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Southwest’s CEO struggles to sell no-growth plan

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Gary Kelly says he’s prepared to steer Southwest Airlines Co. through a recession after halting the carrier’s expansion for the first time. His 35,512 employees aren’t all buying into the no-growth strategy.

In preparing for buyout offers unveiled this week, even supervisors struggled to accept a dwindling work force at the world’s largest discount airline, said Kelly, chief executive officer since 2004. He had to stress to managers at a recent forum that workers who take the offers won’t be replaced.

“We’ve always had a bias to be lean and mean, but also to continue to build the company,” Kelly, 54, said in an interview. “Can’t do that now.”

Kelly’s buyouts and cuts in seating capacity mark the end of the growth era at Dallas-based Southwest, whose burgeoning fleet, annual profits since 1973 and 38 years without layoffs set it apart from a U.S. industry ravaged by job cuts and bankruptcies.

“Shrinking is not really in the DNA of Southwest,” said Hunter Keay, a Stifel Nicolaus & Co. analyst in Baltimore who has a “hold” rating on the shares. “There’s a bit of a learning curve here.”

Southwest shelved its expansion plans because of a revenue and demand slump that is “easily the worst that I’ve ever seen,” said Kelly, who joined the carrier in 1986. He estimates he’s at least “70 percent along the way” in convincing workers and leadership that enlarging the airline must stop for the foreseeable future.

“It’s just coming to grips with the fact that, ‘Oh, so you don’t think we’re going to add 20 airplanes next year,’” said Kelly, who is reducing seating capacity by 5 percent this year and won’t rule out furloughs or seeking union concessions.

Some employees are still grappling with the shift, said Teresa Laraba, 46, who as vice president of ground operations supervises more than 10,000 workers.

“Twenty percent feel like we have a golden shield around us that nothing will ever penetrate,” she said in an interview. “The longer you’ve been here, the more lulled you get into feeling that nothing bad will ever happen to Southwest.”

Southwest relied on its low-cost, low-fare approach to evolve from a regional airline serving Texas cities in 1971 into the fifth-biggest U.S. carrier by traffic. Based on the number of passengers carried, it ranks No. 1.

Over the past decade, the fleet increased an average of 24 planes annually, reaching 539 Boeing Co. 737 jets. The workforce grew, too, with an average of 1,245 employees added in each of the past five years.

While Southwest didn't join other big U.S. airlines that have slashed 29,800 jobs since late 2008, its 17-year streak of quarterly profits ended in September, followed by losses in each of the two quarters since then.

In April, Southwest announced plans for the buyouts along with a suspension of hiring and a pay freeze for officers and senior managers.

“The message is, it can happen to anybody and any business,” said Jerry Glass, president of consulting firm F&H Solutions Group in Washington. At Southwest, “it's an education process because they have a lot of longtime, very dedicated employees who have been used to 30 years of profitability and growth and all these other wonderful things.”

Southwest's losses have been due in part to its strategy of locking in fuel prices in advance, as far out as five years. Masterminded by Kelly, the contracts helped ensure profits as prices rose. They became a liability when fuel rates tumbled 65 percent last year after a July 3 record.

In December, Southwest replaced its hedging contracts to minimize future losses. It has since resumed hedging, and now goes out only as far as 24 months.

“One of the neat things about Southwest is that they have problems, but they recognize them,” said Michael Boyd, president of aviation consulting firm Boyd Group in Evergreen, Colorado. “That means the problem is already half solved. That makes them a very dangerous competitor.”

Investors aren't yet convinced. Through yesterday, Southwest's shares plunged 40 percent after its third-quarter loss, the second-worst return among 13 carriers in the Bloomberg U.S. Airlines Index.

Kelly said he's confident Southwest is winning passengers with its decision not to charge for first or second checked bags. Still, he wouldn't preclude a luggage fee in the future if the lack of a charge isn't a competitive advantage or the amount of missed revenue “renders us unsuccessful.”

“I don't think in this environment a company can say no or never to anything,” he said. “That would be crazy.”

Pilots are among the employees feeling the effects from Kelly's moves to “put the brakes on,” said Carl Kuwitzky, president of the Southwest Airlines Pilots' Association, which began a monthlong ratification vote on May 4 on a new five-year contract. With fewer flights, the old opportunities for quick promotions to captain from first officer are gone, he said.

“I wouldn't say morale is in the toilet, but everybody's anxious to get back to a positive growth mode,” he said.

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