

Streaming Value

By: Bernie Baldwin

Low-Fare & Regional Airlines, Dec 2011/Jan 2012

ANCILLARY REVENUES

13

Feature

Bernie Baldwin reports on the revenue streams which are so vital to airlines, economic downturn or not.

In tough economic times, the difference between having black or red at the bottom of an airline's annual accounts can be the revenues it has generated through ancillary services. Although budgeting for an exact income might be difficult, it is at least an area over which an airline has some control.

Moreover, airlines are getting good at the job. Earlier this year, Amadeus and IdeaWorks reported the ancillary revenues disclosed by 47 airlines in 2010, then took those statistics and applied them to a list of more than 200 airlines to provide a global projection of ancillary revenue activity for 2011. The conclusion was a worldwide estimate of ancillary revenues of \$32.5 billion, a \$9.9 billion increase, equivalent to 43.8%, over the 2010 figure.

The *Amadeus Worldwide Estimate of Ancillary Revenue for 2011* represents the second year that Amadeus and IdeaWorks have carried out the task of calculating global ancillary revenue activity. IdeaWorks' analysis reveals natural groupings based upon a carrier's ability to generate ancillary revenues. The "percentage of revenue" results associated with four defined categories were applied to a worldwide list of operating revenues disclosed by 203 airlines. The four categories defined by IdeaWorks are:

- ◆ **Ancillary revenue champions** – carriers which generate the highest ancillary revenues as a percentage of operating revenues. The average achieved by this group was 19.8% of operating revenues, which is slightly up from the 19.4% reported for 2010. Included in this category are airlines such as AirAsia, Aer Lingus, easyJet, Ryanair and Spirit Airlines.
- ◆ **Major US airlines** – these carriers generate strong ancillary revenues through a combination of frequent flyer revenues and baggage fees. The average for this group was 11.9%, a notable increase above the 2010 rate of 7.2%. Airlines such as Alaska, American and United are included



Streaming value

here, though it will be interesting to see the effect of American's entry into Chapter 11 bankruptcy protection.

- ◆ **Low-fare airlines** – these carriers typically use a mix of à la carte fees to generate good levels of ancillary revenues. The average in this group was 6.5% and is above last year's 5.4%. The examples of these airlines given by IdeaWorks are AirTran, Blue1, IndiGo, Jazeera Airways, Pegasus Airlines and Spring Airlines.
- ◆ **Traditional airlines** – the survey treats this category as a catch-all for the largest number of carriers. Ancillary revenue activity may consist of fees from unbundled services and limited partner activity in frequent flyer programmes. The average revenues gained here as a percentage of operating revenues remained at 2.9%. These carriers include Air China, Emirates, Finnair, LAN, Qatar Airways and Singapore Airlines.

According to Julia Sattel, VP airline IT with Amadeus, airlines operating outside the US and the global low-fare airline market tend to choose a model that sticks to industry

standards, rather than using a customised approach to the development and deployment of their ancillary services. "Our philosophy is to balance the productivity and efficiency that industry standards bring with the desire for some airlines to customise the way in which their product is packaged and sold," states Sattel. "Whatever the model, there is no doubt that the growth of ancillary sales is here to stay."

■ PASSENGER CHOICE

Overall, says IdeaWorks, "savvy airline managers have learned ancillary revenues should not rely upon forced choices, but rather allow consumers to tailor travel according to their budget. Consumers who are treated fairly and receive good value will undoubtedly provide airlines with another good year of ancillary revenue growth for 2012."

So in which areas are the ancillary revenues increasing? Well, much comes from revenues accrued from the unbundling of services, but there are also initiatives which gain ancillary revenues by offering →



Amadeus Worldwide Estimate of Ancillary Revenue

Airline Category	2011 Ancillary Revenue	2010 Ancillary Revenue	Increase for 2011
US Major Airlines	\$12.5 billion	\$6.7 billion	87%
Low-cost Carriers	\$4.8 billion	\$3.6 billion	33%
Traditional Airlines	\$10.9 billion	\$8.5 billion	28%
Ancillary Revenue Champs	\$4.3 billion	\$3.8 billion	13%
Worldwide Totals	\$32.5 billion	\$22.6 billion	43.8%

Source: Ancillary revenue statistics applied by IATA/IATA to individual airline revenue results listed in the Worldwide Airline Report in the July 2011 issue of Air Transport World.

something above and beyond what might have been in a "bundled" fare.

"The most impressive initiatives we have seen are, first, a much broader set of products and services and, second, dynamic pricing and the bundling of ancillaries," reports Ormagh Hoban, VP strategy and marketing at Datalex. "Incremental revenues contributed by ancillary revenues are still a small percentage of the total top line and largely derived from flight-driven ancillaries such as baggage fees and loyalty. Airlines are taking the opportunity to sell a much broader range of products and services before, during and after the flight – for example, onboard meals, entertainment, Wi-Fi, ground transportation, hotels, car rental, insurance and other activities.

"Dynamic fare family bundling," she explains, "is the process whereby the airline can configure pricing of ancillary items in a bundle and position this as a fare family for a customer segment or market. Prices can be added to the air fare and shown as an opaque unit or in detail by fare family benefit."

