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THE CASE OF MORRIS AIR: A SUCCESSFUL STARTUP

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ABSTRACT

Morris Air, which began scheduled operations in 1992, provides an example of a start-up airline that succeeded during the dark days of U.S. commercial aviation in the early 1990s. Morris Air benefited from a favorable regulatory climate for start-ups but owed most of its success to innovations in cutting costs and to its discipline in filling a well-defined market niche. When Morris Air began to hurt the operations of the major airlines, particularly Delta's hub at Salt Lake City, it began to suffer from aggressive responses that could be considered predatory. Morris Air was sold to Southwest Airlines at the end of 1993, resulting in substantial capital gains for its shareholders. There is evidence that Morris Air's founder anticipated a sale to Southwest from the time she incorporated the airline.

INTRODUCTION

This paper examines an unusual case, that of a start-up airline that achieved competitive and financial success in the early 1990s, a particularly difficult time for commercial aviation in the United States. The aim of the paper is to identify factors that contributed to the firm's success. Understanding the conditions under which the airline operated and the way it responded may be useful to future start-ups, particularly if they begin operations during a period of industry downturn. No broad policy recommendations are made in this paper; although the reader may come to his or her own conclusions regarding how regulatory agencies can assist start-ups based on the case.

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In early summer 1992, regulators at the U.S. Department of Transportation (DOT) received a complaint from an unnamed competitor about a small charter operator and bulk fare contractor based in Salt Lake City.[1] The regulators did not remember having heard of the operator before.[2] They checked their records and found that it began operations in 1984 flying one charter flight a week, was a division of a travel agency, was duly registered as a separate charter operator in 1987[3], and had accumulated only seven customer complaints over the previous five years.[4] In 1991 the company offered about 300 flights (about 40,000 seats) per week throughout the western United States and took in about $80 million in revenues. Its charters were flown by Ryan International Airlines and Sierra Pacific, to which the company subleased 11 Boeing 737s that it itself had leased from International Lease Financing Corporation, Polaris, and other aircraft leasing companies.[5]

The competitor accused the company of deceptively holding itself out as a scheduled carrier. The competitor claimed that the charter staffed its own ticket counters and curbside baggage service at several airports; painted its livery on some of Ryan's aircraft; developed its own computer reservations system; and allowed passengers to pay for tickets by credit card, cash, or money orders made out to its name. Under DOT regulations, payments to a charter company must be by check or money order made payable to an escrow account.[6]

Subsequent investigation by the DOT found that the company's radio, television, and newspaper advertisements gave the impression that it was a regularly scheduled airline offering service between many city-pairs with connecting flights and a business class program. There was no indication that the flights were charters, and the direct air carrier was either not identified or its identity was printed in small inconspicuous type.[7] Among the evidence pointing to violation of the rules was a proposal to the Postal Service for mail carriage as a certificated air carrier.[8] The company had also published a flight schedule.[9]

The DOT assessed a $200,000 fine against the company at the beginning of November 1992. One half of the fine was to be paid immediately, and the other would be waived if the company changed its practices. The company agreed to the terms, "…to forestall costly legal fees…" and without admitting guilt.[10]

The company also agreed quickly because of a decision it had made when it learned of the competitor's complaint: it had decided to seek a DOT certificate for scheduled service.[11] Resolving the complaint allowed the certificate petition to go ahead.[12]

The company's decision to seek a scheduled service certificate also derived from its observation that the DOT and the Federal Aviation

Administration (FAA) were uncomfortable with a non-airline company which had obtained operational control of a large number of aircraft, as it had with its leases. In addition, the company had experienced some difficulty arranging for aircraft leases because it lacked an airline certificate. In one case involving a 737-300, a lender indicated that it would not close the loan until the company obtained a certificate.[13]

DOT issued the company a 401 certificate at the beginning of December 1992.[14] The company was Morris Air.

WHO WAS MORRIS AIR?

