



Ancillary Revenue Generation: Here and Now October 2008

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Ancillary revenue generation for airlines seems simple enough a concept. After all, hotels, retailers and other industries routinely generate substantial percentages of revenue from outside of their core product offerings; why couldn't airlines, with one of the more perishable core products in the market, also develop those auxiliary streams?

Low cost carriers were pioneers in the area of ancillary revenue generation, taking advantage of this key aspect of the airline business model years before their legacy counterparts began to. LCCs were often more innovative when it came to implementing ancillary revenue generation initiatives as well, creating opportunities for additional sales instead of charging for existing services or increasing existing fees (though, of course, that was done as well).

But now that legacies have embraced the ancillary revenue phenomenon wholeheartedly, how can LCCs maintain their competitive edge in this arena? If legacies have usurped the ancillary advantage once possessed by LCCs, how will they then differentiate themselves in a newly crowded field?

Low cost carriers can achieve this by focusing on three areas of ancillary revenue development where they are best positioned to compete with legacy carriers;

First, LCCs must continue to evolve toward an ecommerce model at a faster rate than their legacy competitors.

Second, LCCs must continue to leverage the flexibility of their business model to remain at the forefront of ancillary revenue innovation, and continue to lead the industry toward new products and services.

And last, but perhaps most importantly, LCCs can make the next great leap forward in ancillary revenue generation by reimagining one of the more successful legacy-initiated concepts of the last three decades: the loyalty program.

By excelling in these three areas - ecommerce, innovation, and loyalty - LCCs can beat back the legacy intrusion into the ancillary revenue arena and maintain their competitive edge.

Leading Edge Again

LCCs as a group were early to recognize the power of the internet to facilitate ancillary revenue generation. Just look at LCC pioneer Ryanair as it included the two most popular ancillary offerings - hotel booking and car hire- when it first launched its website in 2000¹. Other low cost airlines soon followed suit. Almost a decade on, the role of the individual airline website has increased exponentially for LCCs, becoming the engine of ancillary revenue growth and the launching pad for nearly every new initiative implemented by LCCs. As (increasingly) the only portal through which the customer has contact with an airline before actually boarding the airplane, the typical LCC website must focus on both meeting passengers' expectations and extracting as much revenue from that encounter as possible. Fortunately, these are not mutually exclusive concepts, as the success of enterprises like Amazon.com demonstrates. LCCs will do well to incorporate some basic ecommerce 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 just needs to be taken up by the industry. And if the LCC sector can beat the legacies to the ecommerce model, it can and will maintain its ancillary revenue edge.



The Ancillary Revenue Generation: A New Era

If it seems like legacy airlines have stumbled into the ancillary era, it's probably because they have. While it makes logical sense in a time of record fuel prices to effectively tax excess flight weight, thereby encouraging less fuel usage while simultaneously generating revenue (i.e., the checked baggage fees now imposed by many legacy lines), consumer and media backlash was strong against it. American Airlines began offering passengers the ability to choose their own seats, only to turn around a couple of years later and charge them for the privilege. While both of these examples had been implemented by LCCs long before the legacies adopted them (Spirit Airlines began charging a fee for the first checked bag in 2007², nearly a year before American³ become the first legacy to do so), the LCCs experienced far less consumer anger. In part, this is because many LCCs had the advantage of starting without frills, whereas legacies had to fight a heritage of bundled luxuries. And LCCs, with mostly point-to-point and regional service and operating models that preclude large advertising and marketing budgets, are often farther outside the public eye than their legacy counterparts.

But LCCs have also consistently been more innovative with their ancillary offerings, a trend that makes their 'no-frills' baseline a lot more palatable to consumers. With this, LCCs have created the perception of a customizable flight experience, rather than a slow degradation of a familiarly-packaged item. The myriad and inventive booking path options (including single-use lounge passes, online gaming, carbon offsets, and seat spacing upgrades) have facilitated this perception, as have new in-cabin options coming online (like in-flight internet service Gogo, which is already in use by American and coming soon to Virgin America). LCCs need to maintain their edge in new product innovation if they are to compete with the majors for ancillary revenue market share.

A New Take on a Tried-n-Tested Concept

Perhaps the newest take on an old standby is the substantial revamping of tired frequent flier programs. Probably the first 'ancillary' revenue, frequent flier programs began in 1981 with American's AAdvantage and United's Mileage Plus, and have been bright spots for legacy operations ever since. However, issues with mile redemption and perceived value have dogged the lucrative assets in recent years.

Loyalty initiatives, particularly frequent flier programs, should be linked to ancillary services, either by promotion or by direct sale. This allows for the effective retention of ancillary-purchasing customers to the booking platform. It also serves as an outlet for miles, points or other promotionals that have fallen on disfavor due to lack of redeemability. In fact, frequent flier programs are ideal ancillary opportunities, provided they are framed effectively to participants.

66% of airlines believe frequent flier programs generate significant ancillary revenue, with 65% of that revenue, on average, being derived from the sale of loyalty units (miles, etc.) to 3rd party credit cards.

If LCCs can capitalize on this burgeoning phenomenon, they can lay claim to the first (and last) authentic legacy-initiated ancillary.

With these three strategies firmly in mind, LCCs can continue to compete effectively in a difficult operating environment. Already in a good position from an expense standpoint (low cost, after all, being their defining characteristic), the sector's continued leadership in the area of ancillary revenue generation should help LCCs to thrive, even perhaps grab some market share from the lumbering legacies.

¹ <http://www.ryanair.com/site/EN/about.php?page=About&culture=GB&pos=HEAD>

² <http://travel.latimes.com/articles/la-trw-spirit19jun18>

³ <http://www.nytimes.com/2008/05/22/business/22air.html?ex=1369368000&en=418084a719dc1cd6&ei=5124&partner=permalink&expprod=permalink>

⁴ <http://communication.howstuffworks.com/ff-programs.htm>

