

JETBLUE AIRWAYS: CREATING EXEMPLARY CUSTOMER VALUE IN A DYSFUNCTIONAL MARKETPLACE

*Bill Dodds, School of Business Administration, Fort Lewis College, Durango, CO 81301,
970-247-7495, dodds_b@fortlewis.edu*

ABSTRACT

JetBlue is making the kind of impact in the airline industry not seen since Southwest Airlines took off in 1971. Their business plan was to create a cost structure that could support low fares without doing it on the backs of labor or sacrificing service. JetBlue's ability to charge considerably less than just about any other airline is made possible by their exceptionally low cost structure. The cost advantage that JetBlue enjoys is rooted in two areas: highly productive people and highly productive aircraft. Also, JetBlue's founders were aware that its seemingly contradictory goals-the internal mantra is "high touch, low cost"-were achievable only through aggressive and strategic use of technology.

JETBLUE AND THE DYSFUNCTIONAL AIRLINE INDUSTRY

The U.S. airline industry is in an economic tailspin. Few industries have such awful labor-management relations and dysfunctional cultures as in the airlines. Stanford Business School Professor Jeffrey Pfeffer agrees, noting in a 1994 article: *In the United States, with few exceptions, most airlines have followed practices with respect to their employees that are, for the most part, diametrically opposite of what would be required to achieve competitive advantage through people -- and this in a service industry.*

Flying through the obstacles of a dysfunctional marketplace, JetBlue--whose revenues increased significantly each year since its start--is making the kind of splash not seen since Southwest Airlines took off in 1971. There are reasons aplenty for Jet Blue's remarkable success.

- JetBlue was the best-capitalized startup in industry history.
- The airline serves lucrative, high-volume markets, and most of its competitors are ill-managed and heavily in debt.
- JetBlue has fostered brand loyalty in what had become a commodity industry by offering customers an exceptional experience.

Key to JetBlue's model are low prices made possible by an exceptionally low cost structure. JetBlue charges considerably less than just about any other airline. With its focus on high volumes and rock-bottom pricing, one might assume that JetBlue runs a low-margin business such as Costco or Wal-Mart. In fact, that wouldn't be so bad, given that major carriers rode large *negative* margins to a collective loss of more than \$10 billion in recent years. However, JetBlue adds an emphasis on comfort and customer service. Anyone who has ever experienced Jet Blue's planes, cabin crew, and ground staff will tell you for as long as you care to listen how amazing this carrier is. Better planes, better seats, better service, better fares - better everything.

According to David Neeleman, Chairman and CEO of JetBlue Airways, "We have made great strides toward achieving "the very simple goal of bringing humanity back to air travel." Humanity! Notice Neeleman didn't say, "Bringing low fares and good service back to air travel." He said, in effect, that

most airlines treat their customers in an inhumane fashion and that he was determined that JetBlue would be "a different kind of airline."

PRODUCTIVITY: UNDERPINNINGS FOR EXCEPTIONAL SERVICE QUALITY AND LOW PRICES

JetBlue's success is rooted in two areas: highly productive people and highly productive aircraft. They are aggressive where it makes sense-that's why they have DirecTV in every seat, and why they're ahead of the pack on Web services. At the same time, they standardize where it makes sense, from their PCs right up to the airplanes.

From the company's inception, JetBlue's founders were aware that its seemingly contradictory goals-the internal mantra is "high touch, low cost"-were achievable only through aggressive and strategic use of technology. As JetBlue continues to conquer the odds, their repeated choice of Airbus aircraft proves that efficiency on all levels, including equipment and operations, is a must for an airline's continuing health. JetBlue demonstrates that with the right people, the right product and the right cost structure, airlines can grow, even in this current, challenging, environment."

Productive People

JetBlue attracts and motivates talented crewmembers in a number of ways, including developing a well-deserved reputation for treating crewmembers well and having a great work environment, offering the opportunity for rapid advancement, scheduling efficiently, and contributing 15% of profits to a crewmember profit sharing plan. Key motivators also include stock options and especially the generous employee stock purchase plan -- both of which are linked to JetBlue's soaring share price.

JetBlue is extremely picky when it comes to selecting employees to work for them. They made finding employees who know how to retain customers such a priority that getting hired is harder than being accepted into the Ivy League. Last year 130,000 applicants vied for 2,000 jobs. To choose its hires, JetBlue tests them on how they would handle a long list of hypothetical situations involving demanding passengers.

A JetBlue flight attendant who used to work for United relates anecdotal evidence that while her base pay is lower; she makes it up by working overtime and participating in the stock purchase plan.