In 1970 Lorna June Mayer Morris, then 40 years old, founded the travel agency that would later begin the charter flights that would later become Morris Air. Although the formal connection between the agency and the charter service would be severed when June Morris sold the agency to employees in 1987, Morris' experience as an agent and her established client base would serve her well as the head of an airline. When the now-scheduled Morris Air incorporated in December 1992 as a Delaware S Corporation, June Morris and her relatives retained control of the closely held, family-owned company. June served as CEO and her son Richard Frendt as Chairman of the Board. Other Directors were David G. Neeleman (also appointed as President), Mitch Morris (June's husband), Michael Lazarus (her banker), and Martin Hart. Usto Shulz served as Vice President and General Manager and Kent H. Collins as General Counsel.[15]

The mix of executives turned out to be a good one. Neeleman, a 23-year-old college dropout and failed travel business proprietor when he joined Morris, was the rambunctious ideas man. Frendt, an MBA, was the numbers man and incessant cost cutter. Shulz was brought on board for his operational experience and knowledge of the Federal regulatory bureaucracy. Collins and Frendt shared the role of corporate spokesman. Behind all was the presence of June Morris, who gave the company its direction and reined in the others when their ideas went beyond common sense.[16]

The firm was capitalized at $14,750,000 issued in convertible preferred stock.[17] Morris Air relied on this money, reinvested profits, and long-term debt financing throughout its existence, although continued expansion later made it difficult to not consider going public or using the services of a venture capitalist.[18]

THE BATTLEFIELD

Morris Air entered the industry at a distinctly inauspicious time. The preceding years had been the worst in the history of the American civil aviation business. The airlines' problems could not fail to be noted even by those who paid little attention to the industry. In 1991, Pan Am, Eastern, and Midway folded. America West filed Chapter 11. The following year, TWA went into Chapter 11.[19] Between 1990 and 1993, return on investment (ROI), net profit, and net profit margins were all negative across the industry. Airlines were suffering the effects of a recession, higher oil prices, and fear of terrorism because of the Persian Gulf War.[20] Demand was softening, particularly among high yield business travelers. Corporations were laying off managers and cutting travel budgets.[21] In addition, there was a surge of cost consciousness among all consumers, business and leisure.[22] The decision to enter the business at that time, said June Morris, "…took a little corporate courage, or being a little nuts."[23]

COBELLIGERANTS

There were apparently a lot of nuts in the airline business. According to then-Transportation Secretary Federico Pea, more than 100 start up airlines sought approval to fly in the year before May 1993.[24] Some of those that were approved, apart from Morris, were Carnival, Casino Express, Kiwi, LeisureAir, MarkAir, Reno, Spirit, Sun Country, Tower, and UltrAir.[25]

The new entrants faced several economic advantages over the first wave of new airlines that formed shortly after deregulation in 1978. First, many markets were uncontested.[26] Second, public sources of capital abounded.[27] Third, there was a glut of commercial jets available for sale or lease. About 650 jets were on the market at the end of 1992, about three times as many as in the late 1980's.[28] Lastly, cutbacks at the majors left a huge number of experienced personnel unemployed and desperate for work. Between 1990 and 1992, more than 50,000 industry employees lost their jobs.[29] According to Wall Street airline analyst Candace Browning, the "new entrant carriers [could] hire 20-year experienced pilots for $50 an hour, which means that they would earn less than $50,000 per year."[30] Upstarts were thus able to avoid unionization and exact significant concessions from their employees.[31]

The new airlines also shared a strategy. At least initially, they tried to stay in a niche to avoid the wrath of the majors and to avoid growing too fast.[32] According to the then General Accounting Office (GAO) Director of Transportation and Telecommunications Issues, the startups tended to offer high frequency, low frills, point-to-point service, and focus on low costs. This allowed them to charge much less than established airlines.[33] The new companies also tended to forego yield management: they sold only unrestricted fares and sometimes only coach class tickets.[34]

HELP FROM THE FEDERAL GOVERNMENT

The upstarts also benefited from a policy of active support on the part of Clinton Administration transportation officials. After the Reagan and Bush Administrations paid little attention to new airlines, the new Administration tried to guide them through regulatory hurdles and protect them from predation. Referring to one case in which the Transportation Department successfully intervened when Northwest began flying to Reno in retaliation for Reno Air's opening of a new route to Northwest's Minneapolis hub, then-Secretary Federico F. Pea said that "we will do whatever we can to make sure fledgling carriers have a fair shot."[35] And again, "DOT's staff assists new entrepreneurs in forming new airlines. And we have sent a clear signal to the industry that this Administration will not allow large carriers to compete unfairly against the new entrants."[36] Indeed, there is evidence that the relatively small fine imposed on Morris Air for its charter violations was a direct result of the Administration's policy of encouraging new entrants.[37]

