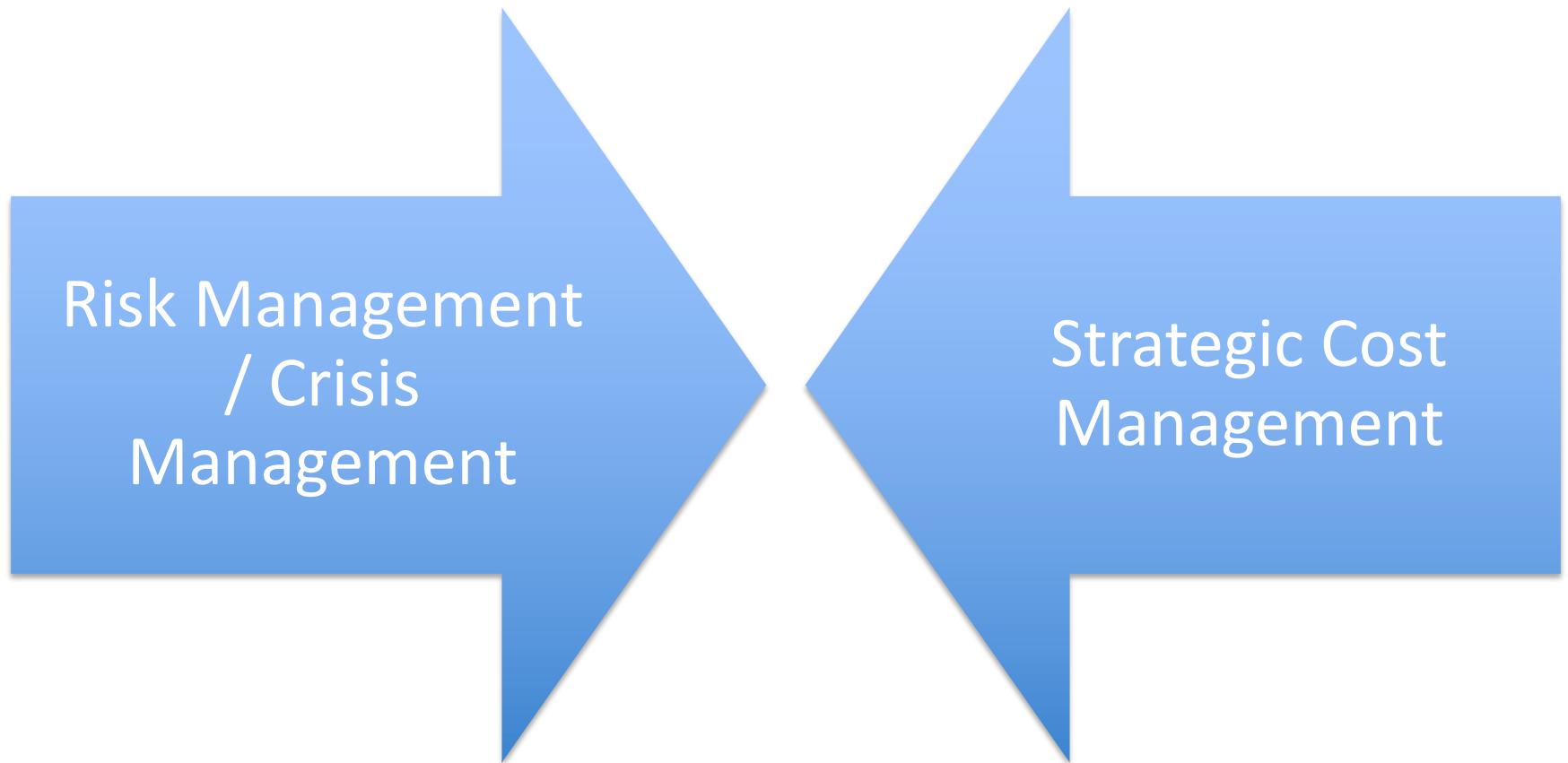


# An Effective Response

Smoldering Crisis and  
Strategic Cost Management

# Risk and Crisis Management Structural and Executional