



Photograph courtesy of Southwest Airlines

Herb Kelleher: The Thought Leader Interview

The cofounder and chairman of Southwest Airlines tells why a firm's people are everything.

Thought Leader
by **Chuck Lucier**

The airline industry is a tough place to make a buck: too many competitors, price-sensitive customers, high capital intensity, boom-or-bust cyclicity, powerful suppliers, and often intransigent unions. Nevertheless, Herb Kelleher, the cofounder and chairman of Southwest Airlines, created the sort of value that any company leader would envy.

From its start in 1971, Southwest has grown into the fourth-largest airline in the United States, with 30 consecutive years of profitability, in an industry in which no other company has been profitable for even five straight years. Total shareholder returns during that period were almost double the returns for the S&P 500. Southwest has managed to accrue a market capitalization larger than that of the rest of the American airlines combined. Major competitors have tried to imitate Southwest with clones. Many entrepreneurial startups in the United States and Europe, including JetBlue and Ryanair, cite Southwest as their inspiration.

Southwest's achievements are widely attributed to its relentless

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focus. From the start, Southwest's strategy has been to draw travelers not from other airlines, but from cars, buses, and trains, by providing them the least expensive and fastest service available. To support the strategy, the company determined to fly only one type of airplane, the Boeing 737, and to substitute linear flying for the hub-and-spoke model that has prevailed in the industry. But at the center of Southwest's success are its culture and employees. "Your spirit," says Mr. Kelleher, a man fabled for his willingness to party hard with his staff, is "the most powerful thing of all."

In recognition of the inspiration he provides all who study and practice strategy, for his contributions in redefining how companies think about strategy, and for his achievements in redefining an industry, in November 2003 Mr. Kelleher was granted the Lifetime Achievement Award by the Strategic Management Society (SMS), the prestigious global association of academic and corporate strategists.

At the SMS annual meeting in Baltimore, Md., where Mr. Kelleher accepted the award, *strategy+business* contributing editor and "Break-through Thoughts" co-columnist

Chuck Lucier led a spirited public conversation with Mr. Kelleher about Southwest's success.

S+B: Let's start with some words from your award. You made an "audacious commitment" to putting employees first, customers second, and shareholders third. How did you get away with that for 20 years?

KELLEHER: When I started out, business school professors liked to pose a conundrum: Which do you put first, your employees, your customers, or your shareholders? As if that were an unanswerable question. My answer was very easy: You put your employees first. If you truly treat your employees that way, they will treat your customers well, your customers will come back, and that's what makes your shareholders happy. So there is no constituency at war with any other constituency. Ultimately, it's shareholder value that you're producing.

S+B: A dollar invested at Southwest's 1972 initial public offering is worth \$1,400 today. Does that come solely from putting your employees first?

KELLEHER: We have been successful because we've had a simple strategy. Our people have bought into it.

Our people fully understand it. We have had to have extreme discipline in not departing from the strategy.

We basically said to our people, there are three things that we're interested in. The lowest costs in the industry — that can't hurt you, having the lowest costs. The best customer service — that's a very important element of value. We said beyond that we're interested in intangibles — a spiritual infusion — because they are the hardest things for your competitors to replicate. The tangible things your competitors can go out and buy. But they can't buy your spirit. So it's the most powerful thing of all.

S+B: Not to deny the importance of intangibles, but what's the source of Southwest's cost advantage?

KELLEHER: The cost advantage is very important because we started out with a philosophy that we were going to charge low fares, come hell or high water. We were going to enable more people to fly. It didn't matter whether we had competition or not. In other words, we just said we're a different type of cat. When we get a load factor that gets into the 70 or 75 percent range over an appreciable period of time, we don't

increase fares. We add flights and put additional seats in. So if you come from that basic position, that this is what you are, then of course you have to have low costs.

Now, how do you get low costs? Through a lot of things, including the inspiration that you give your people, their productivity, the fact that they feel that they're doing something that is really significant and that they enjoy. If you take all of Southwest's compensation together — wage rates, profit sharing, the full 401(k) match, the stock options that our people have — Southwest employees are the most highly compensated people in the airline industry. One of our pilots just retired with \$8 million in his profit-sharing account. Now, you have to do well to produce that.

