

## **The future of CRM in the airline industry: A new paradigm for customer management**

*As airlines struggle to gain market share and sustain profitability in today's fiercely competitive and economically demanding environment, they must develop new ways to manage their customer relationships to optimize customer loyalty and revenues. What tactics should airlines use to acquire, develop and retain customers with greater precision and improved results?*



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## Executive summary

The airline industry has reached a crossroads. The effects of the worldwide economic slump and the aftermath of September 11th attacks have severely impacted airline economics and viability. While the U.S. and certain European markets were most severely impacted, airlines worldwide are striving to both regain and improve profitability. Many have focused on operational improvements to reduce costs, but the customer cannot be ignored. Customer relationships must be fostered for airlines to maintain competitive advantage and profitability in the long term.

Airlines' immediate focus is on cost reductions in driving to more efficient operations. However, many airlines are turning to customer relationship management (CRM) as a tool for managing customer relationships. Unfortunately, in many cases, they have failed to recognize CRM as a holistic strategy, instead viewing it as synonymous with their frequent flyer programs. In order to manage the customer more effectively across all lines of service, airlines must change their approach to CRM in a number of ways:

- *Customer segmentation*—Airlines need to recognize that mileage-based segmentation is inadequate, whereas value-based and needs-based approaches can help guide investment decisions and drive greater insight into the needs of high-value customers.
- *CRM initiative development*—In order to differentiate themselves from the competition, airlines must abandon a “fast follower” approach to CRM initiative development, in favor of investing in initiatives with a high return, which respond to the needs and desires of their own customers.
- *Organizational design and management*—Airlines need to instill a service mentality in their employees, empowering them with a complete view of the customer and clearly articulating the employee's role in the CRM strategy.

By taking steps to implement a truly consumer-centric approach to relationship management, an airline will be better positioned to acquire, develop and retain high-value customers. Through the development and implementation of customer analytics and decision-support technologies, airlines can begin to use customer information not only to differentiate service levels based on customer value, but also to drive crucial operational decisions. In the end, an airline's CRM program becomes a platform for achieving both near-term operational efficiency and long-term relationship management and growth.

Issue

The airline industry is facing one of the most challenging environments in its history. A global economic slowdown, punctuated by the events of September 11th, has led to a decline in passenger traffic, continued yield reductions, decreased load factors, and burgeoning fleet, insurance and labor costs. On a global basis, airlines saw a US\$12 billion operating loss in 2001 before taking into account various government bail-outs.<sup>1</sup> In fact, airline profitability has been decreasing over the past five years (see Figure 1).

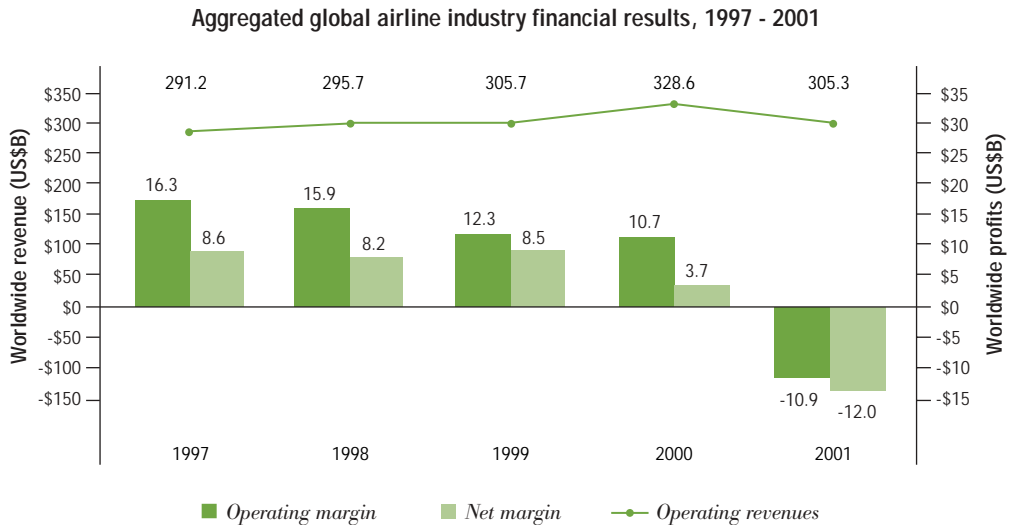
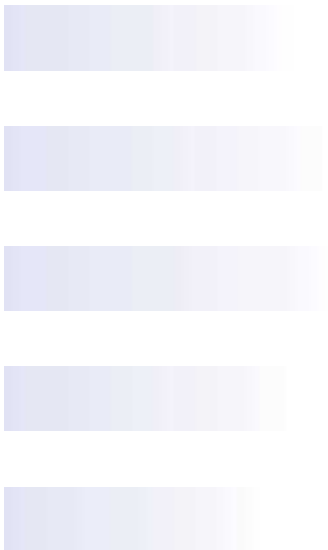


Figure 1. Airline profitability.

Source: IATA World Air Transport statistics, 2002.

