

Spending on high

Ancillary revenues have gone far beyond adding a few dollars onto the bill for a bag. Airlines now see themselves as true retailers operating from virtual mega supermarkets, discovers **Alexandra Lennane**
July, 2011

Well, it's the end of an era. The end of the airline business as we know it. And no, I am not talking about bankruptcies from economic slumps, volcanic ash, poor regulatory environments or emissions trading schemes. No, for once, it's (possibly) positive news. Airlines are moving away from the commoditisation of their products. It's no longer just about bums on seats. Airlines are the new retailers. Move aside, Amazon. There are new kids in town.

Ancillary revenues have moved on considerably since the first days of low-cost carriers, and they have now become a major revenue stream for carriers across the board, netting the industry €15.11 billion (\$21.77 billion) in 2010. United Continental is now the leader in the field, while Allegiant tops the low cost list, making 29.2% of its revenues from ancillary products, according to the latest survey by IdeaWorks.

"A lot of airlines have focused on stacking shelves with ancillaries," explains Ornagh Hoban, vice president of marketing and strategy at Datalex. "We are now at the next stage, where airlines are looking at effectively merchandising these products. This could affect the way they run their businesses." She points out that airlines are still struggling with very low profit margins. "Supplier merchandising will transform the travel distribution market," she predicts. "The product became commoditised, but airlines are now looking to decommoditise it, to leverage the brand and create real value throughout the whole customer experience."

The lexicon has even changed, reflecting a new attitude among carriers. "They no longer talk about the 'passenger' but the 'traveller'. It's no longer a 'flight', but a 'customer journey'. Even the traditional lexicon of distribution is becoming more about retail merchandising," says Hoban.

Raphael Bejar, CEO of Airsavings, agrees that if the airlines want to achieve growth, moving from the traditional seat-only model is the best way forward. "Whichever way you look at it, on one side you have increased fuel costs, and on the other you have reached the ceiling in *à la carte* fees. The next step is going to be increasing these charges, as easyJet has done with its credit card fees. But passenger acceptance of that might not be very high.

So the next thing has to be a series of services where the increased value for the passenger will be tangible." AirBaltic has been a strong proponent of this strategy. In the past year it has launched Baltic Bikes, Baltic Water and Baltic Taxis, as well as hotel bookings and mobile phone cards.

"These products add a lot to our visibility and expand the brand while retaining value," says Janis Vanigs, vice president of corporate communication. "It's a way to generate more money, and add revenue streams which reinforce our business model. The additional revenue helps keep fares lower." Low-cost carriers have always insisted on the adage "keep it simple". But as they expand into the whole travel market, doesn't that complicate what should be a simple philosophy of selling seats?

"If you take an isolated view of what we do – insurance, sunglasses, bags and so on, it could look confused," explains Vanigs. "But there's another view, of the airline as a mega travel store. People come to the website to buy, but then add a hotel, concert, bicycle tour to the package. They can pick up their sunglasses on the plane, as you would in a shop. The flight ticket is just the entrance to the megastore – and the cheaper the ticket is, the easier it is for them to come in and the more they can buy."

Datalex's Hoban agrees, suggesting that far from being a distraction, it is a business imperative – and one that will strengthen the brand. "It's a lucrative revenue opportunity. There are still a lot of untapped opportunities to grow revenues across all the channels. And if we can untap it, we're only at the beginning of the growth curve," she says.



Bejar also says it's not adding complexity.

"The pilots, mechanics and crew are all still there. Their job is to make the aircraft fly. But on the other side, because of the very thin margins, the more money that comes in the better. The purpose is to increase the amount of money coming in to pay for all those operations."

Hoban believes that hybrid carriers will be the first to benefit. "Hybrids have an advantage. Loyalty programmes represent a significant opportunity for incremental ancillary revenues, and there is definitely a shift back to customer engagement and brand alignment. It's true the customer proposition needs to be carefully managed, but as airlines position themselves as more efficient retailers, they will drive new demand and brand value."