Cost Drivers



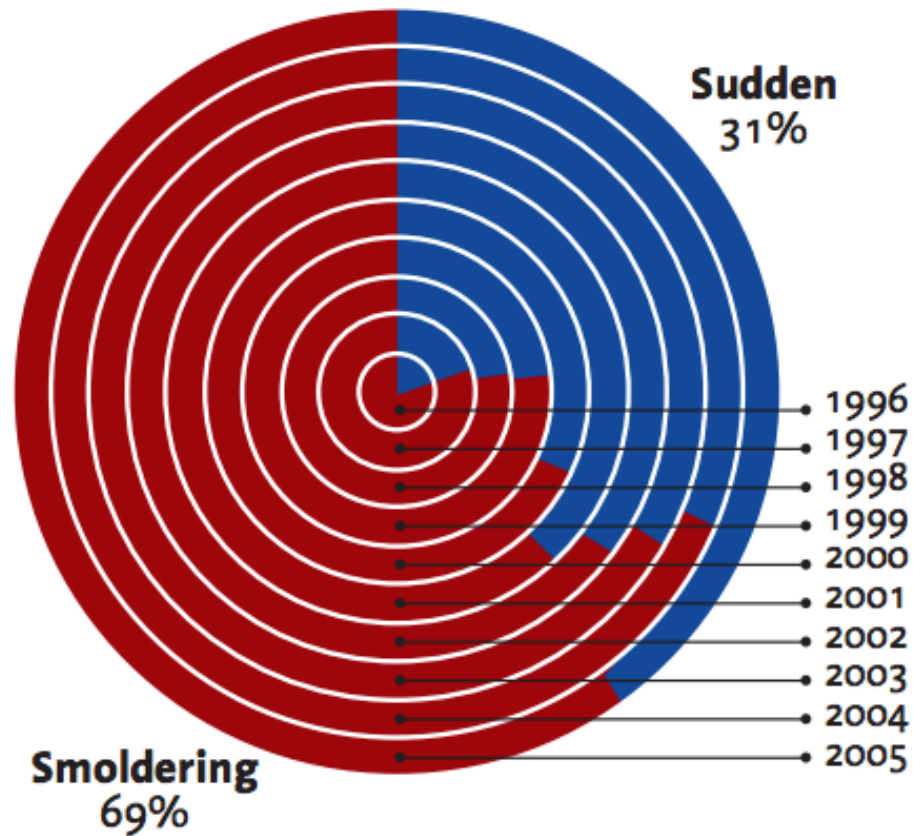
# Integrated Risk and Crisis Management



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

