

ANCILLARY REVENUES

Accruing ancillary revenues doesn't just involve choosing what to unbundle or offer beyond the regular product, it also means making it available in all the sales channels, as Henry Canaday reports.

Getting serious about ancillaries

Legacy airlines invented fare classes, which were adopted and dramatically modified by low-fare airlines (LFAs). Now LFAs have pioneered in ancillary sales, which have been quickly adopted by majors.

Measured by share of revenue, eight of the top ten ancillary leaders are LFAs, with Allegiant, Ryanair and Spirit making 20-30% of sales through ancillaries. But the top three US majors are now capturing \$1-2 billion annually in total ancillary revenues.

More ancillary revenues and much more change are coming, as all carriers are getting much more serious and sophisticated in their efforts to realise these potential gains.

The largest portion of ancillary sales is still represented by the unbundling of flight-related services, especially baggage fees. Here the object is to maximise revenue from those willing to pay more, while maximising load factors by offering lean service to the cost-conscious. These dual aims are basically like those of fare setting and seat allocation, and will thus call for the same sort of sophisticated revenue management tools.

Airlines also want to tap the potential of commissions on non-flight sales, such as hotels, cars and insurance, of course, plus an expanding variety of trip-related products. Here the aim is to find – or invent – the best products, sell them economically and select the best offers, customised by channel, timing and even individual passengers.

Channel choice is critical. LFAs were first-movers partly because they sell all or most of their tickets directly, so they could experiment easily with ancillaries. But the global distribution system (GDS) channel is opening up, allowing ancillaries to be sold more broadly and often to



the business travellers who will pay the most for special privileges.

The ancillary revolution will thus affect all aspects of airline sales, including reservation systems, revenue management and accounting, and relationships with GDSs and online travel agents (OTAs), as well as business travel agencies. The choices are very complicated, but also very much worth getting serious about.

■ VARYING VALUE

As a provider of both reservation and distribution solutions, Sabre thinks about how all airline products are bought and sold. "Distribution of ancillaries is complicated," says product marketing VP Kyle Moore. "But ancillary reservation is much more complicated." On the reservation side, airlines must find the best ways to price ancillaries, manage inventory and revenue, do the accounting,

choose the best channels, and ensure ancillary commitments are fulfilled.

Moore believes experiments with ancillaries will continue indefinitely. He expects airlines to segment customers more, recognising ancillary value differs by circumstances. "For example, you could charge \$25 per checked bag at the airport, but \$20 if you do it online." As with fares, ancillary values differ by time, channel or customer segment. To simplify choices a bit, Moore predicts more bundling of ancillaries into fare families that differ for high- versus low-yield traffic.

Sophisticated revenue management will play an increasing role, tailoring offers, bundles and prices to specific customer segments. "As with trips, the value is not the same from Chicago to Grand Rapids as it is from Chicago to Maui," Moore notes. Sabre is enhancing its reservation system to manage these choices optimally. →



ANCILLARY REVENUES

Business travellers must also be considered. Corporations will want discounts on ancillaries, like they get on fares – for example, 10% off seat-selection fees. Airlines do this crudely now, by changing passengers to elite status. New systems will need to recognise each traveller by specific company and adjust the offer for the right negotiated discount. Sabre is introducing Air Total Pricing to do just this. “We will charge you for checked bags according to your company’s specific deal. We are on the cusp of this.”

Opinions differ on the importance of non-flight ancillaries, whose value depends on potential volumes and profit margins. Moore believes airlines should offer these options, even if most customers still shop on different sites for cars and hotels.

True revenue management of all ancillaries will mean altering prices by stage length, segment and availability, just as for fares. “I think we will see that in the next two to three years, and it will become very sophisticated in five to ten years,” he predicts.

BRAND CONSTRAINTS

Moore also urges airlines to consider channels carefully in selling ancillaries and to recognise the importance of their brands. “If your brand is full service, you cannot do as much,” he acknowledges. “If your brand is that you unbundle everything, you have more freedom, but there will still be customer resistance to some things.”

He recommends that airlines stick to industry standards for ancillaries, including the Airline Tariff Publishing Company’s (ATPCO’s) 100-plus Electronic Miscellaneous Document (EMD) codes, rather than seek one-off solutions. “Use architecture that can handle many changes for many customers, it will cost less in the long run.”