With average ticket purchases made about 30 days before departure, the airlines are given a huge opportunity to engage with their customers before and during the flight. However, Bejar says that some carriers are still resisting the change, namely the larger legacies. "If they could stop using ancillary revenues, they would. The big airlines get them from seat selection, check-in and à la carte fees that were included. It's fine. It's one way of making ancillaries. But the discussion now is how far an airline can transform itself to a more open business model. It's just a question of creativity, but much of it is restricted by the original business model."



Airlines will be able to add services such as restaurant bookings, concert tickets and sports events to their list of products *photo: Genius365.com*

He points to the fact that if airlines are getting 60% of their revenues through the internet, they are an e-commerce business. "And then you can push the customer any other products – the classic ones are hotels, cars, insurance, but they are not transferring in the way they should do. But you can also sell tickets, events and sports tournaments – these are the type of services that can be added."

If airlines agree that this is simple revenue generation, which doesn't take focus off the business of operating aircraft, then according to merchandising experts, there is no limit to what they can do. And other industries can provide the example. "Petrol stations were one of the first industries to embrace ancillary revenues," explains Bejar. "They now make more money from that than they do from fuel. The value to the customer is very clear – petrol stations are open, they are

convenient but it's a higher price. Or look at the casino business in the US. The core business is gambling, but customers get drinks, wifi access, hotel rooms. And the hotel industry has done it too. The price for a drink from the mini-bar is very high, as is internet access. But you have the freedom to take it or not. It's the same with the spas at hotels – they are simply driving more revenues from their facilities. "I don't believe there are any limits," Bejar continues. "There's testing and retesting – and making mistakes. You need to have the courage to see what works. You can't tell an airline they are just about selling seats. There's a full economy around them."

Amazon is one retailer that the ancillary industry much admires, and one, says Bejar, that has made mistakes – when it tried selling fresh food. "It quickly realised it was wrong," he says.

"Lots of industries have looked at the Amazon model," agrees Hoban. "They know how to truly merchandise, recognise a customer's intent and persona and tailor their offering. Airlines are evolving their retail discipline by looking to learn from other verticals," she says. "We are very focused on 'active listening' to the traveller – someone who is a high-value business passenger one day may be a high-value leisure traveller the next. You need to know both personas and treat them accordingly. That's what we are most excited about, giving a consistent and seamless customer experience across channels. Airlines are realising they already know a lot about the customer intent, history and value, and need to use it to inspire, optimise and personalise the retail experience."



She explains that less than a decade ago, airlines were investing in customer revenue management systems for a small passenger base. However, they have learnt far more by selling multiple products and services. The key is the airline being its own distributor. Thalys, the French train company, has a whole different take on the issue – but one which stems from its inability to sell its own tickets. “We don’t use added services so much to increase revenues, but to add value for the customer,” admits Beatrice Paques, chief commercial officer. “We are trying to increase customer satisfaction because we have different selling processes, which are done by national railways. The strategy is customer retention through complementary revenues. We are not a distribution company, so it’s just another way to present an advantage. It makes us more creative. The customer has one price and if he wants he can add seamless travel. It’s integrated, but we don’t get big additional revenues.”

The airlines are wrestling back control of their distribution, arguing that they now want more control over how they retail their own products, with the US Department of Justice (DoJ) investigating the processes in a case triggered by American Airlines’ attempt to change its distribution model. Others are still resisting change, and one of the arguments put forward is the potential cost of turning from seat seller to supermarket.

Datalex, perhaps unsurprisingly, argues that cost shouldn’t be an issue. “It’s not about having to invest in complex systems,” insists Hoban. “We don’t see it as cost prohibitive, and costs are increasingly tied to a revenue promise. We share in the risk and the reward.” But, she adds, it is possible that some carriers could overspend, pointing out that it doesn’t have to be expensive.



In the first days of air travel, it was all about the glamour of flight. The hostesses, the luxury treatment, the ability to access exotic locations. The low-cost carriers quickly put paid to that idea, allowing everyone to travel for the price of a bus fare. And what now? Does the travel supermarket make the process of travel even more mundane, duller still? No, insists Hoban: “The pendulum is just swinging back. Airlines never sold just seats. They sold an experience and a brand. The pendulum is just moving back to a more refined customer engagement with more products and services.”

Adding taxi bookings has become a popular product *photo: Genius365.com*