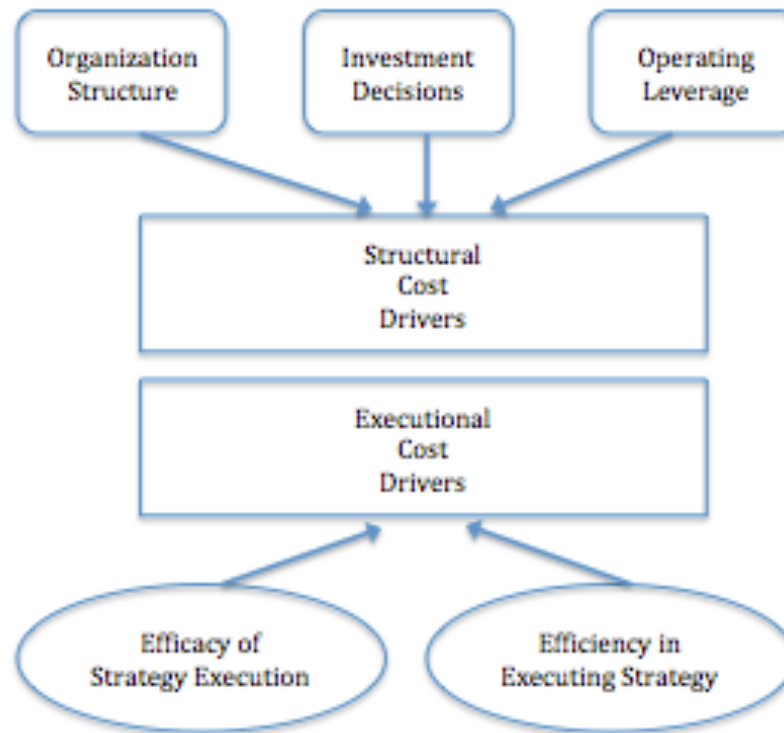
# Risk and Crisis Management

## Sudden vs. smoldering crises



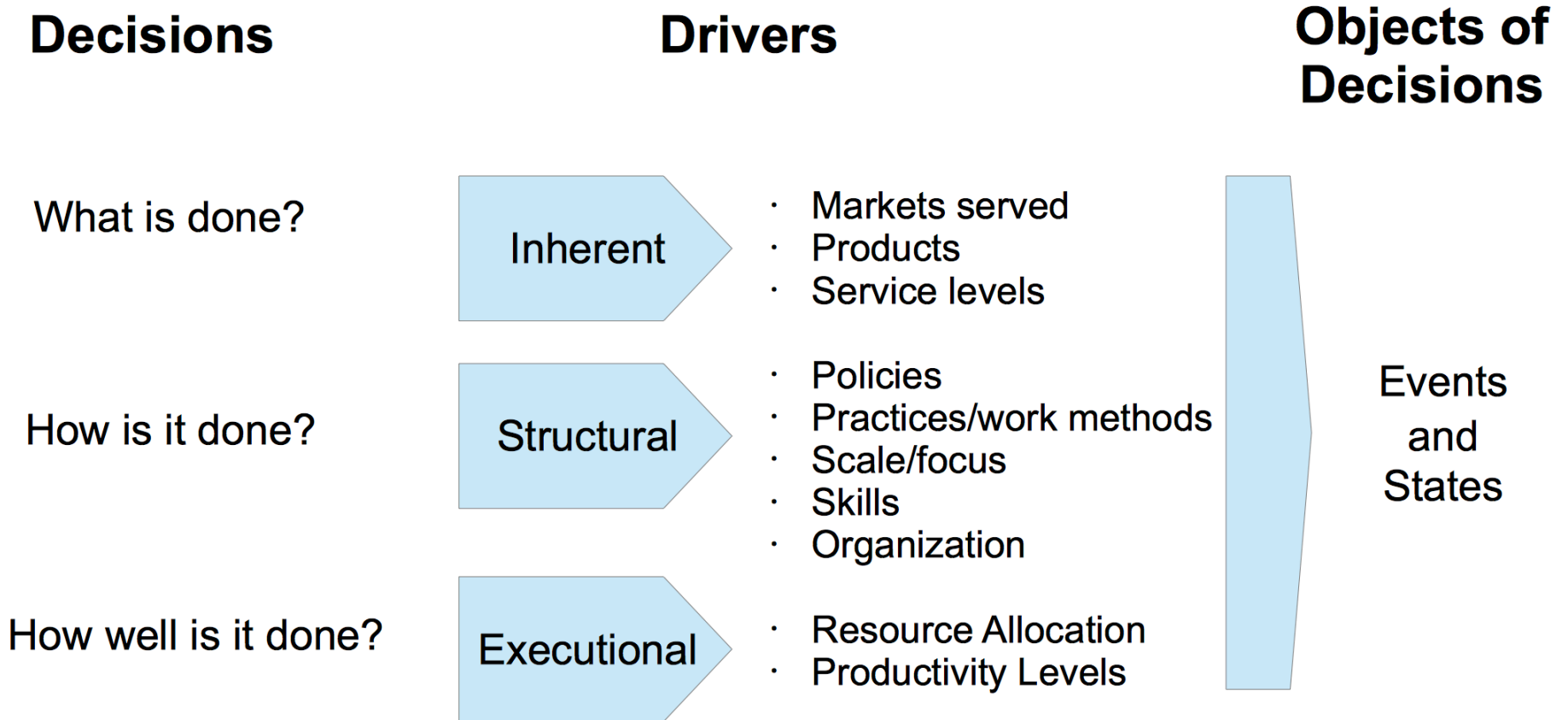
Sapriel. 2007. *Taking the Long View*.

