

Based on COVID-19, the Strategy Research of Airlines Companies – Case Study of Southwest Airlines & United Airlines

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Abstract: This paper uses PESTLE analysis to study the impact of six external factors on the aviation industry after the outbreak of the coronavirus disease (COVID-19) pandemic. United Airlines and Southwest Airlines are selected as industry representatives. United Airlines and Southwest Airlines are chosen because of their response to the pandemic and their different financial position during the period. Especially in the post-pandemic era, the government tends to support and regulate these airlines by enacting Acts to provide funding and subsidies. Airlines' responses to the impact of COVID-19 are analyzed by observing changes in compensation settings for companies' nominated executives during this period and compensation trends over the past three years. The analysis shows that airlines are doing their best to respond to the government and organizations to revitalize the industry and secure their interests. Facing increased costs, reduced passenger flow, and the risk of not being able to service their debt, compensation adjustments and incentives have become a relatively common way to cope with the financial crisis even though differences between airlines persist. With financial difficulties, airline companies have had to cut back on some of their technology spending, especially in relation to carbon emissions, but core programs have been retained to comply with the carbon policy. The financial support provided by the Acts greatly alleviates the pressure on companies to survive.

1. Introduction

The global pandemic COVID-19 has brought a huge strike to the aviation industry. To prevent further infections, many countries have closed their borders and only allowed very limited numbers of international flights. The high capital costs of airlines and airports make the survival of some participants questioned in the short term. The medium-term outlook for the aviation industry is also bleak, as air travel may be affected by the decline in tourism and business travel demand at least by the end of 2021. In order to improve these negative effects, some countries are providing financial support to their airlines and other participants in the aviation value chain [1]. The U.S. government intervened. The Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law on March 27, 2020, and provided \$50 billion in financial assistance to passenger airlines and \$8 billion in financial assistance to cargo airlines through a combination of loans, loan guarantees and wage support [4].

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The main objective of the paper is to discuss the impact of COVID-19 on the aviation industry, especially airlines. As an important part of the economy as well as a vital mode of transportation that keeps the economy running, the aviation industry has been greatly affected by the pandemic. Post-pandemic support and regulation for the industry and companies has become significant, which can influence the recovery and development of the industry and the focus on priorities. To build an understanding of the topic, we conducted an extensive search and read the relevant report about the government's support for airlines after the pandemic and the impact of COVID-19 on domestic airline operations and commercial airport services in the United States. The willingness of the government to support airlines and the type of support it may provide are influenced by many factors and circumstances; meanwhile, government support has also brought changes to the aviation industry. The reorientation of policies is likely to limit and change the pre-pandemic priorities of the airlines, especially with respect to climate change and the environment. Besides, in the presence of policy support (such as the CARES Act), the continuation of COVID-19 still has an impact on airline operations and commercial airport services. In order to be more specific to the airlines, two representative companies are selected for comparison in terms of named executives' (especially CEOs') compensation trends over the last three years: United Airlines, with a downward salary trend, and Southwest Airlines, with an upward salary trend. Proxy statements reported by the two companies in 2021 are considered. They detailed the matters that will be voted on at the shareholders' meeting of each company. The compensation components of the named executives of both companies are analyzed and compared to observe how their compensation settings are influenced by and respond to the pandemic and subsequent financial support. The impact of the pandemic on the aviation industry and companies is discussed, taking into account the adjustments made by both companies in light of the COVID-19.

To sum up, this article focuses on the discussion of how the global pandemic of COVID-19 impacts the two airline companies called Southwest Airlines and United Airlines.

2. Data and methodology

2.1 Data

All the data and information in this article come from two companies' 2021 Proxy Statement & Notice of Annual Meeting.

Southwest Airlines is one of the largest budget airlines in the world, having its headquarters in Texas [7]. While United Airlines is a famous airline company in the United States, having its headquarters in Illinois [9]. In order to have a full understanding of how the two airline companies react to accommodate this change, several business tools and economic tools will be applied for this evaluation. The data part includes the detailed introduction of two companies and the specific content that is being discussed in this article.

