

Southwest airlines risk management essay sample

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As with any company, Southwest Airlines has risks that have to deal with. For starters, co-founder and visionary leader Kelleher will soon be less involved in the firm's operations. Mr. Kelleher is responsible for the decision making of Southwest Airlines so it is going to be interesting to say the least when he takes a lesser role in the daily business of Southwest. Perhaps a more important risk, though, is the simple fact that Southwest is an airline. Past financial indicators have shown that members of the airline industry have been poor performers for shareholders because of risks involved.

Let us review some of the risks that airlines face and what Southwest has done to combat these to remain the only airline to be profitable in the 31 years of their existence. First airlines usually have to fly each flight, even if a flight is only half-full. The emptier a flight is, the less revenue it generates. Southwest has dealt with this risk by pursuing a low-cost/low-price/no-frills strategy that features offering passengers a single class of service at the lowest price possible fares making air travel affordable to a wide segment of the U. S. population.

One of the most noticeable risks faced by the airline industry is price wars that occur when one airline cuts fares on certain routes and forces others to follow suit resulting in reduced profitability. Southwest has almost eliminated this risk by developing a fare structure that is consistently by far the simplest and most straightforward of any major airline. All of Southwest's customers can peruse different fare options at the company's website, and the company's restrictions on tickets are more lenient than fares of its rivals. Most other airlines have complex fare structures with ticket prices varying widely according to several factors such as, how far in advance a ticket is

purchased; travel dates including a Saturday-night stay; refundable or transferable, and an assortment of other factors (Thompson| Strickland, 2003, C-611).

As airline customers know, the price of fuel frequently puts pressure on profitability in the airline industry. During 2000 when fuel prices were on the rise consumers saw the increase of ticket prices of up to \$40 for a round trip ticket. Southwest has used an innovative way of protecting itself against rising fuel prices called hedging. This is when a company simply buys futures contracts on the commodity in question, locking in certain prices early. Since there aren't futures contracts sold on jet fuel, Southwest did research and found that by buying contracts on heating oil, the price of which tends to move in tandem with jet fuel they were able to offset fuel costs. In his annual letter to shareholders, Kelleher noted that Southwest has already covered 80% of its estimated 2001 fuel expenses by hedging, locking in an average price of \$22 per barrel of crude oil, when the price at the time of his writing was \$32 (Trottman, 2001).

Financial risks due to terrorist attacks, like September 11, 2001, are extremely important consideration when an airline develops its financial strategy. Southwest Airlines was one of only two airlines that did not layoff any employees after this tragedy. This was due to a policy of maintaining low debt levels and relatively high levels of cash on hand. On numerous occasions over the years, employees have pointed out on, " At Southwest, we manage good time as though we were in bad times." Southwest financial reserves are not simply coincidental, in fact, the maintenance of financial

reserves is an integral part of the organization's ability to maintain and even strengthen its relationships in the face of crises (Gittell, 2003, p. 245).

Any organization with insufficient financial reserves maybe forced to break their commitments with employees and customers when faced with crisis. Southwest on the other hand having plentiful reserves in the form of low debt levels are in a better position to bolster their relationships by maintaining commitments to employees and other stakeholders in times of crisis.

Above in the preceding paragraphs you can see Southwest Airlines has been successful in turning risks into competitive advantages. In the larger scheme Southwest is able to use it competitive advantage to implement a policy of steady growth. According to John Denison, Southwest's former executive vice president of corporate services; " We promise the marketplace 10 percent growth, but we are only going to grow as fast as we can manage." Matt Hafner, one of Southwest's regional directors was kind enough to explain the Southwest philosophy a little more; " It is nothing new with Southwest. The " experts" always think we need to expand at a more rapid pace. What these so-called experts express is their desire for Southwest to jump at opportunities at a more rapid clip. Apparently growth excites investors. [But] nobody is pushing us. That could never happen" (Gittell, 2003, p. 246).

References

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