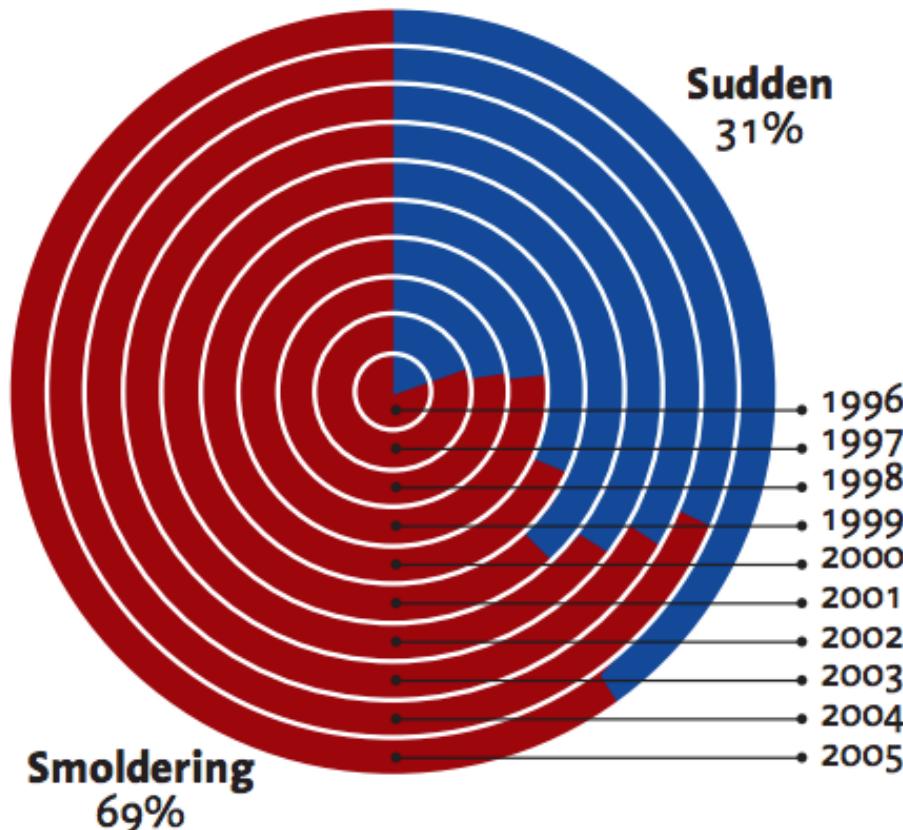
Integrated Risk and Crisis Management



McNair-Connolly et al. 2014. *Integrated Risk and Crisis Management*.