Meeting Life's Needs

S+B: A compensation scheme based on stock is great when the company is doing well. But when the stock doesn't do well, you can have a motivation problem.

KELLEHER: Absolutely, that is a risk. So we don't just give people stock options. We have an educational team that goes around and explains to them what stock options are, how they work, the fact that it's a longer-term investment. From 1990 to 1994, the airline industry as a whole lost \$13 billion. Southwest Airlines was profitable during that entire time, but our stock was battered. Eighty-four percent of our employees continued with Southwest Airlines stock during that four-year period. That's the kind of confidence and faith that you have to engender, so people have a longer-term view, and they're not trying to outplay the market every day.

S+B: Virtually all of the major U.S. airlines have tried to copy you at some point. None of them has come remotely close. What's so hard? It looks like it ought to be a pretty simple model.

KELLEHER: We've had many airlines that professed that they were going to be low-fare carriers. There's only one problem: They had high costs. You can do that, but Chapter 11 is your destiny.

I think the difficulty for them is the cultural aspect of it. That cannot be duplicated. One of the things that demonstrates the power of people is when the United Shuttle took out after us in Oakland. They had all the advantages. I mean, they had first-class seats for those who don't want to fly anything but first class. They had a global frequent flyer program, which we did not have. They probably spent \$25 million or \$30 million on their advertising campaign. I probably have something like a thousand letters at my office that tell you why they finally receded from Oakland. Those letters say, "Herb, I tried them, but I just like your people more, so I'm back." Don't ever doubt, in the customer service business, the importance of people and their attitudes.

S+B: So now we're back to the intangibles — the "spirit" competitors can't go buy. How does a company create a culture like that?

KELLEHER: We used to have a corporate day. Companies would come in from around the world and they were interested in how we hired, trained, that sort of thing. Then we'd say, "Treat your people well and they'll treat you well," and then they'd go home disappointed. It was too simple.

S+B: Or too hard.

KELLEHER: Or too hard — because it's a vast mosaic with thousands of little pieces that you have to keep putting in place every day. It's not a programmatic thing. It can't be. It has to come from the heart, not the head. If it's programmatic, everybody will know that and say, "Hell, they're not sincere; they don't really care, they're just telling us that they care." It has to be a continuous stream of one-on-one communication, not like you sit down and say, "Boy, communication is pretty important. Let's really communicate for the next six months and then move on to what's really significant." It has to be part of your fabric; it has to be something that you do really as a product of your soul.

I'll give you an illustration of why this works, if I might. When the industry was deregulated, I sat down with our very, very creative advertising agency, GSD&M, from Austin. (We call them "Greed, Sex, Drugs, and Money.") They said, "Okay, now we have deregulation, Herb. Airlines can fly wherever they want to. What's different about Southwest Airlines?" I said, "Our people are different." That's where the "Spirit of Southwest" campaign was born. That could have been a huge risk because we were telling the world on television, radio, newspapers that our people are different and they're better and they're special and they welcome customers. We ran that campaign for probably six or seven years and never had anybody write in and say, "You're wrong. Your people are not special." Which I think demonstrates that they are.

S+B: Is that why Southwest flight attendants sing?

“Southwest flight attendants sing because they want to. We don’t program our training to teach people to sing or tell jokes.”

KELLEHER: Southwest flight attendants sing because they want to. We don’t program our flight attendant training to teach people to sing or tell jokes. What we say is, “If that is your basic personality, feel free to go ahead and do it.” We’re not trying to train you to be anything different from what you really are. If singing buoys up your heart, makes you feel good, go ahead and do it. We have tried to say to our people, “You don’t have to put on a mask, you don’t have to be an automaton when you come to work. You can just be yourself.” Wasn’t it Robert Frost who said, “Isn’t it a shame that people’s minds work furiously until they get to work?” Well, that’s because they feel that they become artificial and constrained by the workplace.