Additionally, the emergence of low-cost carriers, particularly in Europe and the U.S., has led to further competitive pressures for full-service airlines. In Europe, low-cost carriers grew ten-fold between 1995 and 2001.<sup>2</sup> In the U.S., the domestic market share of low-cost carriers rose from 10 percent in 1992 to a forecasted 23 percent in 2002 (see Figure 2).<sup>3</sup> Low-cost carriers have attracted customers through substantially lower fares enabled by high-efficiency operating models. Operational efficiency has thus become the top priority across an industry struggling to maintain profitability. Yet, although the development of more cost-effective operations is an essential short-term tactic for airlines to pursue, competitive advantage in the long term will be based in large part on solid, differentiated customer relationships.



U.S. airline domestic market share, 1992 versus 2002

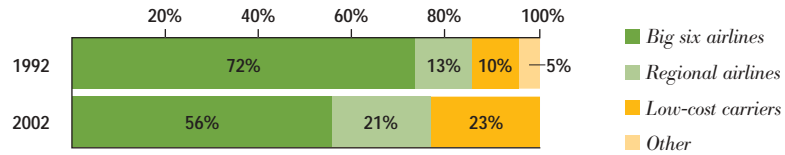
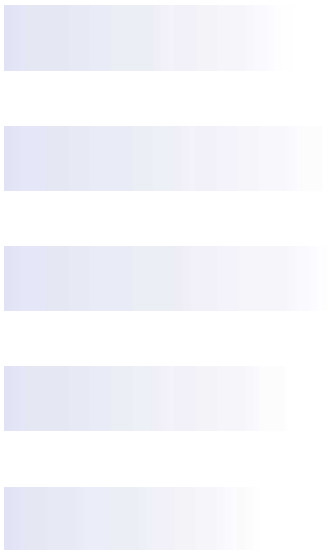


Figure 2. U.S. airline domestic market share.

Source: “Airlines’ Balance of Power Shifts,” USA Today, July 30, 2002.

As airlines grapple with how to deliver a consistent and distinctive customer experience while maintaining low operating costs, they have turned to the promise of CRM. Although operational and security issues became top-of-mind immediately after September 11th, CRM has gradually come back into focus as airlines recognize the importance of effective customer management in establishing long-term competitive advantage. CRM’s promise is indeed compelling: strengthened loyalty driving increased revenue, with lower acquisition costs and improved operational efficiency. For full-service airlines, CRM is an essential component of their corporate strategy—the means of differentiating themselves from competitors in the eyes of the customer. And although low-cost carriers may be less reliant on CRM as a means of driving competitive differentiation, even they must invest in fundamental CRM technologies and processes to manage the customer efficiently over the course of the travel experience. Increasingly, airlines are recognizing that CRM is a long-term investment, with the true benefits reaped through profitable lifelong customer relationships.

Although many airlines understand the significance of CRM to their bottom lines, such programs as they exist today are suboptimal. Few airlines truly exploit CRM analytics to segment their customers based on value rather than miles flown; instead, they are using only simplistic segmentation models. CRM investments are largely driven by the competition rather than the needs of the airline’s most valuable customers. In a bid to imitate first-movers and provide customers with similar services, airlines have effectively eliminated any competitive differentiation provided by CRM initiatives, without fully understanding whether or not they are truly of value to the customer. Execution of an airline’s CRM strategy is often inefficient as well, with no clear vision or direction; competing departments often set separate goals. Employees may not have the tools to provide consistent levels of service across all customer touch points and may not have the service mentality necessary for a CRM program to be truly beneficial to both the customer and the airline. Airlines must begin addressing these issues now, to manage their customers effectively in the future.



Analysis

*Airlines' CRM initiatives have done little to differentiate themselves*

To date, airlines have used CRM primarily as a competitive “catch-up” rather than a means of differentiation. Rushing to imitate the customer-oriented initiatives introduced by competitors, many airlines have done little to determine the value to the customer of those initiatives, or to the business itself. Today, not only are frequent flyer programs a universal cost of doing business, but even recent innovations such as kiosk check-in (see Figure 3), flight-notification systems, e-ticketing, virtual check-in and Web-based self-service have become commonplace. One of the primary goals of CRM is to differentiate a company’s services to the customer through personalization, yet in the airline industry, CRM – at least in the form in which it is practiced today – has become a commodity, with many services indistinguishable from airline to airline.

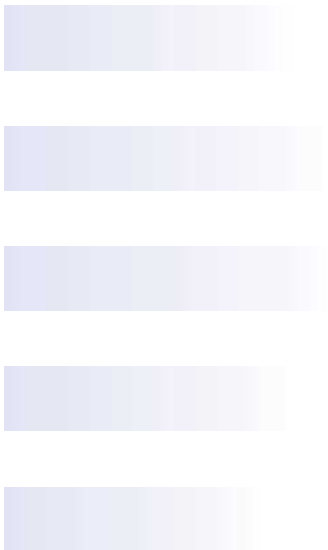
Airline adoption of kiosks, 1995 - 2002

1995	1996	1997	1998	1999	2000	2001	2002
Continental Lufthansa	Alaska Airlines British Airways Continental Lufthansa	Alaska Airlines Asiana Airlines British Airways Continental Lufthansa Northwest	Alaska Airlines Asiana Airlines British Airways Continental Lufthansa Northwest Singapore	Air Canada Alaska Airlines Asiana Airlines British Airways Continental Lufthansa Northwest Singapore	Air Canada Air France Alaska Airlines Alitalia Asiana Airlines British Airways Continental Delta Lufthansa Northwest Singapore United	Air Canada Air France Alaska Airlines Alitalia Asiana Airlines British Airways Cathay Pacific Continental Delta Lufthansa Northwest Singapore United	Air Canada Air France Alaska Airlines Alitalia Asiana Airlines British Airways Cathay Pacific Continental Delta Lufthansa Northwest Qantas Singapore United

Figure 3. Airline adoption of kiosks, 1995 - 2002.