# Structural and Executional Cost Drivers

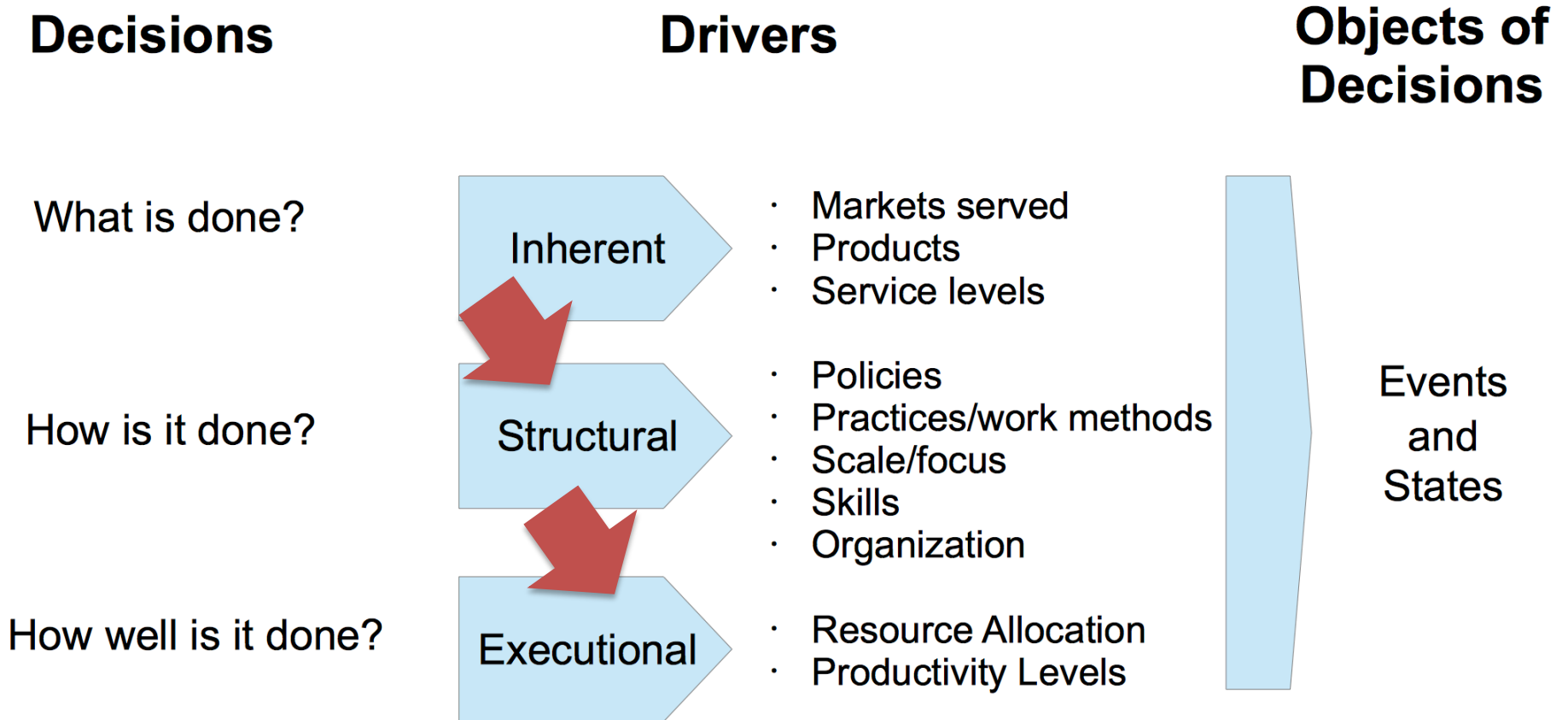


Based upon Shank and Govindarajan 1992, 1994

# 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

