Executive Insights

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Winning Formula: WestJet's Remarkable Success

Across the global airline spectrum, only a handful of airlines have proven to be successful in delivering attractive and consistent financial results. In this installment of our multipart *Executive Insights* series on high-performing airlines, L.E.K. Consulting's John Thomas and Spencer Stuart's Michael Bell and Thierry Lindenau speak to WestJet boss Gregg Saretsky.

From its humble roots as a 1990's low-cost carrier (LCC) in western Canada to currently the country's second-largest airline, Calgary-based WestJet has morphed into the "hybrid" carrier model, maintaining key aspects of the LCC model while steadily building connectivity throughout Canada and selected international destinations. Under CEO Gregg Saretsky, WestJet has parlayed its vast and highly loyal customer base and unique employee-ownership platform into a high-performance airline, delivering approximately C$1.1 billion (US$830 million) in economic profits (returns in excess of cost of capital) over the past decade along with a material share of the Canadian travel market, according to our research.

In this Q&A, Saretsky provides insight into the factors that have helped fuel his airline's remarkable financial success. His key themes line up very well with our hypotheses of what drives outstanding airline economic performance.

What do you consider to be one of the key factors behind WestJet's success?

There is a very clear strategic focus and overall disciplined approach at WestJet: How we operate, how we make investment decisions — everything is focused on generating a 12% return on invested capital (ROIC); it is that simple. If something can't meet that hurdle, we simply won't pursue it. For example, we don't believe in loss-making routes.

Each part of the organization needs to perform at that level, and this expectation is clearly communicated throughout the organization. And against this laser-focused goal of 12% ROIC, we have actually been able to achieve a 15.8% ROIC so far this year. [Editor's Note: This article was originally published in Airline Business in October 2015. As of Dec. 31, 2015, WestJet's annualized return on invested capital was 16.59%.]

Our strategic focus allows us to maintain a low-cost environment and, in turn, offer our customers consistently low fares. Even when we unbundled our products as a means to increase margins, we did it in association with lower fares. For instance, we launched our transatlantic Dublin service at the unheard-of price of C$99, which was facilitated by the unbundling of the product. In other words, we work to keep our base fares low, then give customers the option to add on creature comforts as they wish.

Though our roots are in the low-cost world, the changing nature of the airline industry has compelled us to pursue a hybrid

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business model. To support this, we continue to focus not only on cost reduction, but also on targeting further opportunities for margin expansion. Our focus does not detract from a genuine mindset of caring for the customer and ensuring exceptional guest services that in turn drives high customer satisfaction scores.

What distinguishes WestJet's employment culture from that of competing carriers?

At WestJet, we live and breathe employee engagement as a means to meet our organizational alignment objectives between staff and management. Eighty-five percent of our workers participate in the company's employee share purchase plan, and our people account for some 13% of our total shareholder base — so you can see why they are key constituents of who we are.

"At WestJet, we live and breathe employee engagement." — Gregg Saretsky, CEO, WestJet

We have generous matching schemes that encourage employees to increase their share participation. This is supplemented by a profit sharing program that pays out twice annually and accounts for roughly 12% of an employee's base salary on average. Since the program's inception, we have paid out more than C$400 million. In addition, there are owners' performance awards based on nonfinancial metrics such as maintaining an injury-free environment, on-time performance, guest satisfaction ("Did we show we cared?") and cost reduction. When you combine profit sharing, the Employee Share Participation Program and stock price appreciation, the average employee has approximately 35% upside per annum.

The fact that WestJet employees have a voting seat on the board further underpins their alignment with management. An employee representative remains in the boardroom even after I leave for executive sessions. One could argue that our employees have even better access to the board than I do as CEO!

How has the company benefited from having these kinds of incentives?

Due to the overall level of employee engagement, we have minimal turnover and a very low sick leave rate. Given that we are now more than 20 years old and our pay scales max out at the five- to seven-year mark, a large percentage of our employees are currently at the top of their pay tenure. But because they view themselves as owners of the business, they continue to be highly productive. For instance, our flight crews are required to stay behind and groom their own aircraft, saving the airline huge sums in the process. Yet they do it willingly, as part of their dedication to creating an exceptional guest experience.

We also strongly encourage employee participation in the company's various idea-sharing programs. One of our recent initiatives was called "Ideas That Make Cents," which sought to cut C$100 million from our cost base over a three-year period. With the help of our employees, we were able to realize C$125 million in savings in just two years.

What are some other byproducts of WestJet's employee engagement approach?

We believe that organizational alignment and active employee engagement allow us to take bold steps. A great example of this was the introduction of our regional carrier Encore in 2013, which could have been quite controversial given its potential impact on mainline crews.

To avoid this, we kept employees in the loop throughout the entire decision-making process — explaining why we were doing this, how it would change the airline, what it would mean to them and so forth. Ultimately, the decision to launch Encore was put to a vote, and 91% of our employees supported it. Encore just marked its second birthday this summer and has been accretive to earnings right from the start.

Keeping an open dialogue with all WestJetters is also very important. For instance, each January, I conduct a town hall meeting with staff (spouses are also invited) and we lay out our plans for the airline. We also have numerous online forums, monthly webcasts and a blog that I publish regularly. Plus, employees can bypass their superiors and come see or email me at any time. What's more, each senior WestJet leader is assigned a designated base through which leaders can engage with employees at least twice each year. It's fair to say that we have a very flat organization. That said, it will be our mission to maintain this kind of engagement as we grow from 12,000 to 20,000 employees.

Is WestJet's talent primarily homegrown or do you engage in outside recruitment as well?

We believe in stable leadership and maintaining a strong culture of promoting from within. However, we also appreciate having a fresh perspective; accordingly, our goal is 75% internal promotion and 25% external hires. For a 20-year-old airline, our longest-serving senior executive has only 10 years with the company.

My predecessor, Clive Beddoe, actively recruited outside of the airline industry with the belief that having people with diverse backgrounds provided a different approach in an industry that had chronically underperformed.

To sum up, what do you consider to be the core tenets of WestJet's business model?

Three things: creating a remarkable experience for our guests, maintaining a disciplined approach to meeting our ROIC target and fostering employee engagement through an environment of trust while encouraging employees to have an ownership stake in the business.

The fact that we are one of the few investment-grade credits in the industry with a sound balance sheet could give us a sense of invincibility; however, we also realize that a new competitor could arrive tomorrow and make our lives extremely difficult!

Therefore, we continually have to ask ourselves why we are in the business. And the answer is to continue providing a satisfying experience for our customers. That's what gets our employees out of bed every day.

Editor's Note: *Winning Formula: WestJet's Remarkable Success* was originally published in *Airline Business* in October 2015.

About L.E.K. Consulting

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