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The Strategic Transformation of Southwest Airlines amid External Shocks

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Abstract. Southwest Airlines maintained 47 consecutive years of profitability through a cost-leadership strategy built on free checked baggage and open seating. However, in 2025, the airline abandoned these policies, marking a strategic shift. Existing literature extensively documents Southwest's historical success but offers limited analysis of how external shocks reshape its resource-based competitive advantages during strategic transitions. This paper examines Southwest's transition from a pure cost-leadership model toward a hybrid competitive strategy. Using the Resource-Based View and VRIO framework as the primary analytical tools and PESTEL analysis as a supplementary tool for external environmental analysis, the study evaluates how core resources evolved before and after the policy changes. The analysis yields three main findings. First, the free baggage policy constituted a sustained competitive advantage before its elimination. Second, the shift to assigned seating increased boarding time by 4–6 minutes, weakening the airline's rapid-turnaround efficiency. Third, Southwest is neither the cheapest option nor the most premium one, and loyal customers have expressed dissatisfaction with the new fees. Drawing on these findings, four recommendations are offered: mitigate positioning risk, rebuild trust with frequent passengers, restore operational efficiency, and reduce supply chain risks.

Keywords: Southwest Airlines, VRIO framework, low-cost carrier strategy, hybrid competitive strategy

1. Introduction

Southwest Airlines has long been an exception in the U.S. airline industry. While legacy carriers like Delta, United, and American went through bankruptcies and restructuring, Southwest stayed profitable for 47 years in a row. This success came from a simple cost-leadership strategy: all Boeing 737s, point-to-point routes instead of hub-and-spoke, fast turnarounds averaging 25 minutes, and customer policies that made the airline stand out—especially free checked baggage and open seating. However, the pandemic halted air travel and accelerated industry shifts. As travel returned, consumers became more price-sensitive but also more willing to pay for flexibility and better services. At the same time, fuel costs rose, labor contracts pushed wages up, and competition grew. As a result, in early 2025, Southwest responded by ending its free baggage policy for regular passengers and replacing open seating with assigned seating. These changes broke from the policies that had long defined the airline's identity.

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While previous research has covered Southwest's operations and culture, less attention has been paid to how external shocks force low-cost carriers to rethink their resources. For instance, the strengths lie in its operational efficiency and cost-control strategies, customer loyalty, and company culture, while its weaknesses include limited revenue diversification, lack of premium services, and dependence on a single aircraft type [1]. This research summarizes Southwest's weaknesses, but it focuses only on traditional issues rather than the internal shocks after the pandemic. Another study notes that Southwest Airlines was founded on the principles of high employee productivity and low labor costs. But 53 years after beginning operations, its labor cost as a percentage of expenses—and per seat-mile—is now the highest among US airlines [2]. This document reveals a fact that has been overlooked by academic research for a long time—the labor costs of Southwest Airlines have shifted from an "advantage" to a "disadvantage", and the cost structure has deteriorated from "low-cost" to "traditional". This directly points to two research gaps: internal cost shocks and cost structure reconfiguration. This paper examines Southwest's strategic shift using the Resource-Based View and VRIO framework to estimate the sustainable competitive advantage of internal resources. The findings aim to find which resources constituted Southwest Airlines' sustainable competitive advantage before the transformation. What competitive consequences does the shift from cost leadership to a hybrid strategy bring and how should it be remedied?

2. Competitive advantages before the transition via a VRIO analysis

Southwest Airlines is known as a low-cost carrier that possesses several advantages that are difficult to imitate. Firstly, in terms of system operation costs, the free baggage policy was the core component of Southwest Airlines' friendly brand image before its strategic transformation. In terms of Value, this policy was of great value because it served as the primary means to attract consumers and build brand premium. For Rarity, the policy had relatively high rarity, since competitors did not offer similar benefits. Southwest's operating model provided strong organizational support for this policy. Regarding Imitability, while the free baggage policy could theoretically be imitated, replication would require reconstructing the revenue structure, resulting in massive losses in ancillary revenue and incurring extremely high costs. As for Organization, employees maintained close cooperation and worked in tandem with the supporting system.

Second, in terms of flight operating costs, Southwest Airlines uses only Boeing 737s in its operations. It cannot explore the international or long-distance carrier market due to the limitations of the Boeing 737. Besides, the public trust in the Boeing 737 has decreased significantly following a series of safety incidents [3]. The demand of travelers may fail to correspond due to safety concerns. In terms of Value, this strategy delivers high value, yet it is not sufficiently scarce as other airlines implement similar strategies. This results in competitive parity while still supporting efficient operations. For Rarity, the strategy is not an exclusive advantage of the firm. From the perspective of Imitability, competitors can copy this strategy, and thus it cannot be treated as a unique advantage. Regarding Organization, the firm's organizational setup fails to turn this strategy into its exclusive competitive edge.