Source: Company press releases.

Many airlines have taken a “fast follower” approach, learning from the experience of competitors to reduce costs. For instance, by waiting to deploy kiosks widely, Delta claimed that it would spend one-fifth what other airlines spent on similar check-in technology.<sup>4</sup> Additionally, due to increased technological capabilities, many airlines now have access to the same technologies, reducing the ability to introduce services with sustainable differentiation.

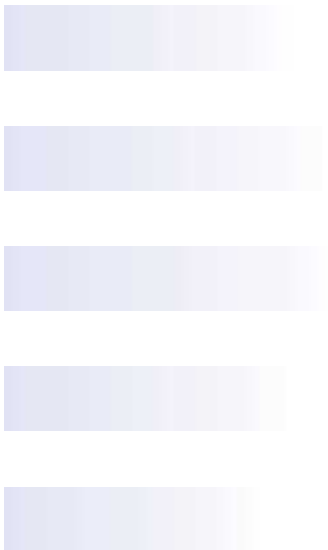


However, airlines can begin to distinguish themselves by concentrating on the relationship-building aspects of CRM. It is not enough to simply mimic the competition for the sake of offering identical services. Airlines need to understand how their core customers respond to specific initiatives, and evaluate the return on investment (ROI) for each new service offered. By utilizing new initiatives to drive customer insights and improve customer value, airlines can improve the return from their CRM program. Airlines can begin to move away from a reactive, competitor-driven CRM strategy if they ultimately base investments on the needs of key customer segments.

### *Some customers deserve greater attention than others*

In order to differentiate their CRM programs more effectively, airlines will need to understand the customer in terms of both value and needs. Effective customer segmentation is vital to the success of any CRM strategy. Although customers can be grouped in many different ways, value-based segmentation enables a business to understand the profitability of each customer. By assessing customers' value to the company, and their key needs, the business can determine which customers it should retain and how it can migrate lower-value customers to higher-value segments. This knowledge, in turn, can help guide investment decisions on, and better enable calculation of ROI, from customer-oriented initiatives.

To date, many airlines have based their customer-segmentation schemes on demographic characteristics or frequent flyer program attributes only. Both methods are limited by their ability to provide the airline with a clear view of which customers they should target to improve profitability. Demographic segmentation does not provide a full picture of the customer. Air travel spending is driven primarily by the customer's profession, in the case of business travel, or by the location of a customer's family or vacation destination preference, in the case of leisure travel. Using frequent flyer status, based on miles flown, to segment customers is a somewhat better indicator of profitability, yet it still falls short. One major airline in the U.S. discovered that its top 1000 customers (by revenue) accounted for 60 percent more revenue than its top 1000 customers by mileage.<sup>5</sup> Some frequent fliers may receive corporate discounts or other perks that, in fact, make them less profitable than a passenger who flies less frequently at full first-class fares. IBM worked with another carrier that found that just over 15 percent of their customers accounted for over 40 percent of its revenue (see Figure 4).<sup>6</sup> In the end, the real question is: what share of profits does a given group of customers account for?



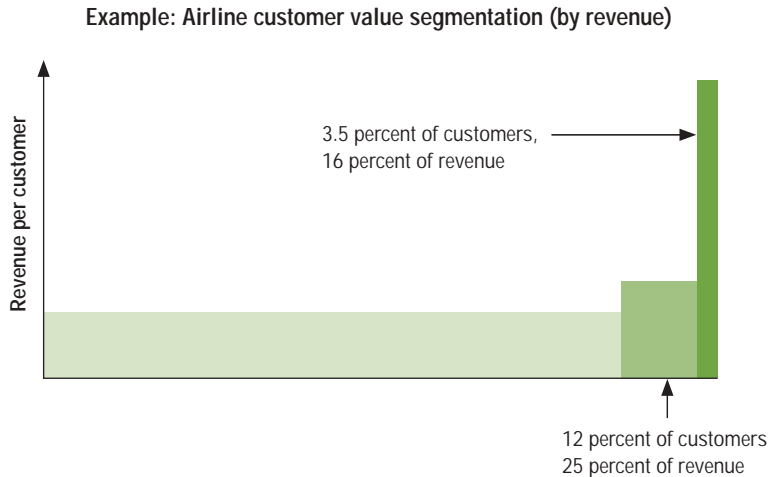


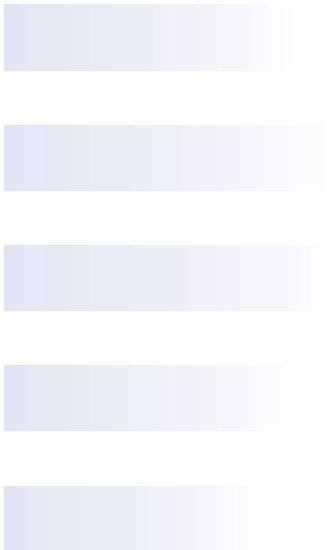
Figure 4. Airline customer value segmentation (by revenue).

Source: IBM analysis.