I like working for JetBlue because the company treats me well, I am already quite senior (meaning that I have my pick of routes), and my fellow flight attendants work as hard as I do. At United, relations with management were terrible, I was among the most junior flight attendants (which was why I was laid off), and was often frustrated by burnt-out, unmotivated colleagues who -- knowing that our union would protect us -- were rude to passengers or simply sat at the back of the plane during the bulk of the flight. The attitude at JetBlue is very evident when you walk up to the counters and are greeted by someone that actually seems to want to help you out. The service attendants are always willing to go above and beyond to make sure that you have a great flight and to make sure that you find everything that you need.

In summary, JetBlue achieves tremendous labor productivity in a number of ways:

1. Employees feel valued and respected and have a sense of ownership, which translates into a motivated, productive workforce.

2. JetBlue flies one type of aircraft, which keeps training costs down, improves productivity, and increases scheduling flexibility.
3. Flight Attendants pursue an aggressive trash-collection policy, which allows JetBlue to turn planes around in about 35 minutes--compared with the hour or more at other airlines--giving JetBlue the opportunity to sell more flights per day.
4. On average, its pilots are paid for 83 hours per month, of which 82% are "block hours" -- the time from when a plane pushes back from one gate and arrives at another. This is a critical measure of pilot productivity since an airline only earns money during block time. JetBlue maximizes this metric primarily by reducing training time (again, flying one type of plane) and by shunning the industry-standard hub-and-spoke system and its associated delays between flights.

Productive Planes

Given an airplane's high cost, it's critical to squeeze every ounce of productivity from them. To keep aircraft operating costs low, JetBlue buys only new planes, which tend to need less maintenance and, even better, come with a five-year warranty. But equally important, JetBlue keeps its planes in the air -- the only time when they're earning revenues -- an average of 13 hours per day. This is the highest in the industry, 18% higher than Southwest (11 hours, though again this is largely due to JetBlue's longer flights) and 44% more than Delta (9 hours).

JetBlue achieves this productivity because:

1. Its planes are at the gate for, on average, 35 minutes, vs. an hour or more for most airlines.
2. New aircraft tend to spend less time out of commission due to unexpected breakdowns and scheduled maintenance.
3. With many coast-to-coast routes, JetBlue flies many planes on all-night "red-eye" flights to reposition them for the next day schedule.
4. As JetBlue grows, one of its technology tools is an "operational recovery system." During any disruption -- weather that grounds some flights, for example -- it allows planners to select various goals before rerouting planes while meeting criteria such as no canceled flights or delays beyond three hours. The software produces a solution and calculates its cost. It factors in each plane's maintenance and fuel needs, and the flight crew's experience and availability within FAA rules.

JETBLUE'S OPERATIONAL EFFICIENCY PLAN

JetBlue Airways began with a plan to create a cost structure that could support low fares without doing it on the backs of labor or sacrificing service. "You can be efficient and effective and deliver a great experience at the same time," says Neeleman. The airline operates at 70 percent of the cost of the biggest carriers, while flying significantly fuller planes. Innovative IT has been the key:

- ◆ JetBlue created the industry's first paperless cockpit, equipping pilots and first officers with laptops, saving 4,800 man-hours a year.
- ◆ JetBlue enabled VoIP lines for 600 at-home reservation agents.
- ◆ A tracking program accounts for all operational data (updated flight by flight), and an intranet connects 2,800 employees.
- ◆ Crew members use wireless devices to report and respond to irregularities such as weather delays.

JetBlue's lower costs are driven by two key elements: lower salaries, wages, and benefits (highly productive people); and lower maintenance and aircraft rentals and depreciation (highly productive aircraft). Heavy automation keeps costs low so customers can pay low fares and still enjoy leather seats

and real TV. JetBlue executives insist that the IT projects that make customers happy also benefit employees. "IT has made a huge impact on our number-one cost, which is labor," says Barger. "It allows us to do more with fewer people, and it also allows us to take better care of the people we do have."

When it comes to creating and keeping that low cost structure, information technology (IT) is definitely the enabler. What's behind this huge cost advantage? Comparative domestic operating statements are shown below for three airlines, converting all expenses into cents/ASM. In the end, IT's effect on customer service may be almost as important as its effect on cost per available seat mile. "The customer experience is our biggest success factor," says Neeleman. "That's what's surprised me the most: the amount of customer loyalty we have after being around just two short years." And that's not just CEO braggadocio. JetBlue filled 78 percent of its planes last year (industry average is 71 percent), landed the number-two spot among economy airlines in the Zagat 2001 airline survey, and ranks first in the Air Transport Association's metrics for on-time performance and fewest mishandled bags.

