

Finance Strategies in the Airline Industry

How Accounting & Finance Professionals Contribute to Sustainable Success

June 12, 2014

Zug, Switzerland

**Charles Thomas, PhD, CMA, CPA
Associate Dean, Graduate Programs**

charles.thomas@ehl.ch

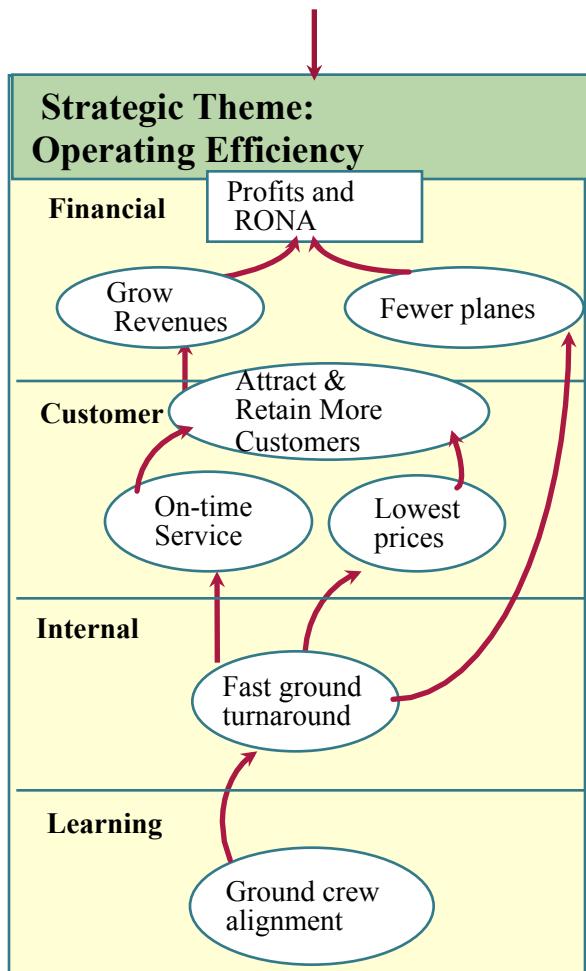


Business Strategy

- Provide Legendary Customer Service
- Produce and deliver at lowest cost
- Dominate the markets we serve
- Keep workers partners
- Healthy profit margins and consistent performance with steady, sustained growth
- Strong balance sheet
- Direct Customer relationship
- Safe, clean, efficient operation



The Strategy Map



Business Strategy

Strategic Objectives:

What the strategy is trying to achieve.

Measures:

How success or failure (performance) against objectives is monitored.

Targets:

The level of performance or rate of improvement needed

Key Action Programs:

Required to achieve targets

Objectives	Measurement	Target	Initiative
<ul style="list-style-type: none"> Fast ground turnaround 	<ul style="list-style-type: none"> Time at gate On-time departure 	<ul style="list-style-type: none"> 30 Minutes 90% 	<ul style="list-style-type: none"> Continuous improvement to reduce cycle time



3 Big Ideas

- Cause-and-Effect
- Understand and attend to your bottleneck
- Be operationally excellent, but be careful how you define 'excellent'.



A Closer Look at Our Strategy

and

**How We ‘Manage’ the Things
that Give Rise to Costs**

**in a manner consistent with our
Culture and Strategy**



Low Cost Structure

- Work hard, 'we'll make it happen' culture
- High quality execution
- High aircraft utilization
- High Employee productivity
- Efficient, cost-effective airports
- Single aircraft type - Boeing 737
- Direct-to-Customer sales of simple, low fares



What Low Costs Aren't

- Not low wages
- Not old aircraft
- Not lousy service



Shorthaul/Low Fares Means No Frills Needed

- One aircraft type - Boeing 737
- Quick turns
- Single-class seating
- Snack service
- Simple, fair fares

