

TRANSCRIPT OF INTERVIEW WITH GARY KELLY, CEO AND
CHAIRMAN OF THE BOARD SOUTHWEST AIRLINES
INTERVIEWED BY CHRISTINE NEGRONI IN NEW YORK DECEMBER 17, 2009

CN: What's a CEO Emeritus and what's it like to work under one?

GK: Herb is the founder. Everybody knows that Herb loves Southwest Airlines. Everybody knows that he's devoted 40 years of his life to Southwest Airlines. So its very intuitive, it's very understandable that Herb would want to stay attached to his baby. He has a very light touch when it comes to the ongoing business of Southwest airlines so there's no issues associated with his ongoing relationship. He's our father figure. I think that's appropriate and I think that will always be the case.

CN: Are there challenges to operating a company that is so inextricably linked to its founder?

GK: I suppose there could be. It's 24 years at Southwest for me too. It's not like I'm a newcomer, I grew up working with Herb, learning from Herb. I'm going on 6 years now as CEO and 2 years as chairman myself. I'm leading the company.

But I think the fact that we do have such a close relationship, and I know how he views things, he must be comfortable having me take over his baby and I'm comfortable in doing it so it's just that kind of relationship....Now, if I went into him and we were having a conversation and I was describing what I had either done or what I am contemplating to do he'll let me know what he thinks, but it's not as if I'm out making a decision or giving a speech or whatever, he's not going to come barging into my office and say, "You can't do that", and that's the kind of relationship we had when he was chairman for that matter. So, he's a tremendous person and that's why he was so iconic because he is really talented and he's shown his talent not only as chairman but now also as chairmen emeritus.

He's a wonderful resource to have around and he's a great friend. I spend a lot of time with him but I don't run all my decisions past him either. That wouldn't be fair to him.

CN: Is there something unique about Southwest that makes that possible where it might not work at other companies?

GK: I don't know that it's so much the company as it is the person. Southwest is famous for focusing on its people and genuinely caring about its people. We care about our customers, we care about other stakeholders and it just comes through. You come to our corporate headquarters and it looks like someone's home. There are family pictures on the wall, and I think that is that's very genuine Herb Kelleher and also Coleen Barrett for that matter, they were a tremendous duo for decades and that as much as anything helps makes this work.

There's no doubt in my mind he cares about me as a person and that he cares that I'm successful in doing my job in addition to caring about Southwest Airlines and its performance, so it's not just, its not just a corporate thing, it's a real flesh and blood thing and I think that is what makes it work.

CN: That flesh and blood characterization, is that a big thing that you think separates you from other airlines?

GK: I think it separates us from corporate America. I mean our company has a soul. We have a mission that people believe in. We really believe we are giving Americans the freedom to fly. It's a cause and it allows for a sense of pride in our individual employees to be associated with Southwest Airlines.

Sports are an overdone analogy, but I'm a University of Texas Longhorn alumni and I couldn't be more proud to be that and to have our team go to national championship. And that's the way Southwest Airlines employees feel about Southwest.

But we'll go to new communities, to existing communities, to parties and you'll interact with customers and they all have good things to say about Southwest Airlines. I was talking to my brother last night. He doesn't work for Southwest but people, when they learn that his brother does, they say, "Hey that is the greatest company. You know, they're such a strong brand and a wonderful company to work for." So there is an emotional attachment by our people and it's hard to put your finger on exactly what that is. But more than anything, Herb Kelleher cares about that. I care about it and it is real. And I do think that sets us apart. We have, year in/year out, the strongest brand rankings of most airlines and that's without offering some of the perceived amenities like first class and some of the other things some of the other frills - Just real people working hard to deliver a high quality product in a very friendly and caring way.

CN: So why do you think other airlines haven't at least tried to imitate the things you do well, at least try a, b, and c of the Southwest program?

GK: You just can have one person impose his or her will on 10 people on a thousand people on 30 thousand, 300 million, you just can't people...it takes trust, it takes understanding, it takes willingness to make all that happen. I don't think I could walk into another organization and have the same impact on people that I can have within Southwest Airlines. Because, there's an expectation at Southwest Airlines about how we're going to approach the customer. Think about the automakers and how insular they are. How do you change that? It's a daunting task. It's much harder to change that than it is to keep that. That's why I give Herb and Colleen so much credit. We've got a 38 year history of very stable leadership, consistent, good results and it gives one confidence that it works and you can believe in it.

CN: Are you suggesting airlines can't change because they didn't grow up that way?