From the aspect of ground operating costs, to minimize the cost of each flight, the company has meticulously developed every flight route and conducted market research on each route and city. The company found that passengers in these small and medium-sized cities were willing to fly with this relatively inexpensive carrier. Ultimately, the company basically gave up the eastern market and mainly concentrated its market in the central and western regions, choosing airports that are relatively close to large airports. This strategy offered two benefits. One is that the airport landing and take-off fees and other costs are relatively low. Second, there are fewer competitors, which is

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conducive to the punctuality rate of the aircraft. In addition, the company's policy of not connecting flights with other airlines has significantly reduced the waiting time for flights and improved efficiency [4]. In terms of Value, this method delivers high value due to its low costs and high efficiency. For Rarity, it focused on underutilized airports that were easily overlooked, and this became a distinctive feature of Southwest Airlines in the United States. Regarding Imitability, it is difficult for competitors to imitate, because they are constrained by substantial switching costs. As for Organization, the whole enterprise was structured around this system, enabling it to maintain a sustainable competitive advantage.

3. Multiple driving factors of strategic transformation

3.1. Macroeconomic and industry-external shocks from a PESTEL perspective

In the post-pandemic era, one major problem that low-cost airlines in the United States are forced to deal with is that their cost advantage is no longer sustainable. Labor and fuel costs are the two largest operating costs for airlines. Several experts note that, after the pandemic outbreak, frequent employee strikes, rising fuel prices, and inflation further pushed up operating costs. A single aircraft model was originally an advantage for low-cost airlines to control costs. However, the grounding of the Boeing 737 MAX and the problems with the engines of the Airbus A320neo series have dealt a heavy blow to low-cost airlines. For instance, the entire Boeing 737 fleet of Southwest Airlines' air cargo operation in the United States was forced to reduce capacity due to the grounding and delayed delivery of the Boeing 737 MAX. As a result, it missed the peak demand period in the market, and its economies of scale were discounted. At the same time, the retirement of old aircraft was postponed, leading to an increase in operating costs. Similar problems also plague Spirit Airlines and Frontier Airlines, both of which operate their entire Airbus A320 fleets [5]. However, as the industry entered its recovery phase, demand rebounded rapidly. According to IATA data, North American carriers reported a 28.3% annual traffic rise in 2023 compared to 2022. Capacity increased by 22.4%, and load factor climbed 3.9 percentage points to 84.6%. The December 2023 traffic rose 13.5% compared to the previous year, indicating the great potential of the air transport market [6]. However, the recovery did not alleviate the cost pressures that had intensified during and after the pandemic.

Full-service airlines have more available resources to offset some of the cost pressures, such as revenue from intercontinental routes and value-added services, fuel hedging, and even investing in refineries like Delta Air Lines. In contrast, low-cost airlines, when faced with a group of passengers who are highly sensitive to prices, have almost no room for flexible adjustments. Fuel costs, which typically account for a substantial part of an airline's operating expenses, fluctuated significantly. For instance, the price of oil in Q1 2020, when COVID-19 was declared a pandemic, was $40.34 per barrel. In Q2 2020, the oil price was $24.65 per barrel when the global pandemic reduced the oil price. In Q1 2022, the oil price skyrocketed to $77.94 per barrel [7].

What's more, labor costs emerged as another major pressure point. Wage growth increased from a pre-pandemic annual rate of around 3.5 percent to a post-pandemic high of more than 6 percent. It remained at similar rates past the inflation peak of June 2022 and the start of disinflation, resulting in a period during which wage growth outpaced price growth [8]. These contractual obligations added significant fixed costs to the airline's operating structure, further constraining its ability to maintain the low-cost model that had long defined its competitive strategy.

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3.2. Industry competitive landscape and capital market pressures

Prior to the transition, Southwest's profitability relied on a cost-leadership model built around three interconnected resources: free baggage as a brand differentiator, point-to-point routing with rapid turnarounds and a strong organizational culture. These resources, analyzed through the VRIO framework in the previous section, constituted the airline's competitive advantage for decades. However, while these internal strengths enabled historical success, they also created a structural constraint—the airline's revenue model remained heavily dependent on passenger fares with limited supplementary income compared to industry peers. This revenue gap became problematic as cost pressures mounted. The post-pandemic period saw labor and fuel costs rise substantially.

The profit incentive for change was clear. Industry data showed that U.S. airlines collected over $7 billion in baggage fees in 2024 alone. Southwest CEO Bob Jordan even publicly suggested that the airline might abandon its single-aircraft-model identity and explore different aircraft types to expand long-haul routes and higher-density markets. The company has set a goal to achieve cost savings of over one billion US dollars by 2027 [9]. Shareholders' pressure accelerated this logic. In June 2024, activist investor Elliott Investment Management acquired approximately 11% of Southwest's shares, publicly criticizing the airline's stagnant financial performance and demanding strategic changes. Elliott's campaign, which ultimately led to a board overhaul in September 2025, centered on one core demand: Southwest must adopt the ancillary revenue model that had proven successful for its competitors. The settlement effectively confirmed that the pursuit of higher profit margins, rather than the preservation of the historical cost-leadership model, would define the airline's future direction.

