

A Feasibility Analysis of Southwest Airlines'

Returning to Colorado

Clay Mitchell

Introduction

Every year over 100 cities request service from Southwest Airlines. As USA Today business writer Donna Rosato explains, "the nation's largest lowfare airline brings down airfares, pushes up traffic and adds millions of dollars to local economies in the form of jobs and businesses" (2000). When Southwest decides to add a new city to its service network, only the very best offers stand a chance. Commitment to disciplined growth is a key differentiator between Southwest and its less profitable competitors. Southwest's former CEO, Herb Kelleher, explained that profit, not market share, is Southwest's primary concern: "Market share has nothing to do with profitability. Market share says we just want to be big; we don't care if we make money doing it" (Freiberg & Freiberg, 1996). In an industry marked by turmoil, Southwest has achieved 30 consecutive profitable years by refusing to chase markets that do not fit its business plan (Freiberg & Freiberg, 1996).

Lately, Southwest has expanded its route network to the Eastern U.S. In doing so, it has left a major hole in its Western U.S. network, namely Colorado. Coloradoans must wonder why Southwest serves smaller cities like El Paso, Tulsa, and Boise, but ignores Denver. In a nutshell, the Denver market has not met Southwest's requirements in terms of operating costs, traffic, government support, and competition (Rosato, 2000). Now

Southwest must determine whether or not it should serve Colorado in the future, and if so, when and how it should implement this service.

Reasons for Southwest's Current Absence

In order to analyze Colorado's prospects of luring Southwest, it is important to understand why Southwest does not currently serve Colorado. The first reason is high operating costs. DIA has some of the highest landing fees in the nation (Kopel, 1997). Some cities have offered Southwest incentives designed to lower operating costs, but Denver has not been able to offer anything substantial enough to counteract DIA's high landing fees. Burdened by billions of dollars in airport debt, Denver finds it difficult to match the incentives offered by other cities. Consider Albany, New York. Its landing fees are roughly half of DIA's, and the local government coerced the city's top 15 businesses to allocate a portion of their business travel to Southwest (Rosato, 2000). In addition, Denver is relatively isolated from other cities, which did not fit well with Southwest's short-haul strategy (Mahoney, 1993). This may not hold true anymore because Southwest recently ventured away from this strategy when it announced its first transcontinental flights scheduled to begin this fall (Ott, 2002).

Another problem is that many airline executives, including Southwest's, believe that the Denver market is overserved. For example, Colorado has the 20th highest gross state product in the U.S., but DIA is the fifth busiest airport in the nation (U. S. Department of Commerce, 2000). While much of this traffic comes from passengers making connections, there is still a great deal of supply in Denver relative to the region's population and economic activity. Furthermore, Denver was once notorious for

congestion and weather related delays. These delays are the primary reason Southwest stopped serving Denver, as Kevin and Jackie Freiberg explain:

Southwest avoids congested airports where it's very difficult to land a plane and get it back into the air quickly. The company's view is: Why work incredibly hard to streamline your system so that you can turn a plane in fifteen minutes, only to sit waiting forty-five minutes on the taxiway for your turn to take off? When congestion at Stapleton Airport caused excessive delays across its entire system, the company decided to terminate service in the mile-high city. (1996)

Delays are one problem that Denver has worked very hard to solve, but unfortunately the solution has come at a high cost: the 53 square mile, multibillion dollar Denver International Airport.

Denver International Airport

The construction of DIA has changed the dynamics of the Denver market. First, DIA is the reason that Denver has such high landing fees. The airport cost \$5 billion to build, and through landing fees the city has imposed a heavy burden on airlines to help pay that cost. Landing fees usually account for only about two percent of an airline's costs, but airlines operate on razor-thin margins (U.S. Bureau of the Census, 2002). Even with Southwest's incredible efficiency, the airline would not be able to charge its typical sub \$100 fares at DIA.

On the positive side, Southwest could achieve its 20 minute turnaround goal because DIA is much more efficient than Stapleton. In the most recent report, DIA had the sixth best on-time performance among major U.S. airports (U.S. Department of

Transportation, 2002). The addition of a \$166 million sixth runway should make DIA even more efficient because it will allow three airplanes to land simultaneously regardless of which way the wind is blowing. On the other hand, the runway may be overkill for Southwest's needs. Designed for jumbo jets, it will be one of the world's largest runways, and Southwest, which operates small Boeing 737s, would be expected to pay for the new runway through high landing fees (Leib, 2002).

The Competition

A strong analysis of the competition is crucial in determining whether or not to initiate new service in Denver. United Airlines dominates Denver with more than 60 percent of the market (Griffin, 2002). For this reason, fares at DIA are 25 percent higher than average (Griffin, 2002). This presents an opportunity for Southwest, giving it a chance to pit its low costs against United, the second-highest cost airline in the business (US Airways, United, 2002). Southwest likes to enter markets with high average fares because it gives the company an immediate advantage (Rosato, 2000). Unfortunately, previous low-fare airlines found it difficult to compete with United in Denver because United, unlike Southwest, is very willing to lose money in order to gain market share. Furthermore, Southwest could not match United's number of flights or its variety of destinations. Business travelers prefer to earn frequent flier miles on large airlines like United because they can use their miles to go to more places.