S+B: One of your values in the mission statement is humility as a corporation. With all of your wonderful results, is Southwest *really* humble?

KELLEHER: No question. I constantly have warned our people over the years that, as we became bigger and more successful, our primary potential enemy was ourselves, not our competitors. Getting cocky, getting complacent, thinking that the

world was our oyster, disregarding our competitors, both new and old. I think humility is very important in keeping your eye on the carrot, keeping focused outwardly instead of inwardly, and knowing when you have to change. An investor in the airline industry some years ago that I was talking to said, “Southwest Airlines is the most humble and disciplined airline that I deal with.” I said, “The two go together.”

S+B: Why do they go together?

KELLEHER: Because you can’t really be disciplined in what you do unless you are humble and open-minded. Humility breeds open-mindedness — and really, what we try to do is establish a clear and simple set of values that we understand. That simplifies things; that expedites things. It enables the extreme discipline I mentioned in describing our strategy. When an issue comes up, we don’t say we’re going to study it for two and a half years. We just say, “Southwest Airlines doesn’t do that. Maybe somebody else does, but we don’t.” It greatly facilitates the operation of the company.

For example, we bought Morris Air. They were a Salt Lake City carrier with only about 14 or 16 air-

planes. We were much larger. When we paid a visit to their headquarters, I told our people, “When you get there, shut up. You can ask questions. But you cannot lecture. You cannot tell people the way they ought to do things. You know why? Because we’re on a learning expedition. Let the Morris Air people tell us. They’re new, they’re young, they’re fresh, they’re untrammled. Let them tell us the ideas that they have.” And we got some fabulous ideas as a consequence of it, and basically *that’s* the value of humility.

Growth and Change

S+B: You’ve grown from a few people to more than 34,000. How much did growth change the way you manage Southwest?

KELLEHER: It didn’t really. Your tactics change, but your basic strategy does not. Our mission statement is eternal. Our mission statement deals solely with people. That never changes — in any way, shape, or form. The focus of Southwest Airlines has always been on its people, regardless of how large we grew. Everybody would keep saying to me, “Wait until you get to a thousand, wait until you get to 5,000,

wait until you get to 10,000” — as if there was some bright line when you go over from the humanistic and entrepreneurial into the totally managerial. There is no such line in dealing with your people. Making them happy with what they’re doing, making them proud of what they’re doing, putting them in a position where they’re telling their grandchildren that Southwest Airlines gave me a greater reach than I ever would have had by myself — that continues to be effective whether you’ve got 5,000, 15,000, or 35,000.

One of the things that we do is continue to emphasize that we value our people as people, not just as workers. Any event that you have in your life that is celebratory in nature or brings grief, you hear from Southwest Airlines. If you lose a relative, you hear from us. If you’re out sick with a serious illness, you hear from us, and I mean by telephone, by letter, by remembrances from us. If you have a baby, you hear from us. What we’re trying to say to our people is, “Hey, wait a second, we value you as a total person, not just between eight and five.”

S+B: A lot of things are changing in the industry that might undermine the strategy you have followed for a long time. For example, you’re doing transcontinental flights. Does that require big changes in what you do?

KELLEHER: No. I’ll tell you, that was an interesting exercise because basically we’ve always tried to be empiricists and not theorize about what people want. When we started flying longer haul, even our own people would say, “Herb, you’ve got to have meals.” We’ve got to do this and we’ve got to do that. I said, “I’m not sure, but let’s just start flying

and see.” Well, here are these people from Nashville who want to fly to Los Angeles. It costs them \$1,200 less round trip, which gives them a lot of money to buy a dinner at Chasen’s, and they save two hours of their time because they don’t go through a hub. You think they care whether we have airline meals?

That’s another thing that we tried to do over the years: ready, fire, aim. In our business, where capital assets travel at over 500 miles an hour, you don’t have a lot of time to fool around with aiming, because by the time you’re finished aiming, somebody else will already be there. So get out there, do it, and clean up the mistakes afterward.