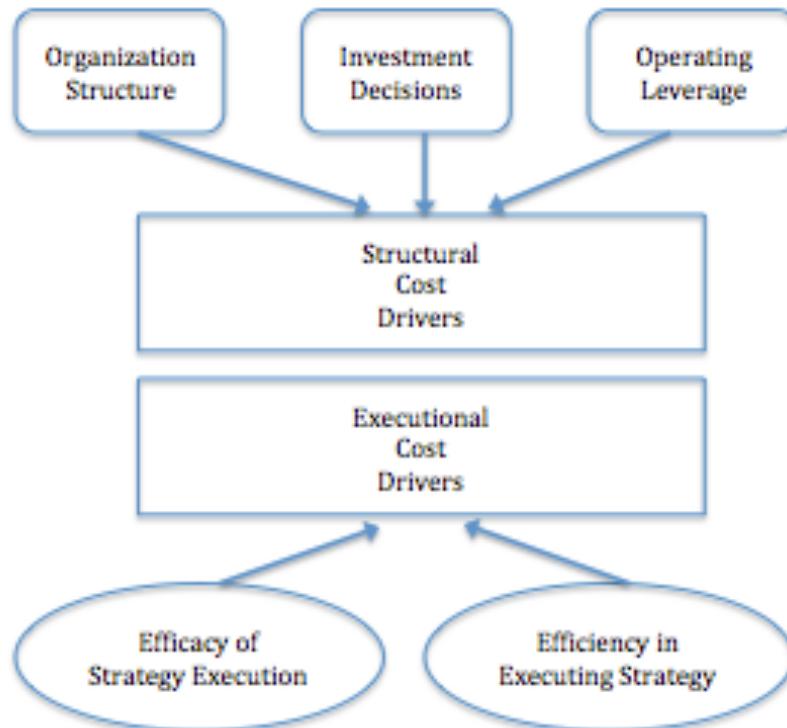
Risk and Crisis Management

Sudden vs. smoldering crises



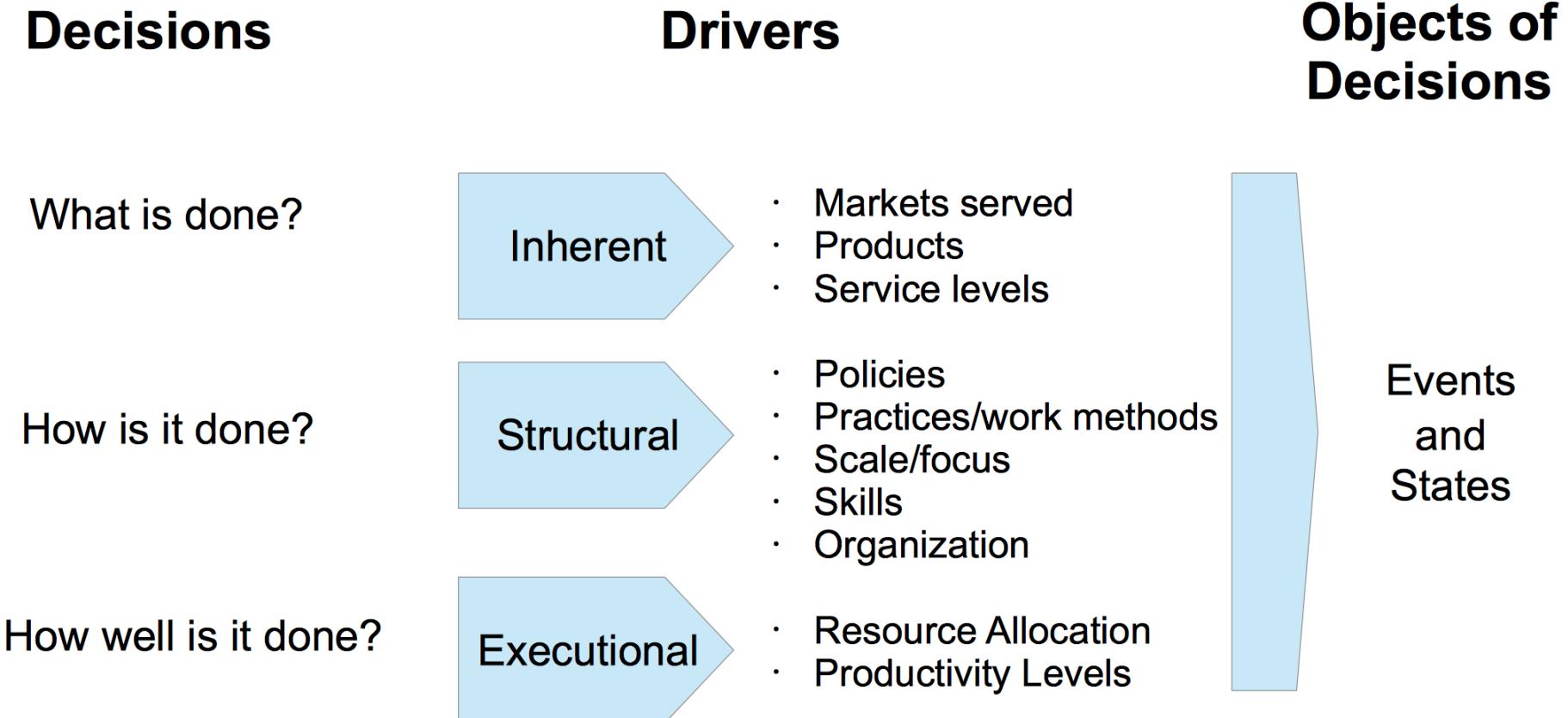
Sapriel. 2007. *Taking the Long View.*

Structural and Executional Cost Drivers

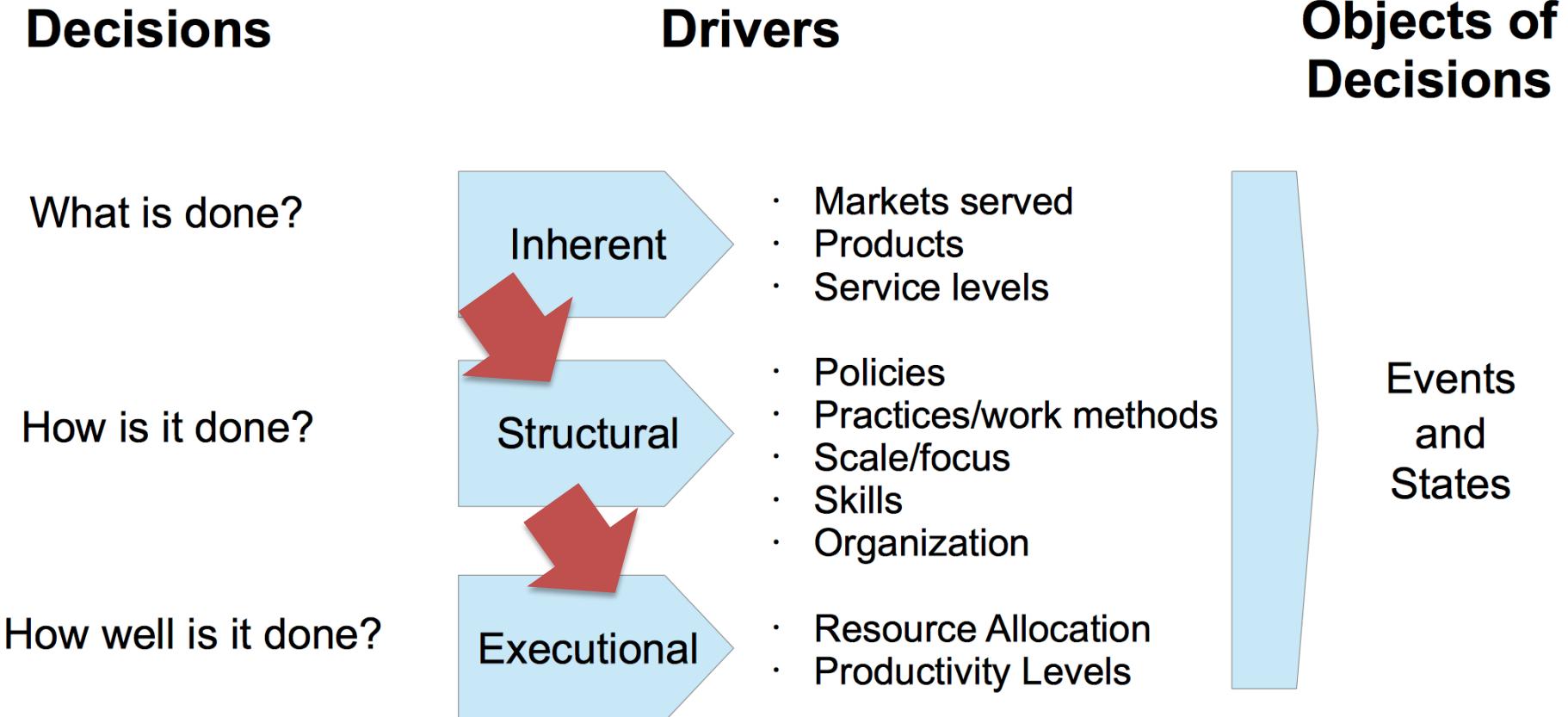


Based upon Shank and Govindarajan 1992, 1994

Structural and Executional Cost Drivers



Structural and Executional Cost Drivers



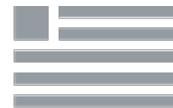
Examine Significant Challenge through the Lens of SCM

- US Airways and Southwest Airlines
- Similar Challenges
- Same Timing
- Structural and Executional Cost Drivers