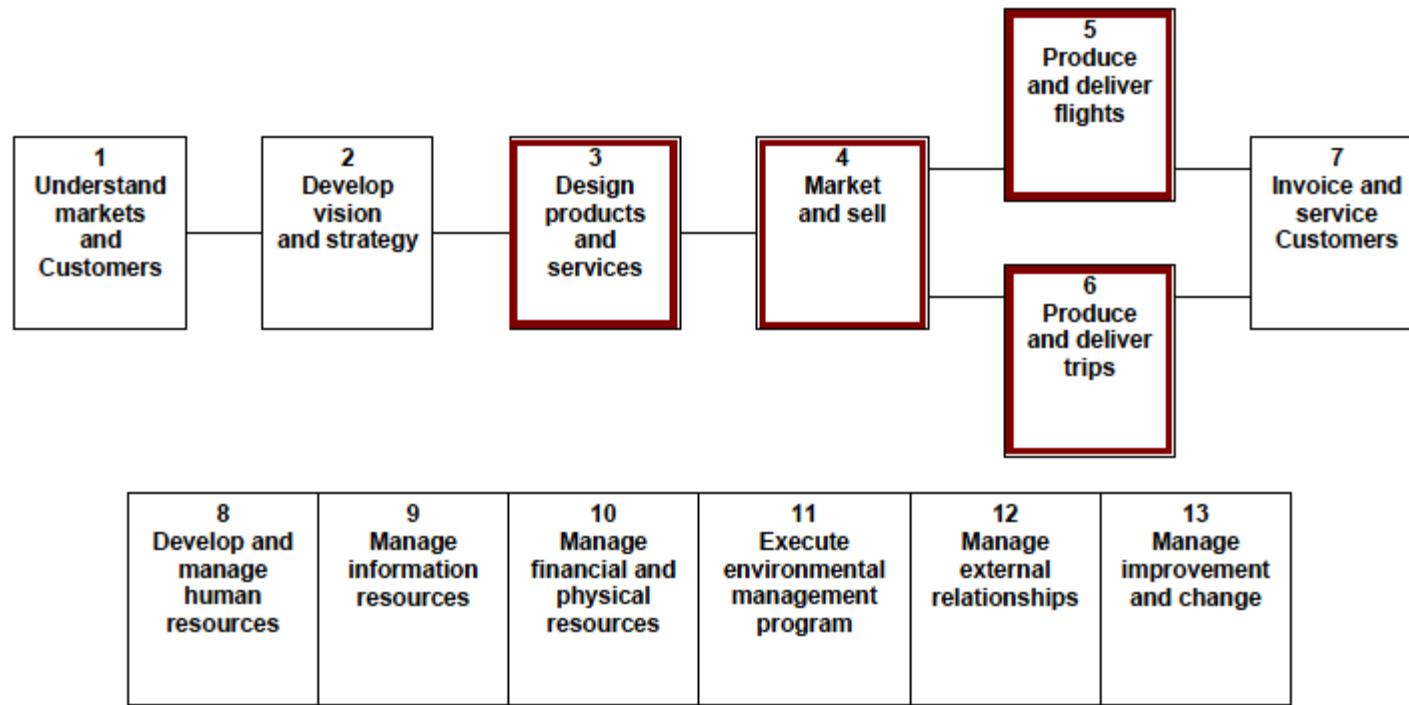


Southwest's Bottleneck



Southwest's Critical Few

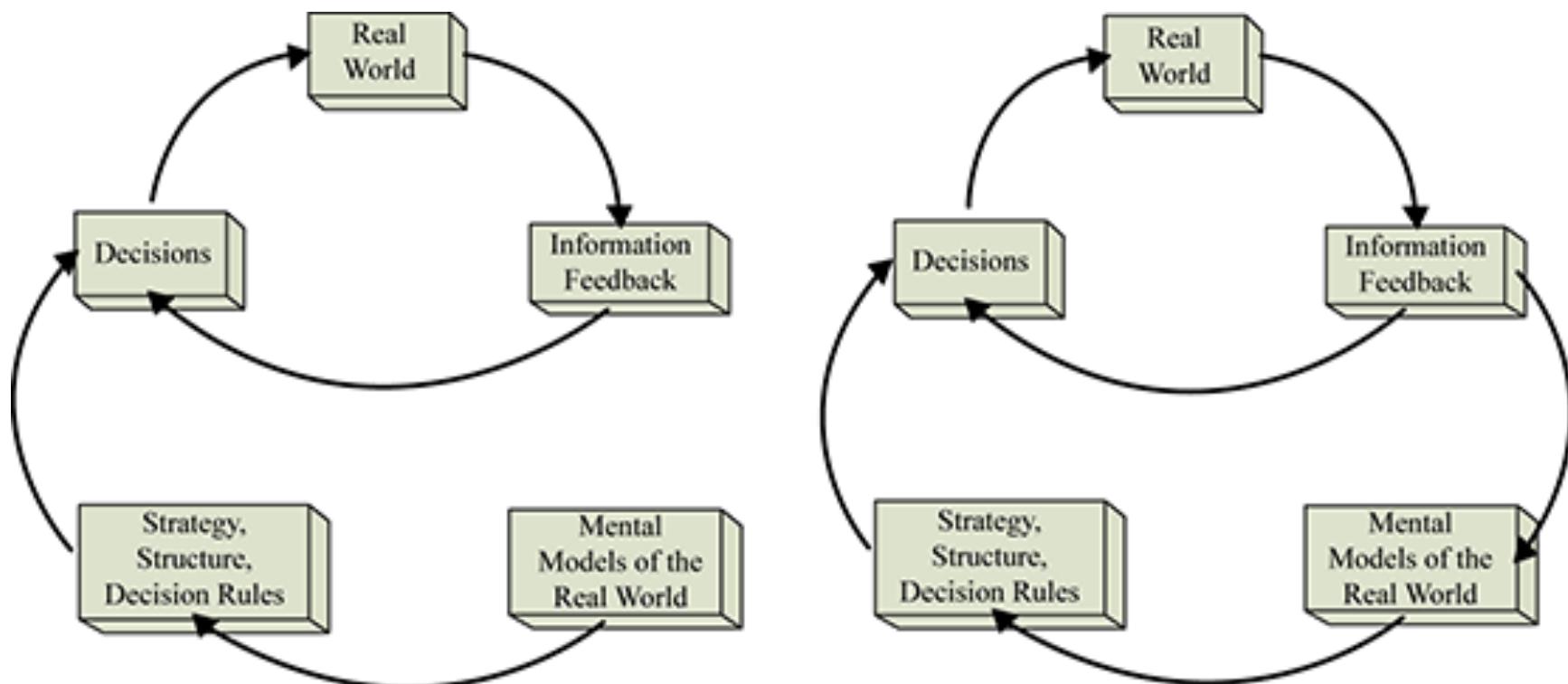
Processes Most Critical to Implementation of Southwest's Strategy*



* Rummel and Brache (1995) describe the core processes of a company as the three to seven processes most critical to the implementation of its strategy. For Southwest, those are "Design services", "Market services", "Operate aircraft", "Maintain aircraft", "Deplane and board passengers", and "Provide service inflight".