THE STRATEGIC IDEA

June Morris and her key executives defined the characteristics for their new company. It would be a low cost, low frills, low price, short haul (average stage length 483 miles[38]), point-to-point jet carrier. In contrast to the majority of the new startups, it would offer low frequency service (an average of only two departures daily).[39] Those characteristics, particularly the last, defined a niche, a market, and a strategy for the company: Morris Air would create new business by getting leisure travelers who otherwise could not afford it to fly. As June Morris put it, "…we're taking people off the road and getting people who otherwise might not go anywhere at all."[40] "Our competition is really the automobile."[41]

In formal economic terms, Morris Air would exploit the income effect of lower prices. When a company establishes prices, which are lower than those of its competitors, it benefits from two effects on the behavior of customers. First, customers will be drawn from the competitors because the relative price is lower than theirs is. Second, customers will be able to save money, afford more of the good in question, and buy more of it. This is called the income effect.[42]

Since businessmen's travel is generally little affected by the income effect,[43] Morris was giving up one of the most lucrative segments of the market. It instead would concentrate on leisure and visiting friends and relatives (VFR) clients. According to Frendt, We specialize in getting grandkids and grandparents together. We're not trying to get the business flyer; we handle mostly leisure travelers.[44]

Morris reckoned that appealing only to the low end of the market would allow the company several advantages. First, Morris Air could cut costs beyond other carriers without risking complaints about receiving unaccustomedly bare service. The airline would have to offer only a few departures a day because leisure travelers, as opposed to business travelers, plan on leaving on a particular day rather than at a particular hour.[45] Second, the strategy would keep Morris Air out of the sights of the bigger carriers. It was banking on the assumption that the big lines would rather lose a tiny bit of market share than absorb the high cost of driving the newcomer from the market.[46]

Throughout its existence, Morris Air would remain true to its vision. This discipline earned it praise from airline industry analysts like Dan Hersh: They know what they are and what they aren't. You won't see them flying to New York or Boston or pushing a frequent flyer program.[47] Even competitors like Delta spokesman Clay McConnell respected it: "[Morris] has been extremely successful because they [sic] have stayed in a niche. Some other low-cost carriers have not done that, and they've failed miserably."[48] Surveying a battlefield littered with dead and dying air carriers, June Morris herself was very conscious of treading carefully: "We want to do it in a very controlled way, and not get in a big uproar here."[49]

AXING COSTS

To keep prices down and appeal to bus travelers, Morris Air needed to make its costs the lowest in the business. Morris executives had lots of ideas to keep cost down so that the company could offer the lowest fares. The company decided early on that it would contract out most operational functions, lease aircraft and crews, not participate in computer reservation systems (CRS)[50] (saving $2.25 per flight segment[51]), fly only one type of aircraft (the Boeing 737-300) to simplify training and maintenance, fly no route longer than 2-1/2 hours (to avoid serving hot meals), and offer only one class of service.[52] To boost economies of scale on each flight, Morris decided to stuff 143 passengers into its 737-300s, 15 more than specified by Boeing in its promotional literature about the aircraft's capabilities.[53]

In addition, Morris employed the following tricks to pare costs:

- Use plastic boarding cards
- Use laser bar code readers on luggage
- Limit traveling executives to $25 for meals per day
- Offer premiums to employees who stayed with relatives or friends when traveling[54]

- Fly at off times to avoid congestion[55]
- Wrap in-flight magazines in plastic to extend their life and discourage pilferage.[56]

Morris also enjoyed the cost savings due to the airplane and labor glut that other startups experienced. Like Southwest Airlines, Morris benefited from less time on the ground and better aircraft utilization rates because of its choice to fly at less congested times and point-to-point instead of through hubs.[57]

These factors, along with others discussed below, gave Morris the lowest costs in the industry. In 1993 the U.S. airline industry's operating cost per available seat-mile (ASM) was 10.5 cents. Southwest pushed its ASM down to 7.03 cents. Morris' ASM was 6.0 cents.[58]

Lessened Startup Costs

Although a new carrier, Morris was able to escape many of the startup costs, which upstarts have to face. A new entrant generally must assemble financing; gather management and operational personnel; secure office space and equipment, aircraft, ground equipment and services, airport gates, and maintenance facilities.[59] Morris had already done these things when it was a charter. In the city-pairs it already served as a charter, it did not have to pay ramp up costs of marketing the service, generating consumer familiarity with the carrier, and establishing patronage.[60]