Although many airlines are intent on retaining their elite frequent flyer members, increasingly, they will need to explicitly understand customer value to focus on the most profitable customers. Many airlines already have the technologies in place to allow them to determine customer value. United Airlines has implemented a customer value model that can help allow it to identify high-value frequent flyers and proactively offer special, differentiated services in the event of a flight cancellation.<sup>7</sup> However, in general, airlines that have the capability to perform value-based customer segmentation have not used it consistently.

Value-based customer segmentation allows airlines to manage their customers as an asset. For example, such a segmentation scheme could group customers by monetary value and travel frequency (see Figure 5). Current value – in historical revenue terms – is clearly vital information. Moreover, it is also useful in gaining an understanding of potential value, such as untapped wallet share and likely future spending; insights which can be used to determine the ideal level of investment in each segment.

Furthermore, the company needs to understand each segment’s respective drivers. For example, some passengers may place greater emphasis on extra baggage space when traveling, while others may want nonstop service. By developing a comprehensive understanding of the customer, the airline can tailor and improve its value proposition using levers such as brand, price, distribution channel and customer service. The company can set acquisition, development and retention targets for each customer segment, pursue strategies for lowering the cost of serving low-value passengers, and develop marketing and sales budgets unique to each segment.



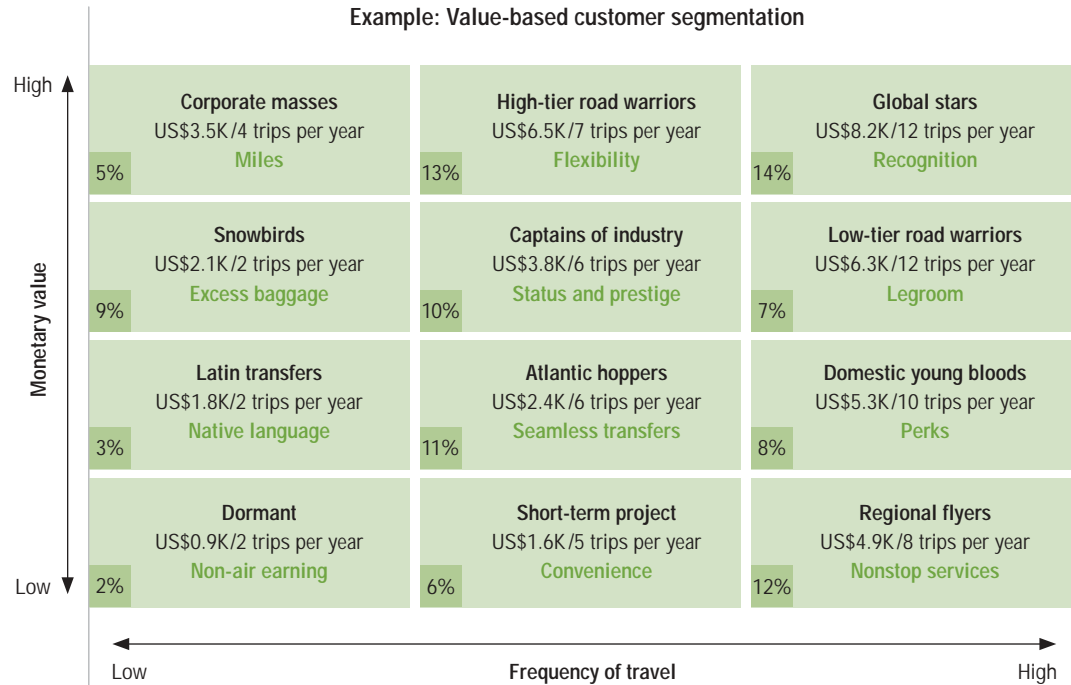


Figure 5. Value-based customer segmentation.

Note: Green text refers to key driver behind customer satisfaction for each segment.

Source: IBM analysis.

*CRM case in point: United Airlines' customer care program<sup>8</sup>*

United Airlines has introduced a sophisticated customer care program to resolve customer travel problems proactively. The “Make Amends” program is dedicated to addressing customer concerns instantly and providing immediate information when flight delays occur. Many of the program’s key aspects are simple, yet can be instrumental in alleviating customer concerns and making them feel more comfortable. For instance, United has introduced a customer advocate center, which helps to rebook passengers if their flight is cancelled prior to their arrival at the airport. Additionally, United is using wireless flight notification to improve information delivery and testing the use of radio frequency identification (RFID) baggage tags to reduce lost customer baggage.

The revolutionary element of the “Make Amends” program is the fact that it incorporates customer value into the service equation. When a customer disservice occurs, frontline employees and flight attendants with access to the system receive information on both the customer’s history and value to the airline. Thus, high-value customers will be the first to be notified of a flight delay and can be offered special services or benefits in the event of a flight cancellation. By using customer value as a key input when delivering value-added services, United is better positioned to satisfy and retain its high-value customers.

Implications

*Differentiate services based on customer and business value*

Gaining a deeper understanding of the profitability and the key satisfaction drivers of each segment will help airlines better assess the business value of potential customer-facing programs. Using a wide variety of direct and indirect customer input (see Figure 6), airlines can map feedback they receive against individual customer segments. Then, in combination with advanced customer analytics, they can develop unique insights into the habits and needs of each customer segment. Thus, customer value segmentation becomes a valuable tool in CRM program definition and execution.