S+B: You’re being honored today as a “lifetime strategist.” Did you have a vision for the whole thing? Thirty-five years ago, did you write, “We’re going to become the largest airline with the lowest cost”?

KELLEHER: Oh, no. We didn’t write it down because when you write things down you confine yourself. That’s why we have never used the fancy titles for empowerment, total quality, etc. Every time you talk jargon you find that people assume that they have the same thing in mind when they really don’t. We don’t apply labels to things because they prevent you from thinking expansively.

Basically what we said 35 years ago was that Texas was captive: Braniff had a monopoly among the larger cities; Trans Texas had a monopoly among the smaller cities. The fares were very high. Because the short-haul passenger was merely an addendum to long-haul service, the short-haul passenger was being totally neglected. In other words, flights from San Antonio to Dallas

were scheduled in terms of what your arrival was in Seattle or Paris. It looked like an opportunity to do something a lot better: provide higher-quality air service at lower fares.

One of the things that people, I think, didn’t understand is that we started out saying we’re going to give you more for less, not less for less. We’re going to give you new airplanes, not old airplanes. We’re going to give you the best on-time performance. We’re going to give you the people who are most hospitable.

We’ve never done the long-range planning that is customary in many businesses. When planning became big in the airline community, one of the analysts came up to me and said, “Herb, I understand you don’t have a plan.” I said that we have the most unusual plan in the industry: Doing things. That’s our plan. What we do by way of strategic planning is we define ourselves and then we redefine ourselves.

S+B: There’s a big market opportunity in Europe. Haven’t you missed the boat there?

KELLEHER: It wasn’t a boat that we ever wanted to get on. It’s just way beyond our competence. International service has lots of complications. You’re dealing with different cultures. You’re dealing with currency exchanges. Compared with going into Raleigh-Durham and operating at 84.3 percent load factor on opening day, it’s much more complex. We would have to vary our fleet.

We have had most of the European carriers coming to Southwest Airlines and saying, “We have to be competitive for the first time in a long time. What should we do?” We

said, “First of all, find out what your customers want. Basically, you have dictated to your customers. Would they prefer to give up the baby-sitting service in Frankfurt in order to get a \$15 reduction in fares?” The startups in Europe like Ryanair also asked our opinion about what they could do and how they could do it.

It was interesting because 15 or 20 years ago there was the assumption that Southwest Airlines could succeed with things in the United States that Europeans would not accept in Europe. I said that’s exactly what everybody told me when Southwest started: that people in the U.S. would not accept it. Well, you have to educate people as to the value of what you’re providing. Obviously Ryanair and easyJet are very successful. I think you’ll see more and more of that kind of activity not only on the continent but also in Central America, South America, and Asia.

Boards and CEOs

S+B: I’d like to get your views on some cross-industry issues. How much has the CEO’s job changed in the last 20 years? How much do you think it will change in the future?

KELLEHER: I think the CEO’s job has changed a lot in the last 20 years. I don’t say that it’s necessarily for the better or the worse, but there has been a significant change. I think that CEOs of substantial companies have now become public figures, whether they want to be or not. You might as well acknowledge that. With all the media coverage of companies, you’re going to be in the limelight. You’re going to have to be able to respond to the media. You’re going to have to be able to address the public. That’s different.

Also, of course, as we’ve gotten more complex in America, we have become more regulated. So you spend a lot more of your time dealing with various governmental agencies than you did in the past. When I started practicing law, I would estimate that 5 percent of our total practice involved some kind of interface with the government in one of its myriad forms — local, state, or national. When I stopped practicing law, it was about 60 percent. I think that’s just a manifestation of what’s happened in business — that the regulatory aspects of it are now much more important than they used to be, and you have to know how to deal with those because that is a fact of life.

S+B: What about the relationship with the board? With changes in governance, Sarbanes-Oxley, and so forth, how is that going to shift?