Fleet

Morris achieved additional cost savings by hewing to its decision to fly only one type of aircraft, the Boeing 737-300. This aircraft is relatively inexpensive (roughly $35 million new compared to $170 million for a 747), employs relatively new technology yet is well proven (over 1,000 ordered), and has performance characteristics appropriate for the short-hop service envisioned by Morris Air.[61]

More important than the choice of aircraft was the discipline to stick to one type. Southwest estimates that it saves up to 25 percent in maintenance, parts inventory, and training by using only one airframe—the same 737-300.[62] Morris accrued additional savings by leasing a majority of its aircraft, mostly from International Lease Finance Corporation.[63] Although Frendt said in 1992 that Morris' goal was to achieve a 50-50 mix of owned and leased aircraft,[64] that goal was never achieved. Morris only ever owned three aircraft, out of a fleet of 21.[65] Morris also contracted out for its maintenance. Pemco Aeroplex performed routine maintenance, modifications, and painting work.[66]

Morris Air's leasing policy allowed it to maintain one of the youngest fleets in the industry; the company's average aircraft was 6 years old.[67] Other upstarts of the period owned aircraft of vintages more suitable to wines than passenger-carrying jets. Laker's planes dated from 1968 and 1969, Key's from 1965 to 1972, and Kiwi's from circa 1974.[68] The fleet's youth had important, positive effects on Morris' safety record. The airline never suffered an accident.[69]

Labor

Morris took full advantage of the depressed air transport labor market discussed above to hire pilots, flight attendants, ticketing agents, and other personnel on the cheap. There was never a successful attempt to organize at the airline, so Morris was able to avoid the confrontations with unions, which paralyzed the rest of the industry in 1993 (the year of the four day walkout by American flight attendants broken only by the intervention of President Clinton).[70]

June Morris instituted an innovative program to reduce labor costs in areas, which required few skills or training: she hired students. College students primarily staffed the company's telephone reservation and ticket sales lines. For even less demanding jobs, such as tagging baggage, high school Go Getters were hired at $5 per hour.[71] The high school students took the jobs because they saw them as a way to get early experience in the business world.[72] Morris Air thus had access to additional cheap labor in the summer, when leisure travel is at its peak.

Ticketless Travel

The most interesting cost-cutting innovation, which Morris had, and the most important for the future of the industry was the invention of ticketless travel. David Evans, Vice President of Information Systems for the carrier, first came up with the idea.[73] Morris saved the cost of paper, printing, postage, and labor amounting to about $2 for each of the 12,000 tickets it issued a day and spared passengers the frustration of long lines at ticket counters and the possibility of losing a ticket.[74]

The innovation was initially fiercely resisted by travel agents who saw it as yet another sign that Morris was trying to cut them out as middlemen between the airline and its customers and because the new system would disrupt their accounting and reporting practices.[75] While Morris officials touted the new system as the wave of the future, others in the industry either did not understand it or ridiculed it. Chris Chiames, a spokesman for the Air Transport Association, asked, "Will you be tattooed instead?" A Delta spokesman said that ticketless travel "may have a place in the future, but it's not the future yet."[76]

MARKETING

Routes

Domestically, Morris operated exclusively in the western United States. It limited itself to this area because its experience in the West as a charter and because the West was less congested so that it could serve secondary markets without bumping up against the majors. Salt Lake City served the carrier as a de facto hub despite Morris' declared point-to point strategy. About half of Morris' flights involved Salt Lake.[77] Morris likely could not resist taking advantage of its monopsony power at the airport to negotiate favorable gate, landing, scheduling, financial, and other terms. In March 1993, Morris share of origin and destination traffic at the airport was 24 percent.[78] Its portion of total enplanements was even higher. Tucson, which was the city with the most flights after Salt Lake, formed a mini hub.[79] The rest of Morris' 22 city net was point to point.

Morris also offered summer seasonal service to popular vacation spots in and out of the U.S. Domestically, it serviced Orlando from Salt Lake and Fairbanks from Seattle. It occasionally flew to Hawaii as well. Internationally, it flew to Ontario and to the Mexican resort communities of Puerto Vallarta, Cancun, Mazatlan, and Cabo San Lucas. The flights to Mexico began in December and ended around Easter.[80]

Pricing

With its costs well below the rest of the industry, Morris was ready to offer its services at low prices to the low budget market. The best way to show Morris' impact is to compare the unrestricted round trip fares that it offered in various city pairs to the next cheapest airline. This is shown in Table 1.