Provide Mental Models

Single- and Double-Loop Learning



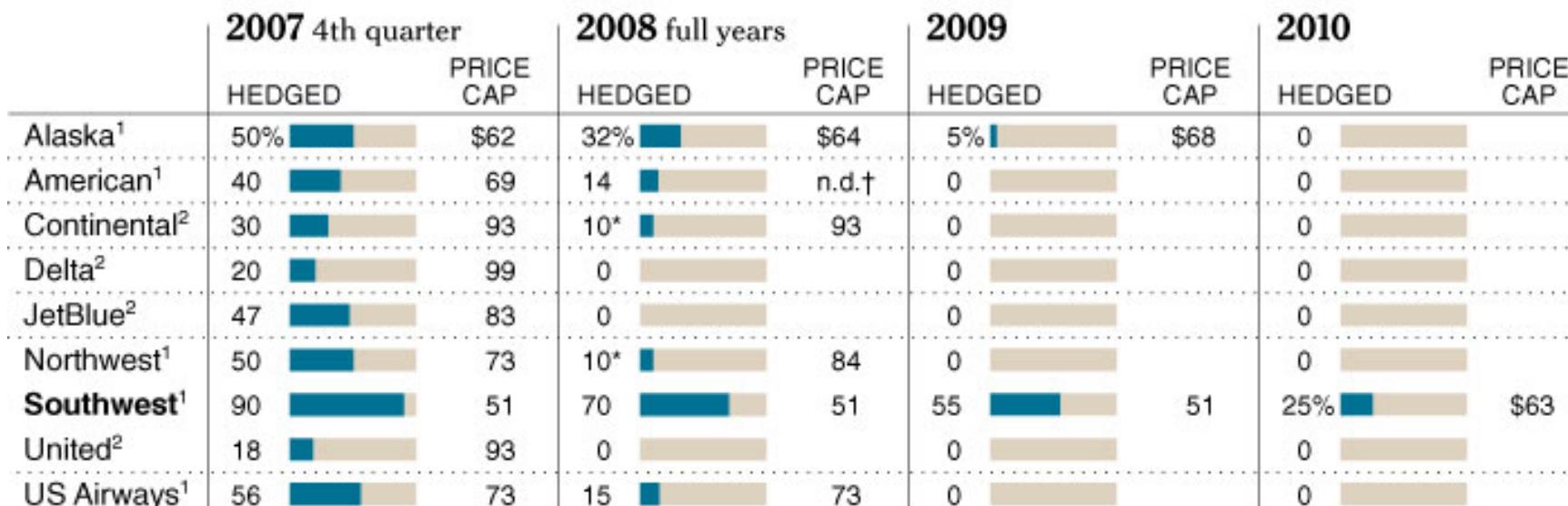
Fuel Hedging at Airlines

- Almost all US airlines maintain a systematic fuel hedging program
- But, that wasn't always the case

Southwest vs The Industry

Southwest's Profitable Bet

Percentage of each airline's fuel needs that are hedged against higher fuel prices and have been disclosed, with the price caps of their hedges.



¹ Price based on crude oil.