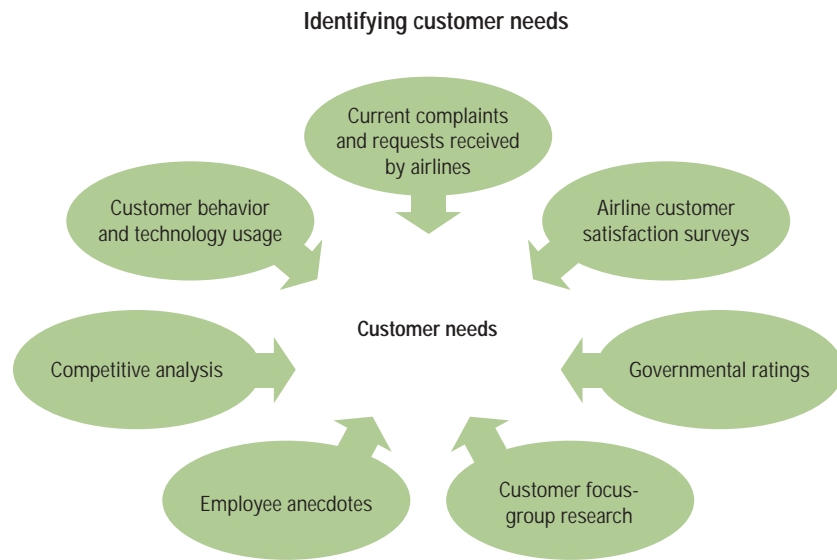
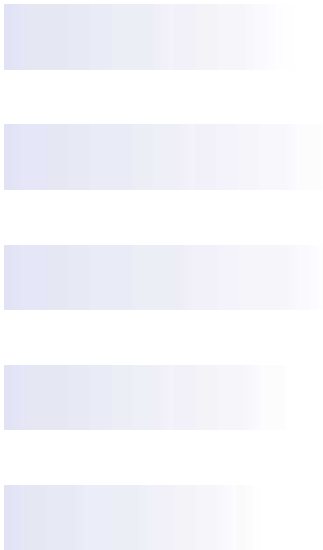


Figure 6. Methods to identify customer needs.

Source: IBM Institute for Business Value.

Customer self-service initiatives, for instance, can be identified as “quick wins,” allowing an airline to reduce customer service costs immediately with a relatively low implementation cost. Airlines should drive low-value customers to use self-service initiatives to reduce the cost-to-serve and improve the efficiency of customer service representatives. For example, some airlines offer frequent flyer rewards for purchasing tickets online or for using a self check-in kiosk. In the future, they may want to charge low-value customers for high-touch services – as occurs in the banking industry today – to encourage the use of self-service options. Keep in mind that self-service is not merely about cost reduction. Customer satisfaction can also be increased through self-service options. The key is to identify where self-service actually improves the travel experience from the customer perspective, by providing greater information access, reducing wait times and enabling greater control over their travel experience.



However, high-value customers also demand special treatment worthy of their status. To date, airlines have used mileage-based frequent flyer programs to provide such incentives as automatic upgrades, special in-flight services and access to airport lounges. Airlines can extend these benefits by understanding the passenger's deeper value drivers. For instance, customers that are particularly concerned about increased work productivity may perceive significant value in having in-flight Internet and e-mail access. Airlines must begin to proactively address the needs of high-value flyers in order to retain them, by using marketing offers, promotional previews, improved seat availability and waiving fees to build loyalty and differentiate service levels.

Besides understanding what its customers want and need, an airline must determine what initiatives best drive shareholder value. Executives must prioritize or reject potential investments based on the expected return to the company and the degree of implementation cost and risk (see Figures 7 and 8). Some initiatives, such as frequent flyer programs, offer high return to the airline, not only in terms of increased customer loyalty, but also in the ability to sell miles or points to third parties, which extends the loyalty program and creates a new revenue stream. Other initiatives, such as online baggage tracing, may offer minimal benefit to the airline, only improving customer satisfaction slightly.

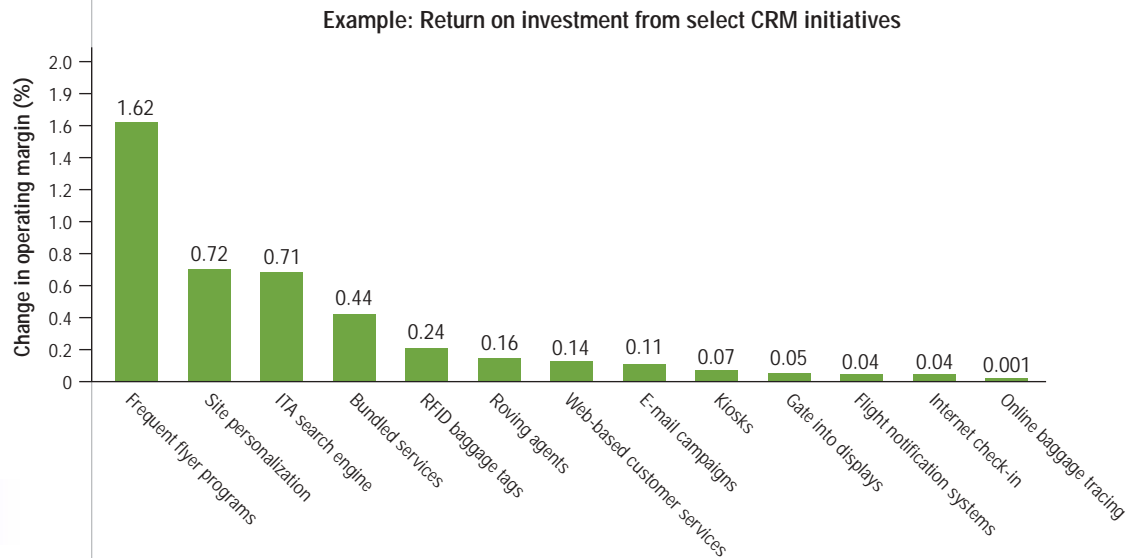


Figure 7. Illustrative return on investment from select CRM initiatives.