Table 1. Cost of Unrestricted Round Trip Fares of Morris Air and Competitors, 1992

Route	*Morris Air*	*Competitor*
Los Angeles-Salt Lake City	$178	$258 (Delta)
Oakland-Seattle	$178	$820 (Alaska)
Oakland-Portland	$178	$760 (Alaska)
Phoenix-Salt Lake City	$178	$720 (Delta)
Seattle-Salt Lake City	$178	$258 (Delta)

Note: All fares from early May 1993.[81]

True to income effect theory, passenger traffic exploded in response to Morris' prices in the markets it served.[82] For example, when Morris began flights between Seattle and Spokane, competing with Alaska, which flew 43,000 passengers per quarter, the market more than doubled to over

90,000.[83] Not all this increase went to Morris. To combat the new company, majors serving the same markets dropped their fares by 50 percent and in some cities (such as Denver) offered double frequent flier miles.[84]

Still, many budget-minded passengers continued to favor Morris because of its lack of restrictions. A single day round trip flight from Denver to Salt Lake in May 1993 cost $141 on Morris Air; United wanted $525 because there would be no Saturday stay-over.[85] Indeed, Morris' only restrictions had to do with penalties for cancellations and premiums for 14-day advance booking. Although the airline primarily offered one class of coach service, in some markets it offered a business class as well, which allowed cancellations without penalties and offered pre-assigned seating.[86] Morris also experimented with companion fares where one person flew at full price and a companion at a reduced fare.[87]

Morris' low prices and lack of restrictions had their intended income effect. Frendt said, "People love to fly. If the fare's right, the market is incredibly elastic."[88] The airline's planes, painted white with a blue tail, soon filled up with new air travelers: "Morris Air carries a mix of passengers that looks familiar to anyone who has traveled on either Greyhound or Amtrak… Lots of denim and polyester; not a briefcase or a power suit in sight."[89]

One unanticipated, positive result of going after the low end market was a large number of advanced bookings allowing more certainty about maximizing the output of each flight without using complicated and confusing yield management techniques. Frendt reported, "The people who book in advance really are the price-conscious ones. I would guess our advance bookings are stronger [than the competition] because the reason you book in advance is because you really care about every dollar."[90]

Morris' low cost, low frequency strategy guaranteed high load factors, 85-95 percent, at a time when the industry average was 62 percent.[91] Morris was not afraid to tell customers that it had sold out a flight-which would only confirm customer perceptions that the airline's fares were a good deal. Load factors determined how Morris increased its frequencies in given markets. "Load factors will build up to 90 percent, and then they'll add a second flight, let that build to 90 percent and then add a third," according to one Morris observer.[92]

Stuart Thatcher, Morris Director of Marketing, supplemented the airline's low cost, few restrictions strategy with two additional innovations. First, building on the charter company's experience, he introduced ski packages with interchangeable ski lift tickets included in the fares. The packages were so successful that Morris thrived after big snowfalls in the Rockies: skiers flew into the Rockies and snow-weary Utahns flew out.[93] Second, Thatcher experimented with selling tickets via the Home Shopping

Network in certain markets. The initiative was aimed at impulse buyers, "people who will spontaneously decide to go visit Aunt Mabel in Oakland."[94]

Apart from gimmicks like these, Morris did not strive to build brand loyalty on the basis of amenities. Besides its low prices, Morris offered only one feature, which set it apart from other budget carriers. It served big, fluffy Costco muffins. They gave Morris a cult following of sorts.[95]

Reservation System

Morris decided to eschew participation in Computer Reservation Systems (CRSs) to save money. Explaining the decision, Frendt said that the airline saved $2.50 per segment by not participating "It's kind of a Catch 22 situation, because we need travel agents so bad, but it's so darn expensive. Every decision we make is based on keeping our cost low. Our long-term survival depends on it."[96]

Morris' non-participation meant that its flights, but not its fares, were listed in the CRSs. More importantly, agents could not book passengers automatically (they could however validate bookings and drive a ticket). The agents had to call the airline, which then manually input ticket information into a computer.[97] Fortunately for Morris, passengers could book their own tickets directly by using the same method. Throughout Morris' existence, about 60 percent of its tickets were sold directly to customers. The rest were sold to agents who called the airline or to a few, high-volume agents with a special system. For the latter, Morris installed a direct data link, via inexpensive PCs and printers, for free.[98]