2.2 Methodology

In order to analyze the impact of COVID-19 pandemic on the two companies from as many aspects as possible, we use the PESTLE model. We chose it because it allows a strategic and systematic assessment of a company's prospects, risks and opportunities in a new environment. It is also a tool for obtaining a macro view of an industry environment. Each letter stands for political, economic, social, technological, legal, and environmental [8]. In this article, we analyze and explain the effects of the pandemic on the two companies from all of the six perspectives. Politically, we illustrate how the two companies react to government intervention and how they find the balance between shareholders' interests and government regulations. Economically, we show the difficulties the entire airline industry is facing and explain the adjustments the two companies made to their financial plans to survive this huge strike. While socially, we point out the administrative accommodations they make subject to the changing social environment, such as the three pillars identified by the United Airlines' management as the basis of their response measures. Technologically, we explain the shift of

companies' focus on their technology projects due to the reduced availability of capital and cash inflows caused by the pandemic. Legally, we analyze the effects of new clauses and acts enacted in response to the outbreak and how they support the companies. Department of the Treasury, how these acts affect the companies is the key point of our analysis. Lastly, we explain how companies operate in conjunction with authorities and regulatory agencies spontaneously to reduce their carbon emission to become environmentally friendly, like the new airplanes and new equipment launched by United Airlines.

3. Results and discussion

3.1 PESTLE Analysis - Political Factor

In the political part, we can compare how each company reacts to government intervention. Analyzing the responses to government intervention allows us to see companies' prospects. United Airlines deeply realizes that the aviation industry is widely regulated. They believe that the company must actively engage with government agencies to ensure that they take into account the interests and needs of United Airlines' customers, employees, enterprises, and communities when making legislative and regulatory decisions. United Airlines advocates policies such as rationalizing the tax burden, reducing unnecessary regulation, reducing fuel costs, modernizing infrastructure, and improving the global competitiveness of the aviation industry. They belong to several industry associations and they believe that these associations provide them with a platform to share and accept business expertise and technical knowledge to improve their industry. This participation also enables them to advocate policies that encourage prosperous and competitive industries and business environments. Although they recognize that some of these associations represent the different company and industry bases, and their interests and policies may sometimes be inconsistent with United Airlines' interests and policies, they believe that participating in these associations is conducive to promoting their policies and the interests of shareholders. However Southwest Airlines does not mention their intention to promote their shareholders' interests directly, they only express their compliance in safe operations. Their Safety and Compliance Oversight Committee is responsible for supervising the company's activities in the field of safety and operational compliance, taking into account applicable government and industry standards, materiality, legal and business trends, and public policy issues, and regularly evaluating the company's safety and operational compliance obligations and the risks and performance related to these standards. In order to fulfill this responsibility, the Safety and Compliance Oversight Committee regularly reviews and specifies the areas to be discussed at its meetings according to the opinions of the management and the information obtained from the reports related to the company's safety and operational compliance activities received from the regulatory government agencies and other parties, and requires individuals from different operational areas and levels to discuss their terms of reference and answer questions.

3.2 PESTLE Analysis - Economics Factor

During the COVID-19 pandemic, almost all industries were hit hard, with unemployment rates rising sharply worldwide and economic conditions depressed. The aviation industry is a relatively small but still important part of the economy, and it was also affected by the general economic environment. It is one of the industries severely affected by the pandemic. While past shocks may also have led to a reduction in passenger traffic, the almost complete shutdown of air traffic over an extended period of time is arguably unprecedented [2]. Most airlines believe their air traffic will not return to pre-pandemic levels until at least 2023, and even then the industry will still be experiencing a period of decline. This prolonged recovery process will have an impact on all aspects of the airline industry, and passengers will bear the burden, further increasing the difficulty of attracting passengers.

At the same time, many companies with additional debt face the risk of not being able to service their debt while deducting interest, taxes, depreciation, and amortization on up to four to five times their previous debt and the cost of increased health-related measures. The outlook for the aviation industry is fraught with uncertainty and remains at risk of a possible return of the pandemic.

Differences between airlines, such as profitability and capacity (productivity differences), have existed since before the COVID-19 pandemic began. Airlines entered the crisis with very different capacities to deal with this shock and the heterogeneous outlook for the future. Within the airlines, salary adjustments and incentives were one way to deal with the fiscal crisis - the named executives of United Airlines and Southwest Airlines chose to give up their incentives or even part of their salaries to tide over the difficulties with the company; meanwhile, relevant employee concessions were also introduced within the companies.