KELLEHER: That’s not really a problem. If you were running your company right, if you weren’t trying to deceive someone, if you were basically making judgments that were intended to tell the public as closely as you could exactly what your earnings were, then Sarbanes-Oxley and the New York Stock Exchange regulations are just minor addenda to what you’re already doing. It may take you a little more time. It may cost you a little more money to comply. But it’s not unduly burdensome.

The primary thing I’m concerned about is that the new compliance focus distracts your board of directors, and this is relatively new. When you see that your board is now spending three hours focusing on regulatory issues and a half hour on the company’s business and what it plans to do, you have the

feeling that perhaps it’s taking people away from focusing on results and achievement, at least on an interim basis.

Another thing that concerns me is the impact on internal controls. I’ve asked several heads of big accounting concerns, “What’s going to be your criteria of what’s material and immaterial?” Business judgment has to enter into it. Years ago, our internal audit department concluded that some passengers were defrauding us. So audit went out and bought a \$300,000 system and hired two people to operate and maintain it. So I asked them, “How much are we losing here?” They said \$18,000. I said, “Let them steal \$18,000. We’re spending \$65,000 a year to keep people from stealing \$18,000.”

It reminds me of a fellow who owned a chain of theaters in Texas. He had a manager of 17 years standing, and went in and fired him one day. The guy says, “After 17 years and this enormous success that we have had, how can you fire me?” The owner said, “Well, for the first 15 years you were stealing \$800 a month, and you were worth that. But lately you’ve been stealing \$1,200 a month, and you’re not

“If you’re running your company right, Sarbanes-Oxley is just a minor addendum to what you’re doing.”

worth that.” So I hope we don’t just surrender business judgment and say that every little thing that goes awry from the accounting standpoint is as important as every other thing that might go awry. That concerns me a little bit.

S+B: I think boards play two very different roles. On the one hand, they play the role of cop: “Boy, this thing is out of control, it’s not working very well. We need to find a new CEO.” On the other hand, they help management by offering advice and counsel and by playing a sounding-board role. Are we in danger of losing the sounding-board role?

KELLEHER: I’m concerned about that. It’s not that I rebel against any of the changes that have been made, because I think in and of themselves they are salutary and not particularly burdensome. But I am a little bit worried about the psychological reaction to them. I was talking to a CEO in Dallas probably a month ago and he said, “I formulated a new strategic paper. It proposes that my company go into another business. I’ve been trying to present it to the board during the last two meetings, but we were so preoccupied with compliance issues and fear of

noncompliance that I haven’t been able to present it to the board.”

Training Entrepreneurs

S+B: You funded the Herb Kelleher Center for Entrepreneurship at the University of Texas. Why?

KELLEHER: Because I think it’s very important to Texas and to our country that we preserve our entrepreneurial spirit. As you get bigger and things get more complex, I think there is more of a tendency to get mired in the details, to get mired in the bureaucratic aspects of things and the hierarchical aspects of things. One of the things I always tried to do was to keep the entrepreneurial spirit alive at Southwest Airlines, even as we grew bigger and more complex. That’s where the job creation is coming from. It’s from the small businesses, not big businesses.

S+B: What would you like business schools to be doing better?

KELLEHER: By and large, our business schools, at least in the United States, are doing a far better job today than perhaps they were doing 30 years ago. Now, business schools are actually talking about entrepreneurship, perhaps kindling that

spark in their students. They’re focusing more on dealing with employees and how you achieve good relationships with your employees. They teach more about customer service and how to do customer service. They’ve gotten away from pure financial analysis and planning, to some extent, which I think is very important if you’re going to have a well-rounded CEO.

S+B: What advice would you give brand-new CEOs if they wanted to have the kind of success you’ve had?

KELLEHER: First of all, they have to focus intently upon what’s important and what’s unimportant, not be trapped in bureaucracy and hierarchy. Be results- and mission-oriented. Keep it as simple as they possibly can, so that the values and the destination of the organization are well understood by all the people that are part of it — so that they can feel that they are truly participants in it. I don’t know whether it was Calvin Coolidge or Bianca Jagger who said — they’re both thin, that’s why I get them confused — “the business of business is business.” We’ve always said, “The business of business is people.” +

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