GK: I would never say can't. I would never say never, but I'm just saying it is a daunting challenge to try to change, because people are people. They chose to a large degree how they feel, how they think and how they react and no program can change that. You can try to influence. You can try to convince people there is a different way to work with each other. I won't tell you what company it was but I just had to laugh, their leadership had a campaign - within the time that I was CEO - it was a poster for their leaders that said, "Don't be a jerk". You mean you have to tell somebody not to be a jerk? Just the concept that people thought being a jerk was okay. It's just... you shouldn't have to teach somebody that. They ought to know that.

Part of our challenge in an environment like ours is to make sure that we hold people accountable. Because it's not about being nice, it's about being respectful and recognizing that all people need to have dignity, but if somebody is not doing their job you've got to have the right person in the right seat on the bus, as Jim Collins likes to say. I think we struggle more with that sometimes although the results may not reflect it. But in a sense that's good in other words it's because people really care about people and they care about people's careers and they put a lot of effort into making sure that our people have a good working experience and on the whole it's a strong competitive advantage for us.

CN: Southwest Airlines has been criticized by some unions for its outsourcing of maintenance. Why did the airline decide to do that and what do you say to the charge that when you separate maintenance from its accountability stateside, you do put safety at risk?

GK: We're not putting safety at risk and no airline has a better safety record than Southwest airlines. Of course we're in an industry that's famous for having an outstanding safety record. It's very, very safe to fly.

We live in a worldwide economy. There's no escaping that no one has goods or services that are produced solely in the U.S.. It's rare if you find that. We fly Boeings but we have competitors who fly foreign made airplanes so I think that is, a disingenuous argument. What we need to focus on is, what's the substance? We only want to use high quality service providers and we spend a great deal of effort making sure that we do, everything we do is in strict accordance with very extensive federal regulations and it works very well.

The union that we negotiated with on that very point agreed to the outsourcing that you're asking me about. They agreed to it, they're not complaining about it. We've also agreed to make sure we have protections on jobs for our people. We've agreed to limits on the number of airplanes we will put in these facilities. The people we work with are top notch, if they're not, we won't do business with them. And we have our people onsite 24 by 7 providing oversight to make sure we're accountable for all of our maintenance to make sure that their work is up to standard.

CN: I don't think I heard the reason why the outsourcing decision was made?

GK: We are always looking for two basic things with anything we do. We're looking for a better performance and a better cost and we're looking for a better cost, a lower cost. And in this particular case we were able to add another supplier to our heavy airframe maintenance program. We have multiple U.S. suppliers across the country. This added more competition. It added more supply if you will for us and we have a fair number of airplanes that are undergoing heavy maintenance checks simultaneously today. Every month we probably have - at any point in time - probably 23 airplanes out of service in a hangar undergoing heavy maintenance out of a fleet of 541 airplanes. So we're always looking for good suppliers and secondly we got a great price and the competition is very helpful.

So in this particular instance we took the cost savings from adding that supplier into the Southwest network and shared it with our mechanics. And in an environment like, were no different from you or anybody else, we're very stressed financially and we are looking for opportunities to become more efficient and give our customers more reasons to pay us more money. So that's our challenge. Rather than going to our employees and asking them to sacrifice we've been able to find ways to avoid that. We've never had a furlough at Southwest Airlines. Ever. No jobs were lost because of using any outside suppliers up to this example. We didn't ask for pay cuts during the recession and in fact every employee got a pay raise, albeit a little bit modest but every employee got a pay raise. You have to tackle this and look at the whole when you hear some of the critics talk about it. You look at the substance of what we're doing, I'm very proud of it.

CN: The other complaint concerns Southwest Airlines' stock price. It's not going up. What's up with that?

GK: It's moved a little bit here so we're at least back into double digits that's all. I think that's a reflection of what the market sees at Southwest for the future. Part of that is telling our story. Part of it, more importantly, it's just showing results. We're very open and we're very transparent and we have admitted that there are challenges for Southwest and for the industry going forward. And we've tried to articulate a path as to how we're going to meet these challenges.

I was here a year ago, so it will be fun for me to walk down memory lane, go back a year ago and the country was in a very severe financial crisis, telling you everything you know, you know. Just to tell you

our story quickly, we were worried about access to the capital markets and we do need access. We're on the hook with Boeing to buy x number of airplanes per year. We can retire some old ones but it's still like buying a new car. You have to come up with the money to buy the new airplane. We were very concerned about the economy and the prospect for a very deep recession we admit that and that does put pressure on near term earnings and the near term stock price and then people are always wondering "oh, how are you going to get through it and what happens next?"