Besides DIA's high operating costs, the second most convincing reason for Southwest to avoid Denver is the reemergence of Frontier. Frontier's market share has grown to 11.2 percent, and it now serves more than 30 cities from Denver. The airline is

locally based, meaning that it may enjoy favorable treatment from the city government. As recently as last May, Denver announced the construction of a \$270 million addition to Concourse A, which will provide Frontier with more gates and enable it to continue growing its Denver hub (Forgrieve, 2002). Like Southwest, Frontier has low costs. Its sub \$300 fares are pushing the limit on low fares in Denver considering the high operating costs there. If Southwest were to enter the DIA market, it would incite tough competition from industry giant United and upstart Frontier.

The Colorado Economy

When it comes to expanding service, successful airlines like Southwest carefully evaluate the local economies of potential cities. Strong economic growth means more high-paying business travelers and more traffic in general. Colorado's economy boomed during the last decade, but the recent economic downturn has brought Colorado's growth to a screeching halt. Although the U.S. is showing signs of a recovery, U.S. Bank economist Tucker Hart Adams predicts that Colorado's economy will take longer to recover. Adams goes on to say, "local business leaders working in a range of industries aren't planning to add more employees or make large investments" (Svaldi, 2002). Other economists, like Nancy McCallin of the Office of State Planning and Budgeting and Tom Dunn of the Colorado Legislative Council, agree that the Colorado economy will take longer to recover than the national economy (Svaldi, 2002).

Colorado's struggling economy raises some doubt as to whether or not traffic growth will be strong enough to support new airline service. With United increasing its daily departures to pre-September 11th levels and Frontier continuing its growth, DIA

may have too many seats to fill. From Southwest's point of view, supply will be too high and demand too low to justify offering new service at DIA.

Another Option: Colorado Springs

Southwest has shown flexibility in avoiding large, expensive airports like DIA. In Chicago and Dallas, Southwest operates out of Midway and Love Field instead of O'Hare and Dallas–Fort Worth Airport respectively. This allows Southwest to avoid high costs and delays at the larger airports. If Denver had a viable second airport, Southwest might find a profitable niche in Denver similar to its niches in Chicago and Dallas. Centennial Airport and Jefferson County Airport could be equipped to handle 737s, but local residents adamantly refuse to allow passenger service at these airports (“Centennial Suffers,” 1998).

An alternative service point in Colorado is the Colorado Springs Airport. Western Pacific Airlines offered low-fare service from Colorado Springs with some success during the mid 1990s. The airline enjoyed load factors of 75.9 percent (“Western Pacific,” 1995). Colorado Springs has much lower operating costs than Denver, and Denver area residents have shown a willingness to drive to Colorado Springs to avoid the high fares of DIA.

Some analysts believe that Western Pacific would have been successful had it not abandoned Colorado Springs for DIA. A much more disciplined company like Southwest would not make the same mistake. Furthermore, Southwest provides profitable service to other small cities in the same population range as Colorado Springs. When Western Pacific initiated low-fare service out of Colorado Springs, United matched

Western Pacific's prices and connected passengers through Denver. Many passengers found themselves driving from Denver to Colorado Springs only to fly back to Denver and then finally to their final destination. Obviously, this strategy left United at a disadvantage to Western Pacific, which offered nonstop service from Colorado Springs to a variety of major markets. Southwest would enjoy this same advantage.

Southwest would have other advantages in a price war because it is cheaper to operate in the Springs than in Denver, and Southwest has much lower costs across the board. While landing fees at Denver are \$17 per 1000 lbs., at Colorado Springs they are only \$1.58 per 1000 lbs. (Mahoney, 1993; Halzerson, 2002). With its low system-wide costs and the cheap landing fees at Colorado Springs, Southwest could offer fares low enough to get people to make the drive from Denver.

Conclusion

Given the market situation, it is not advisable for Southwest to begin serving DIA at this time. DIA is simply too expensive, too competitive, and too out of line with Southwest's business plan for Southwest to begin service there. Southwest executives vowed to never fly from DIA, and unless there are some major market changes, this is the appropriate course of action (Rosato, 2000). Should DIA's market scenario become favorable for Southwest, it would not be difficult to acquire space there, because DIA is incredibly expandable and Denver continues to covet the airline.

If Southwest's executives decide they should provide some service in Colorado, Colorado Springs is the most sensible service point. Southwest could limit its risk by initially only offering a few flights a day. Because Colorado Springs is lightly served,

delays would not pose a significant problem. Armed with substantial cost advantages, Southwest could undercut the Denver operations of United and Frontier and still earn a profit.

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