US Airways and Southwest Airlines

Both built upon short-haul flights

- US Airways



U.S AIRWAYS

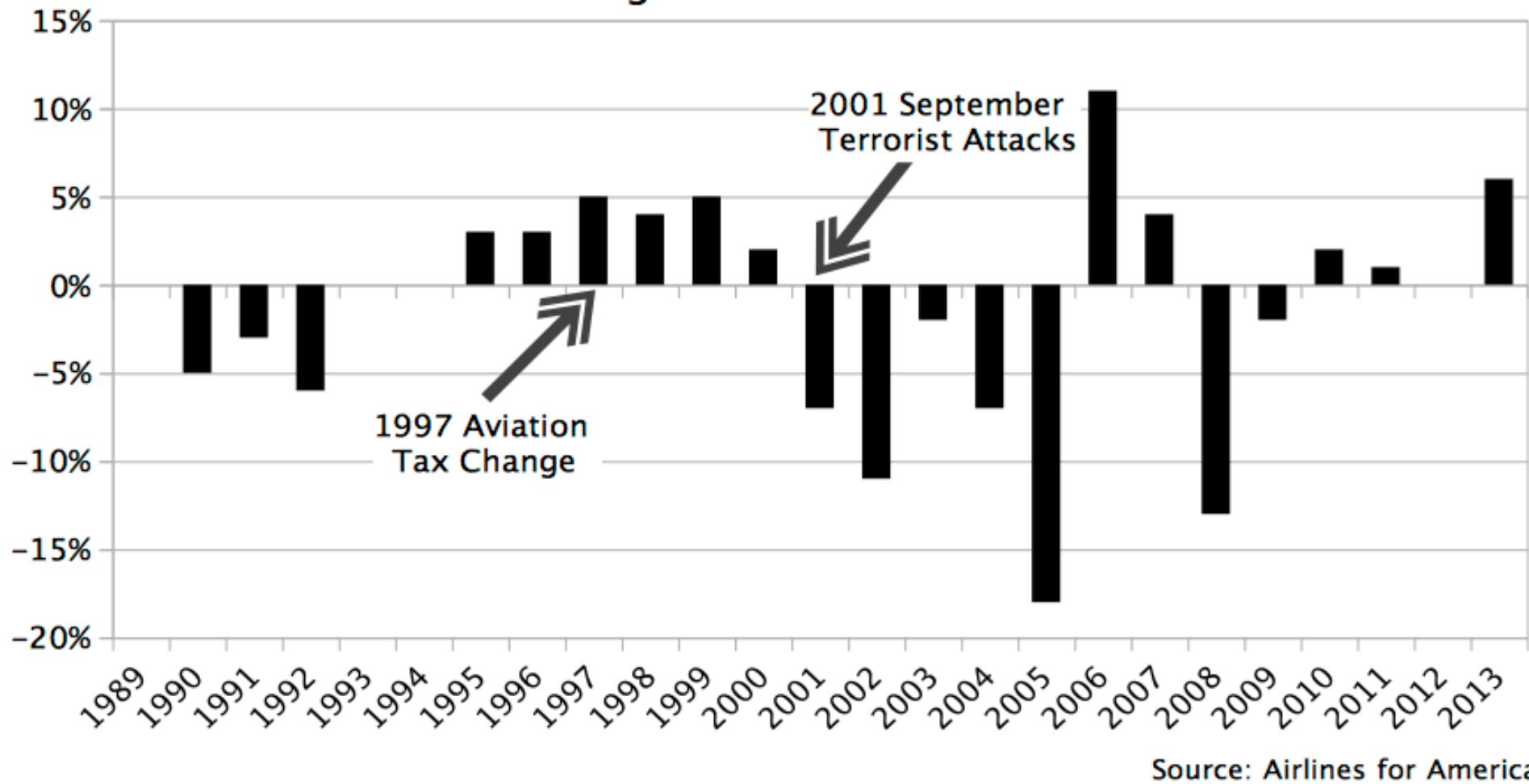
- Founded in 1939
- Among six largest U.S. airlines
- Merged with American Airlines in 2014

- Southwest Airlines

Southwest®

- Founded in 1971
- In 2014 had grown to serve 96 destinations

Annual Net Margins for US Airlines Combined



Source: Airlines for America

US and WN are Squeezed by Continental and United

- United States entered a brief economic recession in 1990
- Airlines recovered slowly 1990-92
- CO enters USAir's east coast markets
 - “We plan to grow now as opposed to waiting...”
- UA declares war on Southwest in California
 - “United is saying it is going to blow Southwest out of the market...”