3.3 PESTLE Analysis - Sociological Factor

COVID-19 is a crucial factor to discuss when it comes to the social part. How companies react to and accommodate the changing social environment, such as the COVID-19 pandemic, allows us to assess companies' adaptability and prospects. According to United Airlines' report, in March 2020, their management team led the industry to realize the significance of the coronavirus pandemic and its serious negative impact on tourism demand. They quickly shifted its focus from the initial 2020 strategic plan to responding to the crisis. The three pillars identified by the management as the basis of their response measures are to improve liquidity, reduce cash consumption and change their cost structure. United Airlines aggressively attacked its cost structure, including reducing capital and operating expenses, suspending and eventually terminating the stock repurchase plan, and quickly began to provide employees with a voluntary resignation plan to reduce the number of employees under such low travel demand. Southwest Airlines also took action quickly. According to their incentive plan since 2013, their Committee has set performance indicators and targets for 80% of the incentive plan opportunities of designated executives according to the company's management incentive scorecard. The Committee approved the scorecard indicators and targets at the end of March 2020. So far, the Committee has focused its attention on the biggest challenge facing the company, COVID-19, which has been declared a global pandemic by WHO and has led to a sharp decline in consumer demand for air travel. Therefore, the Committee has made a 60% weighting on the company's (i) hitherto unknown challenges associated with the COVID-19 pandemic and (ii) the most efficient fuel-saving aircraft's continued suspension, Boeing 737 MAX. Due to the uncertainties associated with these challenges, the Committee believes that it is necessary and prudent to establish subjectivity in assessing management performance.

3.4 PESTLE Analysis – Technological Factor

For the technology factor of the PESTLE analysis for two airlines companies—United Airlines and Southwest Airlines, both companies showed the impact of COVID-19 on their technological part. As the COVID-19 reduced availability of capital and cash inflows, Southwest Airlines reduced the costs of operating expenditures by narrowing down its near-term technology focus and made a great number of technology projects to be deferred. Nevertheless, they still focused on some major technology projects such as aircraft maintenance, planning and record keeping. While for United Airlines, they mentioned lost for them when the COVID-19 comes. This included a huge loss of 56 million dollars for the various cancelled facility, aircraft induction, and information technology capital projects partially from the reduced cash inflows brought by the pandemic. As for the technology of Southwest Airlines, they also invested in Direct Air Capture technology through 1PointFive, which is a joint venture between Oxy Low Carbon Ventures and Rusheen Capital. This will help them to cut emissions, mitigate climate risks and develop a low-carbon economy.

3.5 PESTLE Analysis – Legal Factor

All industries are affected by laws, and the airline industry is no exception. During the pandemic, many new clauses and acts were enacted in response to the outbreak, many of which were directed at the airline industry and the companies themselves, which had an impact on business operations and compensation and incentives within the companies. In March 2020, the World Health Organization (WHO) and International Civil Aviation Organization (ICAO) issued a joint statement in response to the COVID-19. This document states that States must comply with ICAO and WHO standards and

International Health Regulations to prevent the spread of infectious diseases. During the pandemic, the spread of COVID-19 led to reduced demand for tickets and a downturn in tourism, and airlines were among the most affected players in the global market. Many airlines faced significant losses and financial difficulties, a situation that was unprecedented for civil aviation.

As the pandemic continues, governments and organizations are inclined to help airline companies by injecting funds [6]. In a letter to member countries, ICAO explicitly called on governments to implement the relevant provisions of Appendix 9 of the Convention on International Civil Aviation (Chicago Convention), to apply for CAPSCA membership, to increase funding for the response to the outbreak, and to establish a national air traffic facilitation transport committee. The U.S. government and the Treasury Department had also issued a number of grant policies, such as the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”), Consolidated Appropriations Act, 2021 (the “Payroll Support Program Extension”), and the American Rescue Plan Act of 2021. For United Airlines and Southwest Airlines, which we are discussing here, they have both signed final documents with the U.S. Department of the Treasury for further wage support under the Act (United Airlines applied for wage support under all three Acts, and Southwest Airlines applied for support under the “CARES Act” and the “Payroll Support Program Extension”) [10]. These agreements impose restrictions on setting executive compensation (for any 2-year period from March 1, 2020 to March 1, 2022, but there also exist slight differences among companies) [3]. For United Airlines, the 2020 Executive Compensation Plan does not result in any named executive’s compensation exceeding the applicable limits, but these limits create a significant reduction in the overall target direct compensation of the named executives in 2021, and this will continue for the remainder of the period that the provisions are in effect. Compared with the data in the past three years, the total compensation of United Airlines' nominated executives showed a downward trend. Southwest Airlines is in a very similar situation, but the total compensation of its named executives increased over the last three years. To support the company’s financial situation during the pandemic, named executives volunteered to cut down their salaries, but things were getting better with the wage support payments from the U.S. Department of Treasury. Besides, the company withdrew employee concessions which were previously announced. The subsidy provisions enacted during the pandemic were significant in easing the crisis faced by the airline companies.