Note: ROI calculations are based on a financial model for a fictional airline using actual airline experiences as inputs.  
 Source: IBM Institute for Business Value.

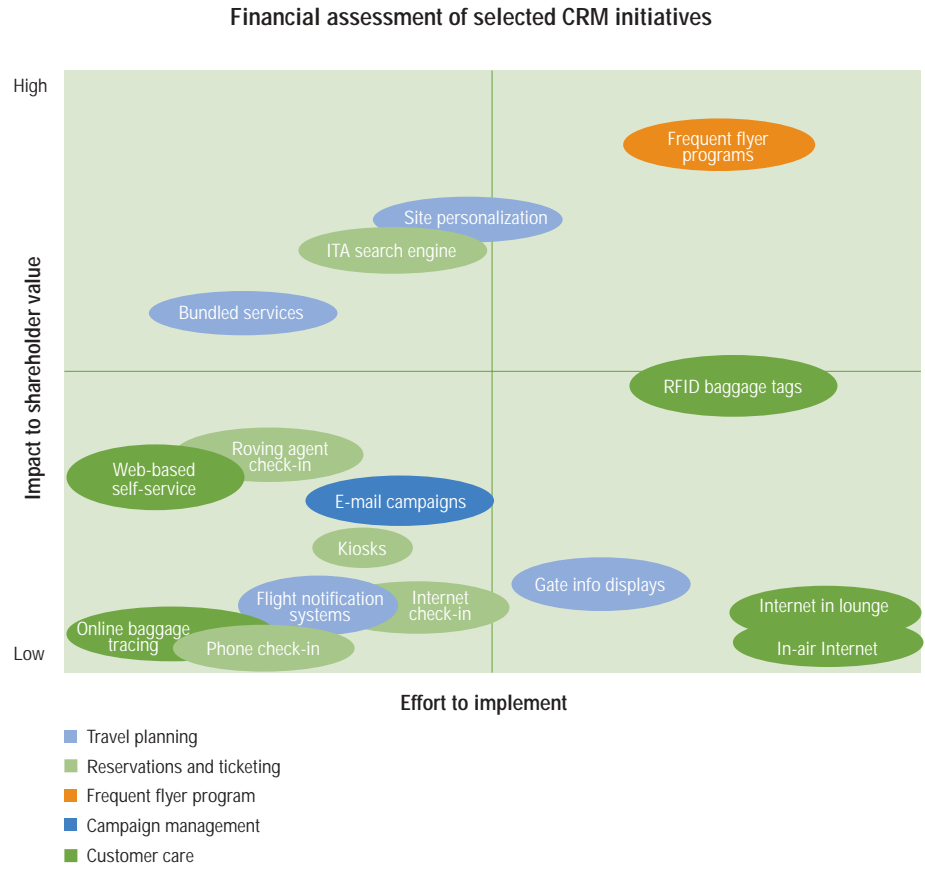
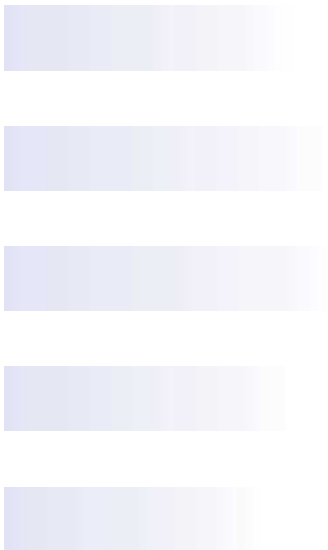


Figure 8. Financial assessment of selected CRM initiatives.

Source: IBM Institute for Business Value.



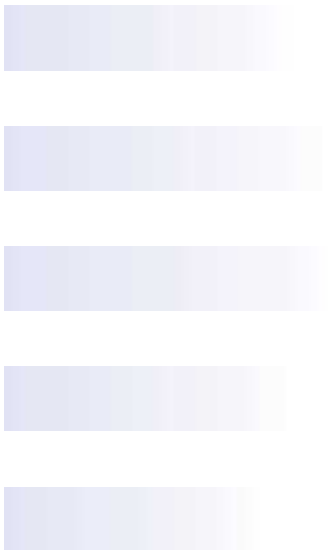
### *Drive better operating decisions*

Customer value analysis is also central to improved operating efficiency—a key goal in the current economic climate. By using value-based segmentation to understand the habits of different customer groups, airlines can begin to make operating decisions that help increase the profitability of specific routes. There are two primary areas where this approach should influence airline operations.