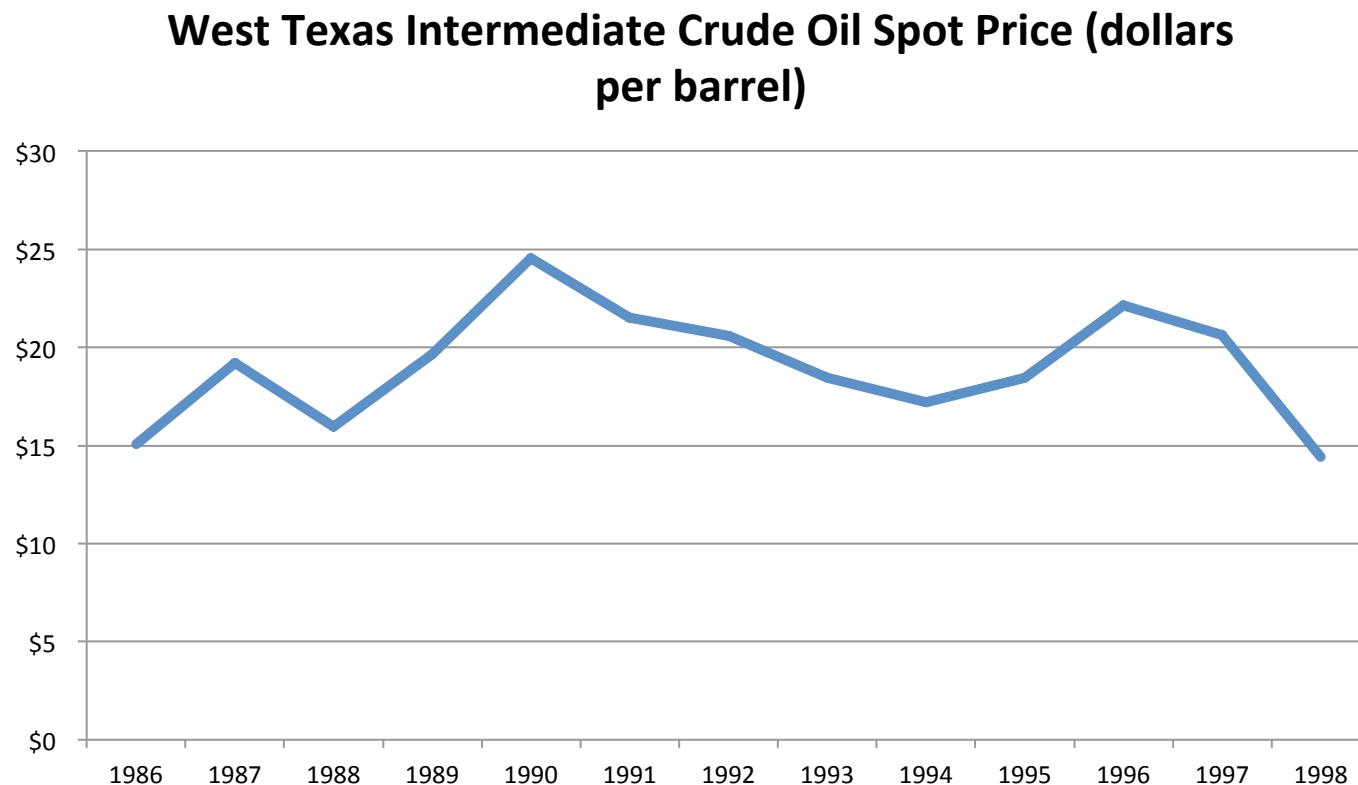
² Price based on heating oil, which is more expensive.

* First quarter only. † Price not disclosed.

Sources: Securities and Exchange Commission filings; the companies

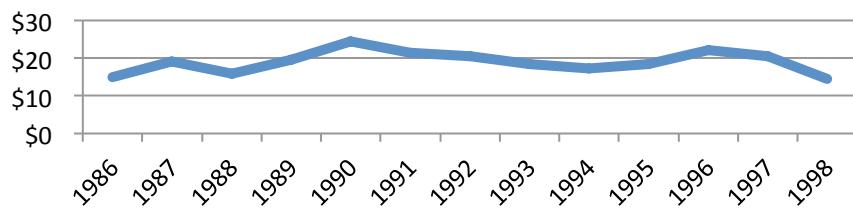
THE NEW YORK TIMES

Southwest's “Billion Dollar Big Bet”