Architecture choices will become increasingly critical. To date, the primary ancillary – more than a third of revenue in the US – is still charging for checked bags. “It’s easy to charge at the airport,” notes Bob Offutt, senior technology analyst at PhoCusWright. “And there is no pre-sale order or delivery to track.”

Airline ancillary revenue as a percentage of total revenue

Top 10 airlines in 2009			Top 10 airlines in 2008		
Rank	Carrier	% of total revenue	Rank	Carrier	% of total revenue
1	Allegiant	29.2%	1	Allegiant	22.7%
2	Spirit	23.9%	2	Ryanair	19.3%
3	Ryanair	22.2%	3	easyJet	15.5%
4	easyJet	19.4%	4	Jet2.com	14.8%
5	Tiger Airways	19.4%	5	Vueling	14.1%
6	Jet2.com	18.1%	6	Germanwings	13.0%
7	Aer Lingus	14.4%	7	Aer Lingus	11.0%
8	Alaska Airlines	13.3%	8	JetBlue	10.3%
9	Flybe	13.2%	9	Flybe	9.8%
10	AirAsia	13.1%	10	Sky Europe	9.6%

Exchange rate applied to 2009 data: 1 euro = 1.23 dollars

Exchange rate applied to 2008 data: 1 euro = 1.33 dollars

Source: IdealWorks/Amadeus

Non-flight ancillaries pose tougher challenges. Commissions on non-flight ancillaries do not account for much revenue yet, but Offutt argues that airlines will try to capture more of this business from OTAs. At the same time, carriers often license OTA technology and fulfilment to sell hotels, cars and cruises on their own websites. “It’s a cheap way to pick up a little change,” he remarks.

Ultimately, airlines can sell anything related to air travel. Wireless connections to mobile devices will expand opportunities before flight time. “When you buy your ticket three months out, you are not thinking of it all,” Offutt notes. “But wireless allows continued marketing. Passengers think of the airline as a one-stop shop, and airlines can message passengers up to boarding.” He also expects access to onboard wireless itself to be a big ancillary seller.

LFAs have the greatest flexibility in ancillary experimentation because they chiefly sell direct. Offutt thinks it will be “many years” before regional carriers can sell ancillaries through codeshare agreements because supporting mechanisms are lagging.

The big change in 2010 is GDS distribution of ancillaries. “Sabre is doing it now, Amadeus is there, and Travelport is a little behind,” Offutt says. “By year end, all will do it.” GDSs are incurring costs, without airline compensation, for selling ancillaries. “They are doing it to sustain share,” he argues.

But there are other hurdles. Businesses that use third-party booking tools cannot handle ancillary sales well yet. “There is a huge challenge in expense reporting, they cannot track ancillaries.” Offutt also worries that GDS sales of ancillaries in the US will be stifled if Congress mandates easy comparison of fares. European codes of conduct could also affect the GDS market.

But overall, Offutt believes airlines will continue to expand ancillary sales. “Once you take them to Paris, they will not go back to the farm. Ancillary money is their profit.”

There are plenty of firms eager to help airlines profit from ancillaries, especially on direct channels. Datalex’s merchandising platform processes millions of ancillary sales for carriers such as Aer Lingus, Frontier and United Airlines. The platform was recently selected by a major Asian airline to enable transactions both online and through call centres.

SETTING STANDARDS

Datalex is moving to a new version that optimises offers for each channel, according to marketing VP Ornagh Hoban. “We enable merchandising across multiple channels: online, call centres and mobile devices.” The new solution works with iPhones and iPads.

Direct sales will also require standards, possibly more flexible than GDSs can handle. Datalex is working with an open access group to develop ancillary distribution standards that will include, but not be limited to, ATPCO’s EMD codes.

Bob Offutt of PhoCusWright expects access to onboard wireless to be a big ancillary seller.