Morris Air's decision not to participate in a CRS brought it into a controversy with System One Corporation, the fourth largest U.S.-based CRS. Since System One displayed partial data on Morris, it requested a payment of $0.50 per segment every time a ticket was printed. Other partially displayed carriers, Aeroflot, Air Quebec, American Trans Air, Arizona Airways, and Chicago Express, all agreed to pay the fee. Morris, along with Southwest, refused.[99] System One decided to cancel the $0.50 fee.[100]

Failure to participate in a CRS got Morris into bigger trouble with some travel agents. Agents who booked a substantial amount of Morris fares lost money because the transactions were not recorded in their productivity contracts, which formed the basis of their automation pricing. Such firms had to make complicated arrangements with both Morris Air, to receive faxes summarizing daily sales, and a CRS, to apply Morris bookings toward their monthly productivity thresholds.[101]

These problems led two travel agents, both Association of Retail Travel Agents (ARTA) board members, to call for a boycott of Morris Air. Jack

Stults of Joplin, Missouri and Susan Bruno of Los Altos, California, said that they would discontinue selling fares for the airline until it fully participated in System One and discontinued marketing programs, which were intended to bypass travel agencies. They accused Morris of trying to get direct bookings.

The two based their actions on ARTA objectives 9 and 4. Objective 9 stated, “Agency bypass is a major problem in our industry. Agents and suppliers must work together to structure marketing and advertising programs to support rather than avoid the travel agent distributions system.” Objective 4 stated, “ARTA urges all airlines that wish to receive full benefits of the agency distribution system to fully participate in all CRS systems.” The boycott came to naught because of antitrust concerns. Neither Stults nor Bruno had consulted their lawyers who would have told them that their status as ARTA board members made their actions legally problematic.[102]

COMPETITION

This section cannot be called *Competition and Cooperation* because Morris went it alone. It did not participate in any alliances, interline or code sharing agreements. Passengers with connections to other airlines had to fend for themselves and their luggage.[103]

As the price leader, Morris initially suffered little from price competition. On the other hand, Morris did hurt the code-sharing partners of the majors at their vulnerable hubs.[104] In addition, Morris also adversely affected the plans and profits of two majors, Alaska Air Group and Delta.

Alaska

Put simply, Morris devastated Alaska Airlines and Horizon, both subsidiaries of the Alaska Air Group, in the routes served by Morris. Horizon was overpriced and Alaska was excessively overpriced. Alaska took pride in having won the first J. D. Power award for regional airline excellence in 1992.[105] The readers of Conde Nast Traveler Magazine had also elected it the best U.S. carrier for the fifth consecutive year.[106] It had obtained these distinctions by offering the some of the best amenities and service in the industry. The amenities sometimes went to excess: two linen tablecloths per service tray, three pieces of French toast per breakfast, etc. These extravagances combined with the high costs of doing business in the state of Alaska made the airline’s operating cost per seat mile 11.5 cents.[107]

The recession of the early 1990s and consequent cost consciousness of air travelers hurt Alaska: its flights averaged load factors of just above 50 percent in 1992–1993.[108] The company lost a staggering $85 million in

1992[109] and $30 million in 1993.[110]

Alaska recognized that about half of its losses were due to competition from small start ups, and it singled out Morris as the most threatening. Harry Lehr, Alaska's Vice President of Planning, said that pressure from low cost upstarts, bottom feeders in his words, was building and that Morris was a trying opponent: "[June Morris] is a very sharp lady. She knows what she's doing. They're picking a niche, they're strong in it, and they're doing very well."[111] Alaska finally matched Morris' fares in an effort to stop diversion of passengers to the smaller airline.[112] It was clear, however, that Morris' cost structure would allow it to sustain a fare war for much longer than Alaska, which was not willing to sacrifice the reputation for superior service, which had become so important to it.

Delta

Morris faced much stiffer competition from Delta. Initially, the big airline ignored Morris Air. Overlooking the upstart was a mistake the major would one day publicly regret. Delta's Vice President of Marketing, Robert W. Coggin, said, "We were so chagrined about not being more aggressive with Morris Air in Salt Lake, we were going to be very aggressive [with other low cost carriers]."[113]

Delta's indifference changed when the upstart threatened its dominance at its Salt Lake City hub, used primarily for connecting flights. Delta had already invested almost $2 billion at Salt Lake and had 4,300 employees working there.[114] The major also planned to establish its second largest reservations center at the city and begin long-haul service from Salt Lake to London's Gatwick Airport.[115] Delta could not ignore competition, which threatened its long-range plans for Salt Lake. According to Delta spokesman Neil Monroe, "Inroads have been made [into Delta's market share] by Morris. We have a tremendous investment in Salt Lake City, and in order to continue that hub's success, we have to retain local market share."[116]