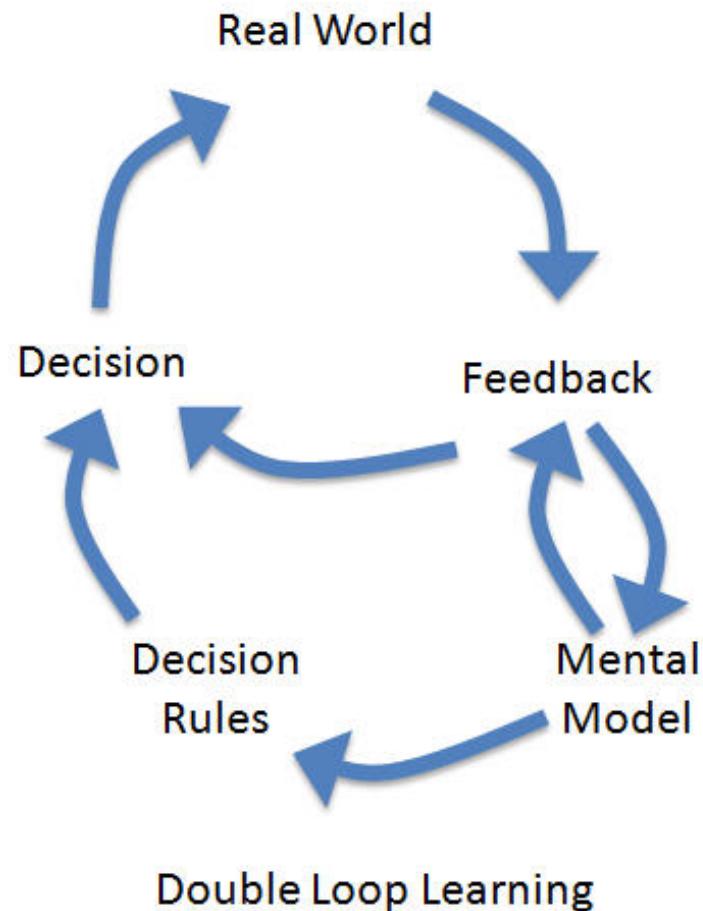




West Texas Intermediate Crude Oil Spot Price (dollars per barrel)