The other thing that's happened this decade that is a huge challenge for the industry is fuel. And our overall operation costs structures are up, since 2005 our operating cost is up 35%, our fares aren't. And you and we know that our customers are very price sensitive, not so much ones unique to Southwest, but the air transportation industry is very - has a very discretionary product. The higher the price goes, the fewer people fly, so there is a balancing act taking place there to try to have the right number of seats being offered with the right revenue result with the resulting operating costs boogie that you've got to overcome. So we're still reacting to that and I think the market knows that. I think the market is gaining confidence that we know what we're doing. They're always impatient and my job is to work through change at a reasoned pace so that it is successful.

Whether you like what the administration is doing or not, you've got to admit, there's a lot of things they've got on the list and if everything is important than nothing gets done. So, that's part of the challenge in this environment. We're trying to pick our goals, execute well against them and understanding it's hard to build a building in a month.

Bags fly free is a wonderful example though of the principal that we really cherish, which is taking care of our customers, focusing on our customers and struggling with the white noise in our industry because everybody throws a low fare out there. So how do you convince 100 million customers that we are the low fare champion? So this is a gift. Because it is something none of our competitors can match. They all charge for bags. It's a measly 15 bucks and we don't. So I think we are getting a ton of extra customers based now awareness from a fabulous advertising campaign, not because I'm in it by the way, I'm the straight guy, the ramp agents really steal the show, but it is really a good execution. You would love it is really humorous. (<http://www.youtube.com/watch?v=p9bkl-ciUU&feature=related>)

But as students of business you would really applaud the message. It's clear, it's compelling, it's engaging and you know who the company is, so all of those things together. This is an academy award winning campaign. So I think that we have critics of that back to the stock price on Wall Street, you know saying, "You ought to be charging for bags." But we have a different view. So you have to obviously set a vision and try to execute it as best you can but staying true to our principals in this particular case has served us well. And I do think that we've seen a very significant market share shift that just raw arithmetic would tell you it's worth \$800 million a year to us, not just because of bags.

The \$800 million is if you said the domestic market for air travelers is worth \$80 billion a year which I think is pretty conservative, one percent of that, if you shift one percent of that number from the legacy carriers to Southwest, that's worth \$800 million. Then it is, well why would that be happening? Well I think it's a laundry list of issues but certainly I think the bags fly free campaign, I would argue, is one of those.

CN: For so long Southwest has been known as the low cost, quirky airline. But is that identity changing? Are you still appropriately known as a low cost carrier or are you transitioning to something else?

GK: You are so right. I started in 1986, we had 100 airplanes and we were the low fare airlines. We were it. And now people say, "Why are you changing?" Well because the world changes. We don't have 20

dollar crude oil prices anymore. We have a whole array of low fare competitors out there. Every single legacy airline posts low fares. The world is different and we have to adjust accordingly.

Here's is one example. We use to serve Boston by flying to Rhode Island and encouraging people to go to Providence. That made Providence, Rhode Island the low fare airport and Boston Logan the high fare airport. When they wouldn't match our fares, that strategy worked fine. We had people wanted to go to Boston, they'd fly to Providence. What happens when all of a sudden you have a low fare carrier comes to Logan? And now both airports compete on fares? We go to Logan.

So you're absolutely right. We're transitioning because competition has changed and customer expectations have changed accordingly and we are trying to be to provide more flexibility within our capabilities so we can tap into new sources of revenue.

CN: So your identity as low cost carrier is more a part of Southwest's past than its future?

GK: I think we have to be more than just a low fare carrier. I completely agree with you. In 1985, that may have carried the day but in 2000...Its evolving and we have a repositioning effort underway.

But our strength is our people which is manifested in great high quality operations but also very caring, that's where we really shine with our people and it's all underscored with by our low fares but now we offer more. In 1985 we were very small. Now we're the largest carrier in the United States of America. We can take more people with more seats to more places. we'll be serving Canada and Mexico next year initially with a code sharing relationship partner. Right now it's more than low fare but I don't know we've captured that yet in terms of...

You know what my biggest problem is? There are so many things we want to tell our customers because we are not just one thing and that's actually a fun marketing challenge. I would look first to have an evolving campaign.

CN: What's the most provocative new thing you can tell me about your airline right now?

I think you've hit on it, it's more than just an airline. It's something unique.