*1. Route and schedule planning*—Airlines already closely analyze route and schedule profitability. In the future, airlines should use customer analytics to help make more informed and effective decisions on route and schedule planning. There are four key opportunities in this area:

- Routes that are loss-making in their own right may be an important customer acquisition vehicle for high-value customers, with costs recovered through ongoing business from these customers.
- On routes served by multiple airlines with similar schedules, customer service and relationship building is essential to capturing customers from the competition and driving incremental profitability.
- To retain high-value passengers, an airline must be able to consistently provide customers with a seat in their desired fare class on each route they fly.
- Airlines must use customer analytics and predictive modeling to help evaluate route and schedule profitability for potential expansions.

*2. Yield management and pricing*—Airlines can also use customer analytics to improve yield management and pricing; determine which customer segments view price as a low priority when choosing an airline; and calculate the highest price that each individual customer segment is willing to pay for a given route. Advanced analytics can help drive pricing strategies, simplifying fare classes and improving yields. By using value-based customer segmentation to help make decisions regarding these basic operational issues, airlines can find opportunities to reduce costs associated with specific routes, while increasing customer revenues.



The key is that the customer is central to improving key operations. In turn, all operational improvements must support strengthened customer relationships for airlines to achieve long-term viability (see Figure 9).

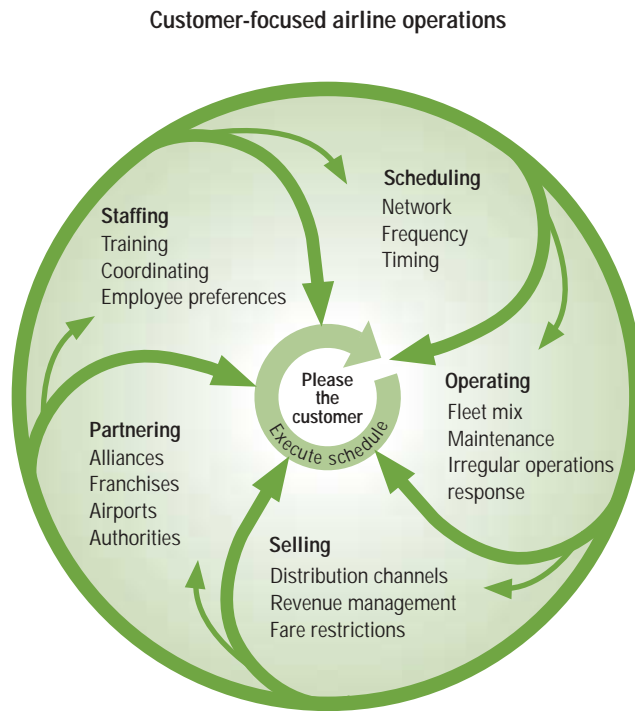


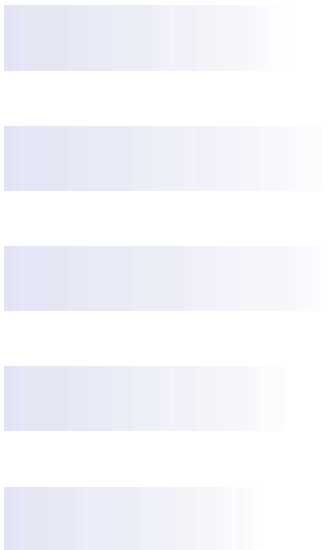
Figure 9. Operational improvements must support strengthened customer relationships for airlines.

Source: IBM Institute for Business Value.

*Empower the organization*

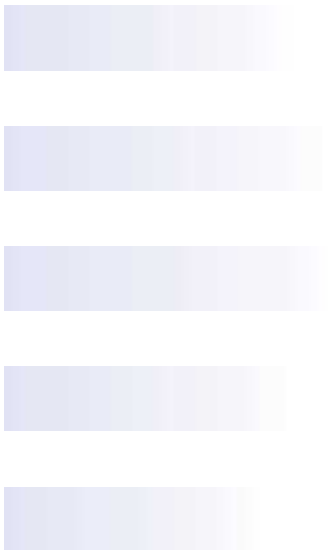
An airline’s CRM strategy will help differentiate services and improve operations only if implemented effectively. The airline’s organizational capability is the true enabling factor behind the CRM program. Effective customer management is dependent on service-oriented employees empowered with a clear understanding of the company’s CRM strategy and the tools necessary to capture and analyze customer information for actionable decision-making. Currently, many airlines encounter three major organizational issues, leading to inconsistent customer service and tenuous customer relationships:

- *CRM lacks a leader*—Often, no one individual assumes responsibility for setting the CRM agenda, ensuring its alignment to the overall corporate strategy, and taking ownership for its successful implementation. Without a truly empowered executive sponsor, an airline’s CRM program is likely to be inconsistently deployed and communicated.



- *CRM strategy is not understood by the organization* – Although many executives claim to understand what their CRM strategy needs to accomplish and what systems and support it requires, they often limit this thinking to the airline’s frequent flyer program. A broader, clear vision for CRM must be developed, fostering a service mentality within the organization and a laser focus on the consumer. The strategy needs to encompass all customer-facing aspects of the business and be communicated throughout the organization.
- *CRM responsibility sits across multiple departments* – Multiple groups within the company may be responsible for CRM strategy definition, each approaching the issue with different goals in mind. Additionally, the teams setting the strategy may not be effectively communicating with those executing the strategy, leading to customer service disconnects and operational mismanagement. To optimize the chance of success, one department should clearly lead the CRM effort, with input and feedback from other groups. Implementation must be effectively coordinated across departments to ensure effective roll-out and integration.