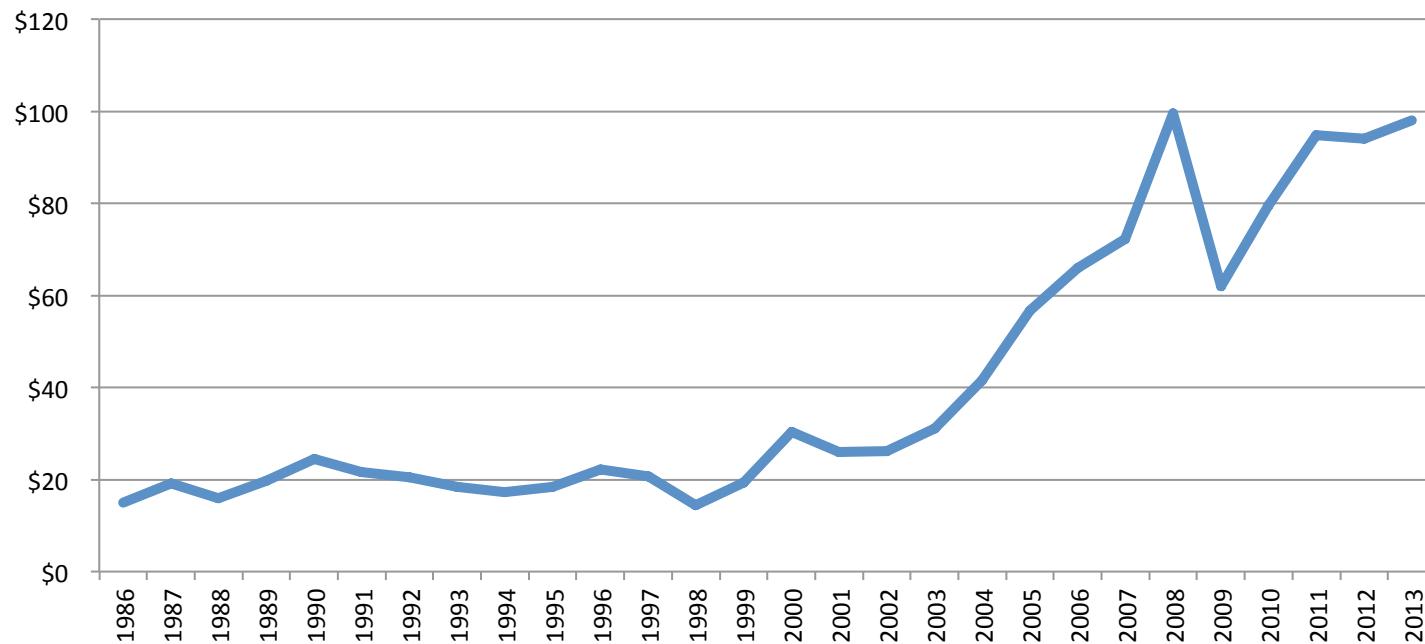
The Mental Model





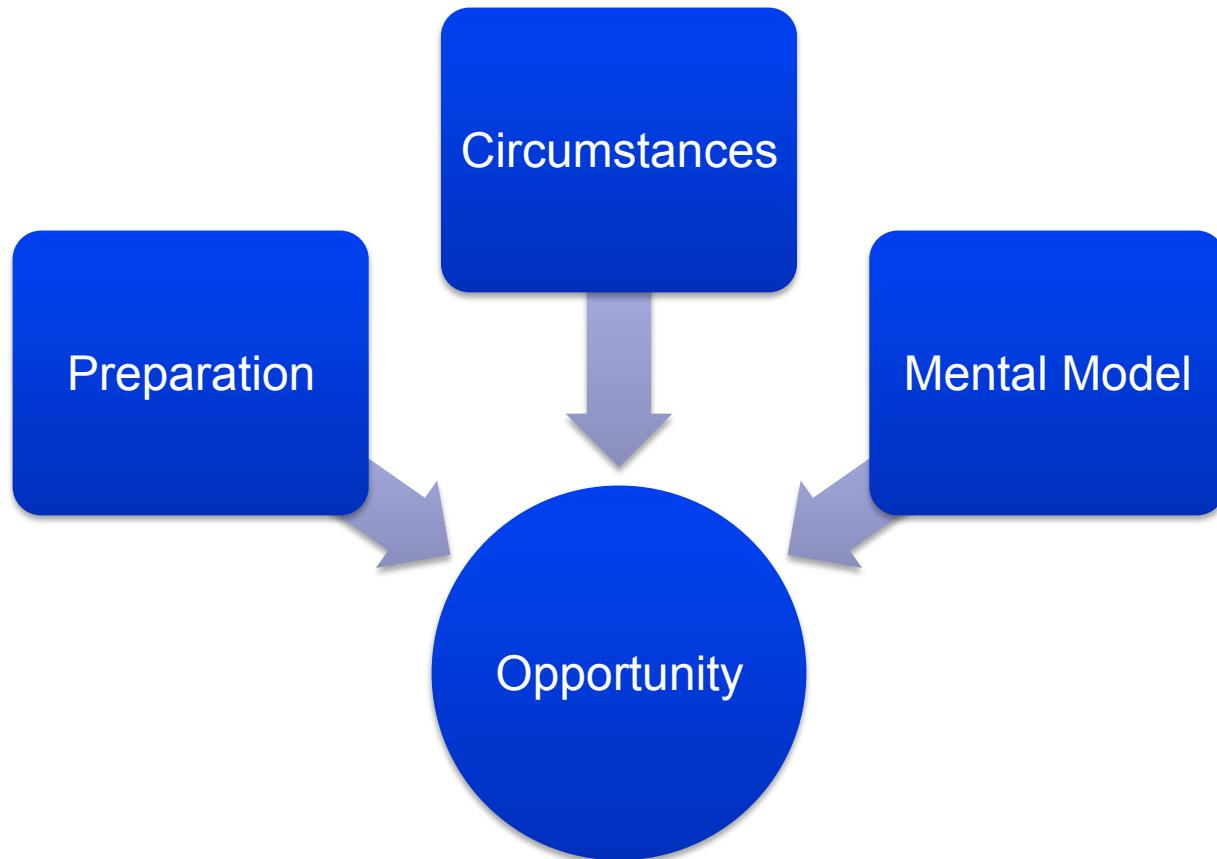
By 2008,
Southwest had saved \$3.5 billion

West Texas Intermediate Spot Price
(dollars per barrel)





“If we don’t hedge jet fuel price risk, we are speculating....”





Simple Rules that Make Us Smart

- My job is to make those around me smart
- As financial professionals we make others smart by providing mental models



OODA loop - John Boyd