3.6 PESTLE Analysis – Environmental Factor

The environmental factor in PESTLE analysis definitely includes the emission of carbon. Both United Airlines and Southwest Airlines had to meet the standard emission of CO₂ and “carbon offsetting” requirements. While as the International Civil Aviation Organization (ICAO) may change their plans and regulations for those airlines companies in the future, both companies have to align with the new policies for carbon emission. After comparing, both companies mentioned that modification of supply chain practices, secure of carbon offset credits or payment for emissions are required, which would cost high fees of protection of the environment and bring an adverse material effect on both companies because they had to toe the mark of the ICAO. Nevertheless, the two companies showed different approaches towards reducing their carbon emission. For United Airlines, they launched new airplanes and new equipment. Some examples are fuel-efficient MAX aircraft, upgraded split scimitar winglets, selected electric equipment at locations for eligible internal combustion ground support, and adjusted timing of auxiliary power units. While for Southeast Airlines, it had pledged on its annual report in 2020 that it would become 100% green by reducing its GHG emissions by 100% when 2050 comes. Also, they invested in a joint venture between Oxy Low Carbon Ventures and Rusheen Capital, helping the company to earn more ability when developing the low-carbon economy. Overall, both the companies are operating in conjunction with authorities and regulatory agencies spontaneously to reduce their carbon emission.

4. Conclusion

With the shock of the pandemic, the aviation industry has to adapt and adjust to fit the new environment. Government support and regulation of the industry and companies after COVID-19 can influence the recovery and development priorities of industries. Southwest Airlines and United Airlines were selected as representatives of low-cost and traditional airlines, with different financial positions, incentive plans, and compensation trends of named executives in the last three years during the pandemic. The companies' financial position and compensation structure are specified in proxy statements, which are the main source of data and information.

Based on those data and information, PESTLE analysis was used to analyze the impact of the pandemic on the airlines in terms of six external factors. Politically, the company's response to government intervention reflects the company's outlook. Airline companies believe in maintaining active cooperation with government, industry, and associations to ensure that the interests and needs of the company's customers, employees, businesses, and communities are taken into account. The high level of engagement advocates policies that create a more positive and competitive industry and business environment. Economically speaking, there are differences and adjustments within and outside the airline in facing shocks. The recovery of the airline industry, especially civil aviation, will continue for some time, but the cost of this will be borne by the passengers, which further increases the difficulty of attracting them. Meanwhile, some companies face the risk of not being able to pay their debts and the various costs that continue increasing, which further adds to the disparity and growth crisis among companies. From societal and technological perspectives, the way the companies respond and adapt to the changing COVID-19 allows us to assess the company's resilience and outlook, and the COVID-19 has reduced both companies' capital investment in technology. From the legal side, the enactment of pandemic-related policies has had an impact on business operations and compensation as well as incentive policies within the companies. Governments and organizations have tended to support airline companies through capital injections. The subsidy provisions enacted during the pandemic were important in easing the crisis facing the airline. In environmental terms, aligning with the new carbon policy would impose high costs on Southwest Airlines and United Airlines, further burdening them. The two companies have shown different approaches to reducing carbon emissions, but overall both companies are working voluntarily with authorities and regulators to reduce carbon emissions.

By comparing Southwest Airlines and United Airlines' incentive plans, it is clear that both companies consider it very important to match their stockholders' interests with their owner's. All of United Airlines 2020 long-term incentive awards are linked to their stock price performance through potential share price appreciation. The company's long-term incentives for 2020 include performance-based RSU awards and restricted stock units granted at the same time. These awards also have a three-year time-based vesting schedule, and are settled in stock. United Airlines' long-term compensation incentives are an important part of the compensation plan and align the financial interests of their executives with their stockholders. The same for Southwest Airlines, as a long-term performance reward, the equity should be an important part of total compensation. It can provide incentives and rewards and further align the interests of everyone in the company. In 2020, the commission awarded long-term incentive compensation opportunities to retain managers and attract people to compete for management positions.

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