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



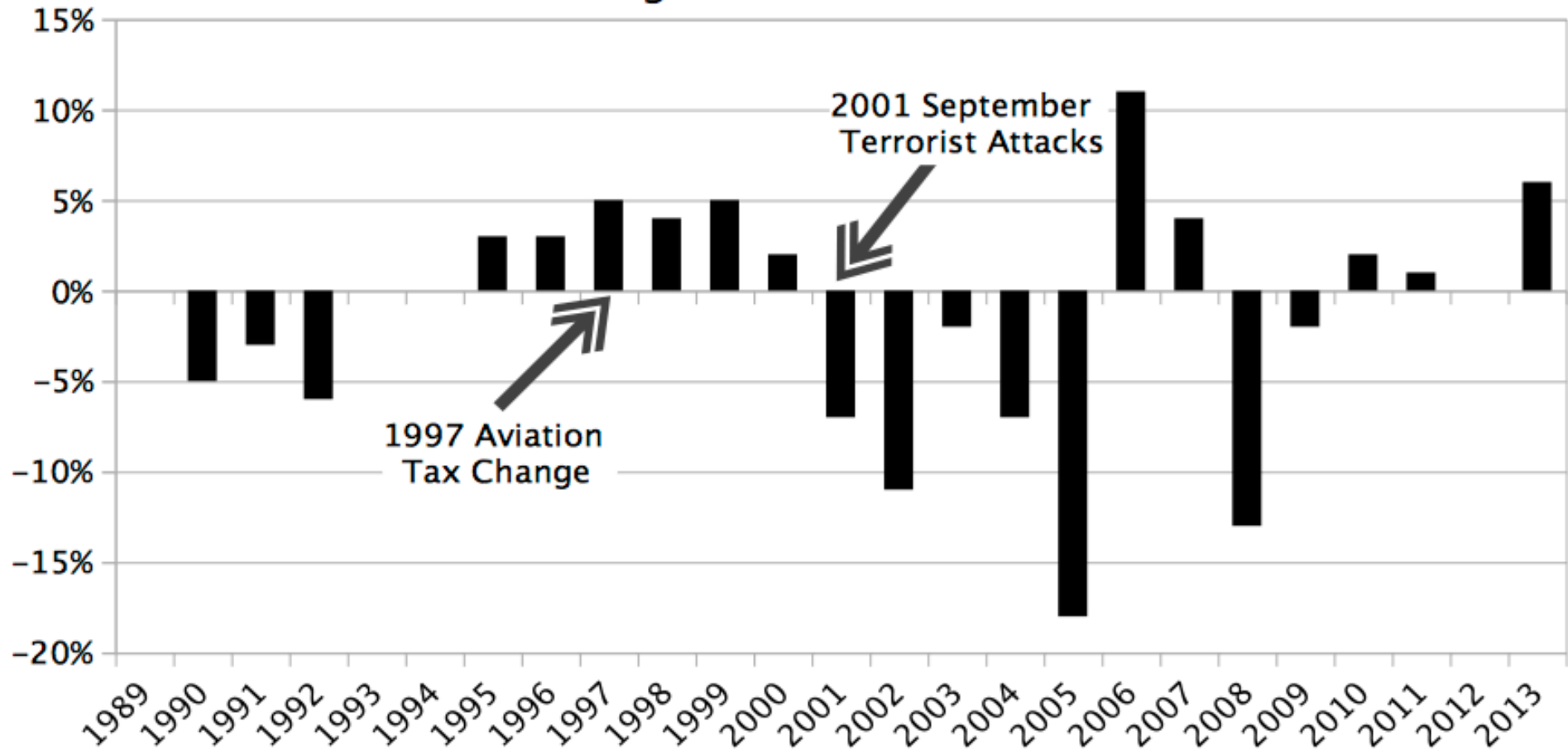
**U-S AIRWAYS**

- Southwest Airlines

- 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?)