Thus, the transition was not only a defensive response to external shocks but also an active pursuit of profit-driven incentives. Rising costs destroyed the margin of the traditional model, while the visible success of competitors' ancillary revenue strategies presented a clear alternative. The combination of cost pressure and profit opportunity created an internal logic that made the abandonment of free baggage and open seating not only necessary but also financially rational.

Cost pressures, the industry's exemplary effect, and the demands of the capital markets are collectively driving the implementation of this strategy; however, this revenue-driven transformation will have a series of knock-on effects on the company's existing internal resources, brand equity, and competitive position in the market.

4. Transition and its competitive consequences

Southwest Airlines plans to completely abandon the core symbols it has relied on for over five decades—free checked luggage and open seat selection services. Instead, it aims to open up new auxiliary revenue sources through basic economy class fares, premium seat selection fees, and checked luggage fees. This means that Southwest Airlines is proactively transforming from an innovator of low-cost models to a follower of full-service models. The transition helped Southwest Airlines ride out a storm. It brought a great deal of revenue and profit, which hit a new high in Q2 2026. Consequently, more consumers were willing to upgrade which allowed the enterprise to strengthen its loyalty programs. However, such a turn has also brought about the problem of ambiguous identity recognition. How to balance the friendly brand image established over the years and the newly launched paid services will be a new challenge for the management [9]. A notable exception to the charging for checked bags trend was Southwest Airlines, which turned its resistance to this practice into a "Bags Fly Free" marketing campaign [10].

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Without these signature differentiators, the airline risks being perceived as just another carrier. Second, Stuck-in-the-Middle Positioning. The airline now occupies a middle ground: it offers neither the lowest prices nor the most premium experience. Without a clear strategic identity, it risks being squeezed from both directions.

Third, loss of customer trust. Ancillary revenues from unbundled flight products represent an increasing portion of airlines' total operating revenues, especially for ultra-low-cost carriers [10]. Meanwhile, understanding customer behaviour is critical to retaining loyal customers and attracting new ones when considering an airline brand [11, 12]. Loyal passengers have reacted negatively to the introduction of fees and fixed seating. Fourth, Operational Complexity. The assigned-seating model has introduced procedural complexity that extends boarding times and increases gate congestion [13].

5. Proposed strategic solutions

To address the consequences of the strategic transition, the following solutions can help Southwest Airlines in the future:Rebuilding the differentiation: The Southwest Airlines should focus on short-haul business travelers market. By increasing the frequency of core routes, it can protect brand features that competitors can imitate in terms of services and prices but not in terms of route density.

Clear strategic position: Southwest Airlines is neither the cheapest nor the best in terms of services. It needs to choose a new position such as the most reliable low-cost carrier. Reliability is the basis of differentiation. Southwest Airlines should present punctuality as its core value via its long-term experience and historic culture.

Optimizing the existing membership system: Since the membership system already exists, the solution to consumers' trust loss is not to establish a new membership system but to optimize the existing one. Currently, free luggage is available to A-list preferred members, and other passengers do not have a clear path to obtain the same services. It is suggested to introduce a consumption mechanism. For example, unlocking free luggage for those who have consumed over $1000 or more flights of 10 segments per year. This transforms the passive experience of required spending into a goal that can be achieved through effort.

Technology to solve efficiency problem: the assigned seat system has led to an increase in luggage rack disputes and boarding time. Southwest Airlines should use advanced technology, for instance, optimizing the allocation of boarding crews. Passengers seated at the rear of the plane could board first, followed by those in the middle, and finally those in aisle seats, to avoid congestion and reduce the time spent stowing luggage.

6. Conclusion

This study examined Southwest Airlines' strategic transition from a pure cost-leadership model toward a hybrid competitive strategy, using the VRIO framework as the primary analytical lens. Three main findings emerge from the analysis. First, prior to the 2025 policy changes, Southwest's free baggage policy satisfied all four VRIO criteria and constituted a sustained competitive advantage. Its elimination for regular passengers effectively reduced this resource. Second, the shift to assigned seating has generated operational friction that decreases the rapid-turnaround efficiency to Southwest's cost advantage. Third, Southwest now faces a positioning risk, occupying an ambiguous space between ultra-low-cost carriers and full-service airlines. While the transition has delivered short-term financial gains, these have come at the cost of strategic clarity and brand

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distinctiveness, as reflected in declining customer satisfaction. The study has limitations: it relies on publicly available data and focuses on a single case, which limits generalizability.

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