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Ancillary revenues critical to new airline business model

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Paris-based airline consultancy Airsavings believes that the new face of the industry has been evolving for years - and that focus on broadening the revenue base of the business is the path forward from here.

CEO Raphael Bejar says that, "The standout characteristics of aviation in 2009 and 2010 - i.e., the emphasis on ancillary revenues, the adoption of a business model that closely resembles that employed by low cost airlines, the unbundled airfare, and capacity limitation - were brought into bare relief by the recession, but have in fact been developing over the past ten years."

The following are selected highlights of a recent industry briefing delivered by Bejar:

This is not the face of an industry disfigured by the recession. It's the changing face of an industry moving toward the next plateau in its evolution.

The recession, on the other hand, brought both the industry's greatest strengths and greatest liabilities into stark relief.

While other sectors were scrambling toward US and EU governments for bailouts and relief, the airline industry stayed in the air without major government assistance.

And while airlines' partners in the travel and tourism sector continue to struggle, some airlines operating in the right markets (with the right business model) are on the brink of returning to profitability sooner rather than later.

For the established markets, this resilience can be credited to both the capacity reductions enacted in late 2008 as a response to out-of-control fuel prices, as well as a growing recognition of ancillary revenues' importance.

The ability of the industry as a whole to respond to a low-demand environment, not with destructive fare wars but with a renewed emphasis on load factor, as well as the industry's willingness to collectively revamp a decades-old operating strategy (in the full service, bundled airfare), proved to be two of its most notable strengths.

2009's challenging operating environment also highlighted some of the industry's shortcomings: its inability to effectively manage fixed costs and its continuing challenges in changing consumer expectations.

Fuel was not the bogeyman in 2009 that it was in 2008, nor does it figure to be in the next 12 to 18 months, but the industry's forays into fuel hedging and its razor-thin margins (even with oil at half of its 2008 levels) indicates a lingering problem in need of a permanent long-term solution.

Likewise, the consumer backlash against a-la-carte fees, though not significant enough to prevent those same fees from being major revenue contributors to most airlines' operations, nevertheless indicates a widespread failure on the part of the airline industry to effectively manage consumer expectations in a changed era.

The remnants of the unbundled airfare, a-la-carte fees, and the higher growth potential commission-based services will be central aspects of most airlines operating strategies in 2010 and well beyond.

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In fact, ancillary revenues are the cornerstone of the new airline business model.

The true engine of the ancillary movement is the web-based booking path. As a result, airline websites become increasingly integral to the booking process: 20%-30% of all passengers industry-wide use the internet to book flights

If 2009 demonstrated anything definitive about the airline industry's practices, it was that ancillary revenues have evolved from an innovative solution employed by a small handful of (mainly European) low cost carriers to an industry-wide operational imperative around the globe.

The airlines that execute ancillary revenue strategies best continue to be low cost carriers. (But) legacy carriers are engaging in wide-ranging ancillary revenue strategies as well.

The most obvious shortcoming of an all a-la-carte ancillary revenue strategy is its inherent limits; there is only so far the airfare can be unbundled.

Are airlines prepared to hinge an entire ancillary revenue strategy on unbundled services and a selection of in-cabin offerings that is necessarily restricted based on space and fuel? Probably not in 2010.

Instead, airlines are looking toward commission-based ancillary services, the bulk of which are usually positioned within the online booking path.

The real growth area for ancillary revenue streams are commission-based services most often encountered during the booking process.

The big three - hotel booking, car rental and trip insurance – are already well-known (and accepted), but the potential in this area is limitless.

Private event retailing, online gaming, carbon offset and SMS itineraries are all commission-based ancillary services presented to the passenger in the booking path.

These ancillary offerings require comprehensive systems and software for integration and implementation.

Some of the most successful systems are built on an e-commerce framework, in effect transforming passengers into internet shoppers. Recommendation engines, preference tracking, dynamic packaging, and business rules are all tools to achieve this strategy.

The single most important reason commission-based ancillary revenues are the future of airline revenue development is their sustainability.

With a minimum of overhead, an airline can partner with a reputable service provider, offer their product alongside the airfare, and take a commission on that sale in perpetuity.

The quantity and quality of those partner services or products is limitless, and the incremental revenue earned is making these offerings the ancillary revenues of choice for forward thinking airlines entering 2010.

Sustainable ancillary revenues, particularly commission-based ancillaries… are clearly described and properly priced, to encourage consumer participation, and they are exhibit high potential for cross and up-selling.

Sustainable ancillaries are also easy to fulfill, meaning they are deliverable to the passenger immediately or close to it, and are applicable regardless of destination.

Obviously, a good partnership between the ancillary service provider is critical, as is the potential for the ancillary offering delivery system (the booking path) to be outsourced, further limiting the investment on the part of the airline.

The new airline business model is not about making lumbering legacies look more like LCCs - or vice versa - but rather incorporating new techniques to make a challenged industry viable for the long term.

The new airline business model features a renewed emphasis on the only true revenue generator for airlines: the customer.

The rights of the consumer, particularly in a time of substantial change, are paramount, as is the need for more direct interaction with the consumer.

Facilitated by social media and governed by various passenger bills of rights, this increased interaction is a key aspect of the new airline business model.

Airlines will do well in 2010 to further incorporate more e-commerce tactics into their overall web strategies, primarily the effective tracking and management of customer data and the automatic presentation of additional high-adoption-potential offerings.

This technology is already available; it has only to be accepted by the industry - and 2010 may finally be the year of widespread e-commerce adoption.

All of that makes great sense to us, for now.

Our concern would be that airline websites might not continue to be the first-call conduits that provide their current value and attraction.

It seems quite likely to us that airline sites may be subsumed into more sophisticated and comprehensive marketing sites that offer 'one-stop' shopping at a higher level.

After all, why should the consumer have (or want) to deal with a plethora of airline websites, when a super site would do the job far more effectively?

Nonetheless, the potential for immediate revenue benefits from the suggestions delivered above is highly seductive.

The full text of the industry briefing may be accessed at www.airsavings.net