At the time, Delta had suffered worldwide losses, which probably contributed to its determination not to be upstaged by little Morris. Delta had an operating loss of $450 million in 1991, a $675 million loss in 1992, and a $563 million loss for the first nine months of 1993.[117] The financial toll and necessary countermeasures were wrenching to an airline, which had always considered itself superior to the competition in morale, customer service, and financial performance.[118]

Delta finally responded to Morris' growth at the end of 1992 by slashing its fares by 50 percent and offering double frequent flyer mileage on flights involving Salt Lake City. Morris was little affected however; as its fares remained lower than Delta's, up to 35 percent lower on some routes.[119]

Delta finally decided to match Morris' fares out of Salt Lake in May 1993.[120] By then Morris had established itself in the market and did not get knocked out. Near the end of Morris' existence, however, Delta became even more aggressive. In December 1993 it announced low fare service to Albuquerque from Salt Lake. Morris had been planning to enter that market at a higher fare at the beginning of 1994.[121] It was unclear how much longer the new entrant could survive Delta's attention.

Predation

Delta supplemented its aggressive (some would say predatory) pricing and frequent flyer bonuses with one additional trick: market share travel agent overrides. In testimony before the National Commission to Ensure a Strong Competitive Airline Industry, Morris President David Neeleman appealed for an end to the practice in which airlines paid travel agents cash incentives when the agents increased the airline's proportion of total tickets sold. Neeleman noted that the overrides make it difficult for travel agencies to support a start-up carrier for fear of losing the incentives.

In Morris' case, Neeleman stated that all major Utah travel agencies had overrides based on market shares with Delta, and the agencies had told him privately that they could not support Morris aggressively because of the incentives.[122] After making these remarks, Neeleman was approached by Department of Justice officials for additional information. A few months later, the Department launched an investigation of Delta's "marketing practices that may be used to maintain hub dominance."[123]

The bonuses were common in the industry. A 1992 Travel Weekly survey found that 69 percent of agencies had received them and that two-thirds of the agencies reported that the bonuses were sometimes or usually a factor in which airlines they chose for customers.[124] Although the Department of Justice later widened its probe to include TWA, Continental, United, American, USAir, and Northwest,[125] Delta remained a focus of the investigation.

It was discovered that Delta sent a memo to Utah travel agents in summer 1993 reminding them of their obligation to report Morris Air ticket sales to the Airline Reporting Corporation (ARC). The ARC usually serves as an industry clearinghouse for tickets, but Morris was not fully included because of its reservation system discussed above. The Delta memo had a chilling effect on agents who worried about losing their overrides: after the memo, Morris Air's travel agent bookings dropped 20 percent.[126] Justice made no determination in its probe of Delta while Morris was in existence.

THE END OF MORRIS AIR

In October 1993, Morris Air approached Southwest Airlines proposing a buyout. Shortly afterward, June Morris and her husband had dinner with Herb Kelleher, Southwest's chairman, to explore the possibility. Negotiations began, and Southwest purchased Morris on December 14, 1993.[127]

June Morris cited several reasons for her decision to seek a buyout: "…unspecified future business concerns," a desire to reduce her schedule after a lifetime of hard work, and a desire to spend more time with her husband.[128] David Neeleman later revealed that June Morris had started to feel ill as well. She was diagnosed with inflammatory breast cancer at the beginning of December, an ailment from which she eventually recovered after a grueling battle.[129]

The sale was accomplished by a stock swap in which no cash changed hands. Southwest acquired 100 percent ownership of Morris by giving its owners 3.6 million shares of newly-issued common stock valued at a total of $133.8 million on the last day of 1993 when the transaction took place. Former Morris Air owners ended up controlling about 2.5 percent of the bigger company's stock.[130] June Morris was elected to the Southwest Board on January 20, 1994, and received options to purchase 10,000 shares of Southwest common stock at $36.625 per share, the value of the stock at the time.