Wi-Fi



Airline ancillary revenue per passenger

Top 10 airlines in 2009			Top 10 airlines in 2008		
Rank	Carrier	\$ per passenger	Rank	Carrier	\$ per passenger
1	Allegiant	30.61	1	Allegiant	26.60
2	Jet2.com	27.69	2	United	22.80
3	Spirit	27.50	3	Aer Lingus	19.91
4	Qantas	25.05	4	American	19.62
5	United	23.07	5	Jet2.com	18.99
6	Air Canada	21.19	6	JetBlue	15.93
7	Aer Lingus	20.57	7	Qantas	15.79
8	Alaska Airlines	20.26	8	Ryanair	14.42
9	American	17.75	9	Delta	14.11
10	easyJet	16.57	10	Vueling	14.03

Exchange rate applied to 2009 data: 1 euro = 1.23 dollars

Exchange rate applied to 2008 data: 1 euro = 1.33 dollars

Source: IdeaWorks/Amadeus

ANCILLARY REVENUES

Hoban predicts airlines will sell more products through direct channels in coming years. "There will also be an expansion in commissionable, non-flight ancillaries, such as hotels, cars and insurance. Airlines have powerful retail brands and will become increasingly adept at optimising the retail experience for consumers." She expects onboard sales and ground transportation ancillaries to increase.

Other providers are extending ancillaries to multiple direct channels. Frontier Airlines recently went live with GuestLogix's onboard store solution, bringing the total number of airlines using the solution to about 40, which together carry nearly 40% of world traffic. "We have all the US majors, many in Europe and are starting to get a foot in Asia-Pacific," summarises GuestLogix co-founder Brett Proud. Ryanair has been using the service for years, and Southwest Airlines went live in 2008. "We are going after the low-cost folks like Jetstar and also regionals," Proud adds.

GuestLogix still sells mostly food, beverages and duty-free goods on board, but it is also seeing increasing sales of ground

transportation, having worked out deals with transportation providers at over 400 airports. More change is coming. "We work with the airline website pre-order platform so you can buy a movie and meal before boarding," Proud explains. "The meal is delivered on board, and we provide a token so you can enter a code on the screen and see the movie."

The company started out selling ancillaries on board through special devices. Proud calls this the 1.0 version. Now, in version 2.0, it is moving to sell at all touchpoints, including in lounges, at gates and on mobile devices.

Proud is bullish about the market potential for these sales, which go well beyond traditional airline service. A survey of passengers has estimated that more than half are willing to buy food, beverages, ground transportation or other destination-related products and services.

SHARED REVENUE

GuestLogix integrates its solution with ancillary providers, saving the airline the cost of individual integration. Providers receive the bulk of the revenue, with the rest split between GuestLogix, the airline and the flight attendant, if the attendant is involved in the sale, as happens with GuestLogix 1.0 on board. The company has negotiated some degree of exclusivity with most of its ancillary providers.

Proud believes the "sweet spot" for ancillaries consists of items that not only make money but enhance the customer experience, such as tickets on the Heathrow Express that GuestLogix can print out for arriving passengers.

Proud sees the future as greatly expanding both access to ancillaries and the breadth of products offered. "People know us through those handheld devices on board, but we will be able to sell through kiosks and all personal devices, like the iPhone. And there is a huge

market opportunity for selling products on board and then fulfilling them later. We can sell much more than SkyMall."

Seven airlines use Airsavings' AirlinePlus platform to sell ancillaries during booking, and another eight use the firm's group buying power for non-flight ancillaries. Group buying keeps costs low, so when sales are made, there is more profit for the airlines.

ORIGINAL OFFERS

Airsavings aims to be innovative in the ancillaries it secures. It has just launched, in partnership with Czech carrier SmartWings, two new products designed especially for LFAs. The first is called MeteoBonus, and it insures vacationers against rain and lack of sunshine during their holiday. The insurance can be sold in the regular booking path, reaps commissions for the airline and helps build customer loyalty with distinctive attention to passenger needs.

Next up is WiFiBonus, which was due for launch in September. This combines regular travel insurance with 30 minutes of free Wi-Fi access, usable at hotspots in airports, hotels and other locations for the duration of the trip. The wireless access is available at 470 airports around the world.

Where is all of this going? Jay Sorenson of the consultancy IdeaWorks still thinks the big ancillary growth will be in baggage. "Fees will spread worldwide and existing prices will be tested for increases," Sorenson predicts. He also sees growth in pre-ordered food. "It allows carriers to offer a better product and reduces the cost of unsold meals." Even international airlines like KLM are experimenting with upgraded meal options to replace free food in coach.

Sorenson thinks carriers will eventually package ancillaries as subscriptions, with an annual fee paying for a year of selected service, such as checked bags. He says the key to maximising profits will be switching from fixed ancillary fees to variable pricing based on demand. Continental is already doing variable pricing for extra leg room. But prices must be continuously tested for this approach to work. ■



THALES