Raphael Bejar, CEO of Airsavings, has his own theories on where increased ancillary revenues are coming from. "I would classify the success of an ancillary revenue product or service in two ways: firstly, how much money it generates and, secondly, how the passenger perceives and adopts such a product or service.

"In the area of unbundling, I can identify only one that is able to satisfy both those 'success points', and that is seat selection. Before the explosion of ancillary revenues, seat selection – or, at least, the charge for making a selection – was not offered by any airline. A passenger had the right to select his or her seat

at check-in or over the phone several days prior to departure.

"By unbundling this service and making it available online for a fee at the time of booking, which could be days, weeks or even months before a flight, airlines have been able to identify a very sweet income spot – and one that has not caused ire amongst passengers as, say, baggage fees have. Once a passenger has paid for seat selection, the chances of repeating the purchase on future flights is very high. As the fee generated did not involve any labour or physical cost to the airline, it is a pure profit item."

PERCEIVED VALUE

"In fact, seat selection was one of the most rewarding ancillary incomes generated by airlines last year, along with baggage fees – which made up as much as 20% of the total ancillary revenues for major US airlines in 2010. Unlike baggage fees, however, seat selection has a highly positive perceived value among passengers," claims Bejar.

The big three ancillary streams are insurance, hotels and rental cars, and airlines are always looking for the right initiative to create the next big ancillary product.

"As we've seen with the overall acceptance of the seat selection fee, perceived value is one of the key drivers needed for passengers to adopt a service or product – with a willingness to pay for it," Bejar continues.

"With this in mind, I see the next major, and successful, ancillary stream being one that has a perceived value to the passenger. An example is concierge services. The possibility of having a personal travel assistant or a concierge who is able to assist with every travel

need or emergency has a very high perceived value for travellers. What's also interesting about this service is that it has multiple price points: the leisure traveller, the business traveller and the luxury traveller are all willing to pay for this service but at different levels according to their perceived value.

"Up until very recently, this service was available only to a select few and in a high-end category," he continues. "What we are seeing now, however, is the trend of democratising the concierge service in both Europe and United States. It spreads the cost among travellers very much like insurance services do. For the convenience offered, as well as an attractive price, there is a high perceived value for what the concierge service can bring, so I believe this will be the next successful ancillary revenue offering."

For Datalex's Hoban, the next big thing is advances in merchandising practices to capture more share of the travel wallet. "The airline has only reached the tip of the iceberg. In an always connected world, the possible consumer touchpoints to access that share of the ancillary wallet have increased exponentially; for example, across Wi-Fi, in flight, or via social networks and loyalty programmes. The next big thing will be more effective merchandising of a much broader set of products, prices, promotions and rewards."

While ancillary revenues are obviously good for carriers in the US, many people describe the process of paying per service as 'nickel-and-diming' and see it as the airlines simply squeezing more money from them. Some carriers, though, do "upselling" well, particularly online, with other airlines able learn from them.

"In my opinion, there are a number of airlines in the US that are head and shoulders above the pack: namely JetBlue, Virgin America, Allegiant, Spirit and Frontier – all of whom, I believe, are doing a very good job at marketing new fee-based offerings in a positive way and endearing customers, instead of alienating them," declares Bejar. "And while these airlines tend to be successful in launching new products and upselling to their passengers, many of the legacy airlines are trailing far



behind because they lack the workforce flexibility to realise that the successful operators are becoming e-commerce companies, willing to invest in innovation and take some risks.

"I also have to say that non-industry media in the US have consistently battered the airline industry over fees. I can't understand why airlines aren't allowed to be profitable or why they are chastised for attempting to generate revenues, when other industries are widely encouraged to do so," he adds.

In upselling, Hoban admits that Datalex's customers impress the company the most. "We love the Frontier Airlines 'AirFairs' fare families, where travellers can choose from three levels to fit their budget and travel needs. Their continued focus on optimal price differential and real value are exemplary. Also, Aer Lingus

continues to roll out effective new ancillary offerings, such as car parking and onboard meals," Hoban remarks.

IT TOOLS

When it comes to IT which enhances ancillary revenue generation and who is using it well, Hoban holds her hands up again. "We're biased, of course, but have basis," she claims. "Our TDP Merchandising Platform is recognised as one of the most versatile and comprehensive solutions in the market. Customers using TDP are among the carriers generating the highest ancillary revenues as a percentage of operating revenues."

Bejar also has "a bit of a plug" as he comments, "We have developed a module which we are implementing at several airlines

over the coming months and which can be deployed for any type of commission-based ancillary revenue. This is by far the most flexible and quick-to-implement module that I have seen, not because we have developed it, but because other IT suppliers are implementing the same services with a lead time of anywhere from six to twelve months, instead of four weeks. We believe that speed to market is absolutely critical.

"Despite all the talk, I believe that ancillary revenues are still very much in their infancy. Once airlines have understood that they have to consider themselves e-commerce companies, and act as such, then we will jump to the next level. As long as you bring value and quality of service to the clients, there are no limits," Bejar concludes. ■