After the airline has developed an overall CRM vision and strategy, it must empower its employees to carry out that vision. At every stage in the employee lifecycle, airline staff should be provided with the tools and incentives to deliver a high level of service. First, customer-facing employees should be hired based on their service capabilities. Training should provide the employee with a vision of the airline as a “service organization,” with every employee having a customer, even if that customer is internal, a philosophy espoused by profitable Southwest Airlines.<sup>9</sup> The airline should constantly collect employee feedback on service issues. Technological tools should be provided to employees to give them better knowledge about the customer, enabling them to tailor their interactions with each customer regardless of channel or point in the travel experience. Finally, employees should be evaluated on their ability to deliver a high level of service, with additional incentives used to encourage employees to exceed customer expectations.



### *CRM case in point: Southwest Airlines' customer focus*

Southwest Airlines is recognized throughout the airline industry for having an exceptional organizational model, enabling it to maintain strong customer relationships. The company incorporates customer service into its core mission statement: "Dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit."<sup>10</sup> Furthermore, Southwest strives to treat employees with the same concern, respect, and caring attitude within the organization that they are expected to share externally with every Southwest Customer. By focusing on the customer, Southwest has been able to consistently receive the highest customer satisfaction rating in the industry.<sup>11</sup>

Effective organizational management is central to Southwest's strong relationship with its customers. According to Colleen Barrett, Executive VP Customers, "we spend a disproportionate time on hiring. We've developed profiles for every customer contact position we have, as well as for pilots, mechanics, ramp agents."<sup>12</sup> Every employee within Southwest has an identified "customer," whether internal or external.<sup>13</sup> Additionally, all Southwest employees receive annual customer service training, with several award and recognition programs introduced to recognize employees for exceptional customer service.<sup>14</sup>

Southwest's approach has delivered impressive results. According to Barrett, "I'll get letters from regular customers apologizing because they had to take another carrier... I'll get a call from an employee who's in tears because she read that one of her regular customers is in the hospital with a heart attack."<sup>15</sup> While Southwest may operate as a low-cost carrier, it has always maintained a clear organizational focus on the customer, allowing it to truly differentiate itself in the industry.

### **Moving forward**

Managing customers effectively is critical to the success of all airlines, as competitive and economic forces change the dynamics of their customer relationships. In developing and implementing CRM strategies, airlines need to take a systematic approach, based on rigorous, factual analysis, in order to realize the full economic value of each customer. The following five key guidelines provide a path forward for airline executives striving to reinvigorate their customer relationships.

- *Develop a vision*—Understand how CRM can help you to transform customer relationships. Develop a business case supporting your vision, including both revenue benefits achieved through wallet share growth and customer retention, as well as potential operational cost savings. Only through clear communication of an overall vision for the CRM program will managers and staff be convinced of its importance.

- *Focus on customer value*—Understand the profitability of each customer. Segment all customers, regardless of frequent flyer status or membership, based on value. Use customer value to differentiate service levels, identifying opportunities to build the loyalty of your most valuable customers and to recruit new customers with similar profiles. Value-based segmentation is the key to an effective CRM program, allowing an airline to focus directly on creating the greatest lifetime customer value.
- *Empower the employee*—Communicate to employees the importance of customer service. Provide them with access to information on key customer interactions, whether on the Web, at baggage claim, with a flight attendant or through reservations. Use appropriate incentives to encourage the deepening of the customer relationship. An airline's CRM program will only be as strong as its weakest link; thus all employees must develop a service mentality and be empowered with customer insights.
- *Set targets and success metrics*—Quantify the payback from CRM. Ensure that both the business and the customers is obtaining value from the CRM program. Airlines need to determine what sort of return they can reasonably expect from their CRM initiatives and manage towards explicit goals. The company should regularly obtain and act upon feedback from both customers and employees.
- *Address customer needs throughout the lifecycle*—Become an essential partner to the customers. Analyze information gained through customer interactions to learn more about them continuously, refining business actions to target the customers' needs better and creating an even more customized and consistent experience over time.

### Conclusion

Full-service airlines must adopt an integrated CRM strategy if they are to pursue competitive differentiation and profitability effectively in the future. Low-cost carriers also need to invest in fundamental CRM capabilities to optimize the efficiency of customer-facing operations. Airline executives who develop their CRM program in a deliberate, holistic way will substantially increase the likelihood that their efforts will succeed. By creating a truly customer-centric organization, based on a firm understanding of customer value and needs, and empowering employees with the tools and knowledge to respond to the customer, airlines establish a virtuous cycle that can lead to renewed economic success.

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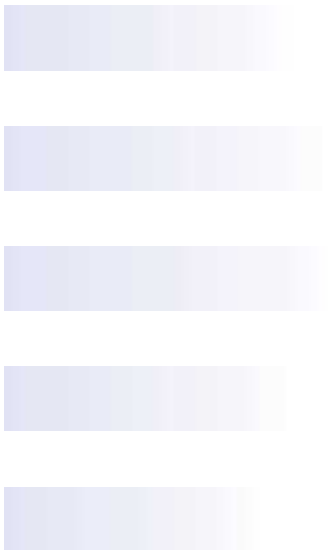
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