FINANCIAL RESULTS

Their investment in Morris Air paid off handsomely for the owners of the airline. Although Morris was never a public company, and thus did not have to report its results, it is possible to reconstruct a picture of its financial status through comments made by Morris officials and investors. In 1992, Morris made a profit of $10 million, a 7 percent margin on operating revenues of $142 million.[131] By comparison, the charter service had revenues of $82 million in 1991.[132] The company projected revenues of up to $200 million in 1993,[133] but it had only achieved $116 (with a profit of $5.3 million) by the end of the third quarter of that year.[134] By then, Morris had accumulated $50 million in long-term debt, and shareholders' equity was $27.5 million.[135] Thus the debt to equity ratio was about 2:1, relatively low for an airline during the early 1990s.

A measure of the capital gain on the company's share can be taken from a statement by one of its owners, the Weston Presidio venture capital company. Weston Presidio stated that it had invested $2 million in the company's initial private placement in December 1992. When its stake was sold in 1993, Presidio made 2.5 times its money.[136]

A HIDDEN AGENDA?

It would be easy to accept the public statements about the motives that Morris had to seek a buyout by Southwest at face value. But there is evidence that supports a different interpretation of the story of the airline: that June Morris considered an eventual sale to Southwest from the beginning. Morris' integration into Southwest went exceptionally smoothly since the two airlines were so similar. They both offered low frills, low cost, short-haul, point-to-point service, in the same, single type of aircraft.[137] Neither participated in a CRS or code sharing agreement, assigned seats, or served meals.[138] Kelleher stated, "You couldn't put two carriers together that are more alike than Morris Air and Southwest Airlines."[139]

June Morris modeled her new airline on Southwest, and the airline's incorporation only followed discussions between her and Kelleher's management teams.[140] She deliberately tailored Morris' route system so that it would dovetail nicely with Southwest's[141] (while the two airlines flew to eight of the same cities, they did not compete in any city-pairs).[142]

June Morris would have needed to make her airline as appetizing and easily digestible as possible. Southwest's only previous acquisition, of Muse Air in 1985, was a disaster.[143] Southwest had lost its appetite for acquisitions. At the time, Kelleher said, "Morris Air is a very special situation to us. This does not signify that Southwest Airlines has caught the acquisition mania. If Morris Air were not the special situation that it is, we would not even have considered Morris Air."[144] In 1995, he repeated, "We expect all of our growth to be internal. Morris Air was a very special situation…[It] had used us as its role model."[145]

Is it possible that June Morris, a very sharp lady, constructed her airline with an eye to quickly selling it to Southwest for a lot more money than she had put into it? The timing was perfect: Southwest was planning to expand in the western U.S. just as she approached Kelleher.[146] In a telling statement, which gives the lie to public stories of the need to sell, Morris spokesman Tom Kelly said, "This is not something that had to be done. If Southwest had not had any interest, I don't think we would have continued [to look for a buyer]."[147]

CONCLUSION

As we have seen, Morris benefited significantly and throughout its existence from being under the watchful eye of the DOT. The Department's notice that it would not tolerate predatory practices, backed up in Morris' case by the investigation into Delta's travel agent overrides, protected the new airline from obvious attempts on the part of the majors to do away with it.

In terms of government action, Morris had little to complain about. When David Neeleman testified before the National Commission to Ensure a Strong Competitive Airline Industry, apart from discussing agency overrides, he only wished for less taxation and less reporting requirements.[148] This latter point brought Morris once again into conflict with the majors.

On July 1, 1993, Morris Air asked DOT to keep its traffic, capacity, and market data (included in T-100 reports) confidential from other carriers for a period of three years. Morris argued that as a new entrant, it faced unusual competitive pressures from established carriers whose "mere size…makes the identification and tracking of smaller air carriers' fleet operations an essential part of their competitive tools."[149] Delta and United objected to the request, particularly its singling out new entrants for preferential treatment, as inconsistent with the basic deregulation principle of equal treatment for all airlines.[150] Morris' request was denied,[151] rightly in our opinion. The story of Morris Air shows what an upstart can do on a level playing field under deregulation. Morris did not need the government to favor it, just to let it compete.

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APPENDIX
FACTORS THAT CONTRIBUTED TO THE SUCCESS OF MORRIS AIR

ENVIRONMENT

- Many uncontested markets available
- Buyer's market in jets
- Employer's market in labor
- Federal support for start-ups

STRATEGY

- Low frequency of service
- Avoid congested airports and schedules
- Fly only short routes
- Create new air travelers
- Discipline in adhering to strategy

COST CUTTING

- Use only one kind of airframe
- Lease planes and crews
- Contract out services
- Eschew computer reservation systems
- Low seat pitch
- Leverage charter brand, experience, and investments

INNOVATION

- Ticket less travel