This is a smoldering crisis...

USAir Responds by Shrinking

	Full-time Employees	Jet Aircraft	Airports Served
1992	44,502	440	129
1997	38,011	376	96
(Decrease)	(6,491)	(64)	(33)
	(23%)	(15%)	(26%)

All of USAir's moves seem to be working—Robert Fornaro, SVP for planning

Employees and Airports: June counts from DOT Form 41 filings

Aircraft: December counts from SEC filings

Using structural driver...

Then, US Responds by Changing Its Relations with Workers

We are “ending discussions with unions on a wage concession and restructuring package...”

“If management is looking for a fight they will get one. When our company fell on hard times we offered generous help. Now that there’s cash in the bank, management seems intent on going it alone....”

Southwest Responds to Its Threats

- Southwest threatens to add long-haul service in the West
 - “We intend not to give up one single customer...this is not a threat; it’s a promise.”
- Southwest buys Morris Air
 - Roughly eighth the size
 - Adds 14 cities in Northwest and West
 - Slowly merging over 2 to 3 years

Federal Aviation Tax Change (1997)

- Big Seven airlines lobby Congress for “fair” taxing
- Get rid of flat rate ticket tax (10%)
- Expected to save \$3 billion over next 5 years
- Low-fare carriers would bear the \$3 billion

Federal Aviation Tax Change (1997)

- Congress shifted tax burden, as requested, to short-haul and other low-fare flyers
 - Southwest's taxes raised \$75 million annually
- “I don’t get it; I don’t even begin to get it.”
 - Congress, though, surprised the Big 7 with overall tax increases
 - \$3 billion tax cut turned into \$3 billion tax increase

Southwest Goes Long

- Adds Next-Generation Boeing 737-700
 - Bigger wing
 - More fuel
 - Longer range
 - Same aircraft family
- Connects the dots

Using executional drivers only...

USAir Continues to Adjust Scale

	Full-time Employees	Jet Aircraft	Airports Served
1997	38,011	376	96
2001	42,411	342	89
Increase (Decrease)	4,400	(34)	(7)
	12%	(10%)	(7%)

Structural cost driver—capacity—triggers acute crisis...

Employees and airport: June counts from DOT Form 41 filings.

Jet aircraft: December counts from SEC filings.

1995 to 2000

- Common Stockholders' Equity
(\$ millions)

	Year-end 1995	Year-end 2000
Continental Airlines	\$ 305 million	\$1,160
Delta Air Lines	1,827	4,873
Southwest Airlines	1,427	3,451
US Airways	(836)	(358)

2001

- By mid-2001, US economy was weakened
- Prior economic downturns had threatened airlines
- And, then, terrorist attacks of September 11



US and WN Both Squeezed by Fallout from 2001

- Short-haul flights most affected by security procedures
- Consider Dallas/Fort Worth and Houston

US Airways Responds with Further Workforce Cuts and then Attempts to Rally Its Remaining Troops

- 10 days after 9/11/2001, plans announced to reduce workforce by 23%
- September 11 was the initial catalyst, but other factors emerged over time as primary
- “They’re coming to kill us. Herb Kelleher...wants our customers...wants your jobs.”

US Airways continues to tinker with structural drivers...

US Airways Enters Bankruptcy-- Twice

- August 2002 enters bankruptcy
(7 months)
- March 2013 emerges from bankruptcy
(18 months)
- September 2014 returns to bankruptcy

Southwest Continues Expansion with No Structural Driver Changes

- But, adjustments were made—
 - Larger aircraft
 - To flight network of short-haul flights between mid-size cities, added long-haul flights between large cities
- Alternate choices

Resolution

- Following emergence from Bankruptcy #2, ever-smaller US Airways merged in 2013 with American Airlines
- Southwest reported record profits in 2014 and began to expand beyond U.S. borders
- Next,
 - AA with US, record profits, strong position
 - WN significant challenges with labor (another smoldering crisis?)