In the airline industry, analysts track what's called passenger revenue per revenue passenger mile (RPM). In English, that's what an airline charges the average paying customer to fly one mile. For JetBlue, in 2002, that number was 7.71 cents. By contrast, Southwest Airlines, the industry gold standard for discount fares, charged 8.02 cents/RPM while Delta Air Lines, considered one of the better major carriers, charged 9.39 cents/RPM, 21.7% more than JetBlue -- though this, in part, reflects Delta's first-class seating and other perks. Its little wonder customers were flocking to JetBlue.

But JetBlue's operating margins were remarkably high -- 16.5% in 2002. By contrast, Southwest's was 7.5% and Delta's a *minus* 9.8%. The differences in the first quarter of 2003 were even more dramatic: JetBlue, 15.9%; Southwest, 3.4%; and Delta, -17.0%.

So, how does JetBlue charge the lowest prices and still earn the highest margins? Simple: Its costs are the lowest, by a long shot. Airline costs are typically measured by dividing operating expenses by available seat miles (ASM). In other words, how much an airline spends, on average, to fly each seat (whether filled or not) one mile. For JetBlue, in 2002, that was 6.43 cents. The same thing cost Southwest 7.41 cents/ASM (15% more than JetBlue) and Delta 10.31 cents/ASM (a staggering 60% more than JetBlue). Below is a breakout of operating costs for the three airlines shown as a percent of revenue.

COST COMPARISONS

(cost as a percentage of revenue)

	JetBlue	Southwest	Delta
TOTAL REVENUES	100.0%	100.0%	100.0%
OPERATING EXPENSES			
Salaries, wages, and benefits	25.6%	36.0%	46.3%
Fuel and oil	12.1%	13.8%	12.7%
Maintenance materials and repairs	1.4%	7.1%	5.3%
Aircraft rentals & depreciation	10.6%	9.9%	14.0%
Landing fees and other rentals	6.9%	6.2%	6.3%
Other operating expenses	<u>27.0%</u>	<u>19.5%</u>	<u>25.2%</u>
Total operating expenses	83.5%	92.5%	109.8%
OPERATING INCOME	16.5%	7.5%	(9.8%)

2002 Data

After 2003, JetBlue was able to maintain low operating cost but cost increases such as for fuel was starting to put pressure on their cost advantage while competition keep their operating revenue low. These two forces combined to squeeze JetBlues operating profit by the first quarter of 2006.

COMPARATIVE DOMESTIC OPERATING STATEMENTS
(per available seat mile in cents)

	1 st Quarter 2004	1 st Quarter 2005	1 st Quarter 2006
JetBlue Airways			
Operating Revenue	6.8	7.2	7.5
<u>Less Operating Expenses</u>	<u>6.1</u>	<u>6.7</u>	<u>7.8</u>
Operating Profit/Loss	0.7	0.5	(0.3)
Operating Profit/Loss %	10.3%	6.9%	4.0%
Southwest Airlines			
Operating Revenue	8.1	8.2	9.1
<u>Less Operating Expenses</u>	<u>7.8</u>	<u>7.7</u>	<u>8.7</u>
Operating Profit/Loss	0.3	0.5	0.4
Operating Profit/Loss %	3.7%	6.1%	4.4%
Delta Airline			
Operating Revenue	12.3	12.0	14.4
<u>Less Operating Expenses</u>	<u>13.9</u>	<u>13.7</u>	<u>15.8</u>
Operating Profit/Loss	(1.6)	(1.7)	(1.4)
Operating Profit/Loss %	(13.0)	(14.3%)	(9.7%)
American Airline			
Operating Revenue	10.3	10.8	12.4
<u>Less Operating Expenses</u>	<u>11.1</u>	<u>11.3</u>	<u>12.5</u>
Operating Profit/Loss	(0.8)	(0.5)	(0.1)
Operating Profit/Loss %	(7.8%)	4.6%	(0.8%)

Source: Bureau of Transportation Statistics

This case is intended as a basis for classroom discussion and analysis and to reflect some of the issues faced in the airline industry. The case is not designed to illustrate effective or ineffective handling of an administrative situation.

A comprehensive teaching note and supplementary tables of information are available by contacting the author at dodds_b@fortlewis.edu. Please use your university affiliated e-mail account when making inquires about this case.