

## Ancillary Revenue Generation: The New Operational Imperative for Airlines

By Raphael Bejar, CEO of Airsavings

When it comes to evaluating emerging markets from an air travel perspective, one of the leading indicators in recent years has been the percentage of saturation by low cost carriers. Assessed this way, the Southeast Asian region has no rival. With 27% growth in arrivals in 2004, followed by more than 8% growth in 2005 (that percentage in spite of that winter's tsunami and subsequent international travel bans), coupled with commensurate GDP growth (8.4% in 2007, projected 8% in '08), 'emerging' seems too modest an adjective for the travel market in this part of the world.

Low cost carriers have captured more than 12% of this market, and the results are palpable. Since 2004, when Singapore's airport hosted no LCCs, 24 budget airlines have begun serving the Malay country. AirAsia alone served 8 million passengers in 2005 and by 2006, 67 South Asian cities were served by low cost carriers. This trend follows the global proliferation of LCCs, which have enjoyed marked success - in Europe particularly, but also in the Americas and, to an extent, in Africa.

LCCs overtook the lumbering operational model held over from the golden age of air travel - full service lines emulating the amenities of postindustrial ocean voyages- with cost efficient aircraft and stripped-down services. Some lamented the loss of expected services, but customers flocked to fledgling lines like Ryanair and easyJet. Given unprecedented ability to seek and find discounts through the internet, consumers were drawn to regional flights offered for less than \$100 in some cases, gladly enduring smaller jets and meal-less flights for the chance to save money. Gone forever, it seemed, were leg room, complimentary cocktails, well-appointed airport lounges and in-flight entertainment.

Of course, the old model was untenable; air travel ceased to be a luxury undertaking when it ceased being a novelty. Once the regulatory barriers were removed, particularly in the US, the notion of maintaining a fleet safely and efficiently while bringing a realistically priced product to market, virtually necessitated the reduction of bundled services. The advent of low cost carriers, which by no coincidence coincided with the rise of internet bookings, simply gave customers exactly what they wanted: fast, safe conduct at the lowest possible price. This has, for the most part, worked extremely well, as is evidenced by LCC dominance in Europe and increasingly in Southeast Asia.

But the low cost model is not without its challenges. The big expenses associated with all airlines are still realized by LCCs; the incredible infrastructural burden of having to furnish multi-million dollar aircraft, high and increasing skilled labor cost, and of course, skyrocketing fuel costs. Combined with a customer base groomed to eschew loyalty and dive for bargain-basement offerings, and running even an LCC becomes a dicey proposition. Two key aspects of an airline's operational model must be addressed for any semblance of success to be achieved: effective purchasing and ancillary revenue development. Fortunately, these are within reach.

### Group Buying

For a market like Asia, which has enjoyed significant growth in LCC presence in the past eight years, carving out a competitive advantage is imperative. Struggling against legacy carriers with international purchasing departments and economies of scale will invariably lead to unfavorable operating margins. Similarly, competing with another LCC that engages in group buying practices or contracts a group buying services firm to create purchasing alliances will likewise lead to insolvency. The solution, then, on the expense side of the ledger, is to devise a strategy that incorporates some sort of collective purchasing. Other industries, notably the lodging industry, have practiced this for years, lowering their supply costs in like markets to facilitate competitive advantage. For airlines, our company, Airsavings, is the industry leader for providing group buying services among low cost and mid-sized carriers.

### Ancillary Services Development

From the unbundled package arises revenue opportunity. For a low cost carrier selling only a seat, anything else that can be offered becomes a point of sale. Those vestiges of the golden age of air travel? Still available, but for the right price. Even the internet, often cited as the engine behind low-price seeking, loyalty-less clientele, offers new and exciting ways to create ancillary sales. In fact, most ancillary sales are increasingly made during the online booking process.



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The process of developing an ancillary revenue development strategy is threefold. First, the slate of offerings must be expanded. A good service portfolio will include the three internet-driven pillars of hotel booking, car rental and trip insurance, along with other non-flight related services like airport lounge privileges and SMS flight change notification. It should also include further unbundled flight services, like baggage check and in-flight meals. The extent of a service portfolio is limited only by imagination and market pressures. The big three are almost imperative, as they are services the general public has come to expect from popular online booking agents like Orbitz and Travelocity. Without these incorporated into an airline booking engine, it is nearly impossible to capture a customer with the more esoteric ancillaries. That said, one-day lounge passes and gourmet meal availability are exciting high-retail items that evoke the luxury feel and have potential in the budget vacation market.

With an extensive line of services offered, the focus shifts on selling as many as possible. Increasing the volume of ancillary sales is the second stage of an effective strategy. To maximize volume, it is imperative to integrate all of the service options into the booking process. Relying on a point-of-contact sale is predicated by the presence of a sales-motivated staff, something most airlines do not have in their cabins or at their check-in desks. In fact, with labor costs increasing worldwide, hiring and training additional salespeople is a luxury the typical LCC can ill-afford. This is particularly true if the booking process is attractive and efficient enough to generate an ancillary sale on its own, as the success of independent online bookers has proven. Cross-selling of ancillary services is also key; some services go hand-in-hand, like hotels and rental cars, and so passengers engaging in the reservation process for one should be prompted automatically to the other.

Loyalty initiatives, including lucrative 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.

The third major factor in instituting a good ancillary revenue strategy is to secure favorable margins for the proffered ancillary services. Some ancillaries are inherently profitable; like warranties in the electronics industry, trip insurance is virtually overhead-free and an exceedingly popular ancillary purchase. Likewise, hotel booking and car rental can be obtained cheaply with some negotiation with suppliers. Other services and products should be pursued with a group-buying program in order to get the absolute best prices, keeping in mind that their sale is limited to ancillary revenue, by definition an unreliable stream.

### Implementation

Putting all of this theory into practice can be daunting, particularly for the LCC with limited initial capital investment. Is it truly worthwhile to have a dedicated IT department to develop an ancillary-ready booking engine? How about the time investment involved with setting up appropriate partnerships with hotel room providers or rental car agencies?

Companies like ours exist to solve just such dilemmas. For nearly a decade, we have been providing dynamic booking platforms, facilitating group buying schemes and developing ancillary revenue streams for low cost and mid-sized airlines. Towards the end of 2007, we expanded into Southeast Asia, ready to help the region's LCCs continue their rise to prominence.

Our company has a long tradition of success in the implementation of ancillary services and has earned a long and notable list of satisfied clients. The proprietary dynamic booking engine, aptly named AirlinePlus, is scalable to the needs of nearly any airline and features a host of ancillary service offerings pre-installed. For Atlas Blue, one of client LCCs serving Europe and the African continent, we are about to implement one of the newest ancillary value-adds - carbon offsetting. And for many other client airlines, we have hosted web-based reservations systems and spearheaded ancillary revenue creation initiatives, effectively pioneering the low-cost revolution in Europe.

Ancillary revenues are clearly key for low cost carriers, no matter what region they serve. Perhaps in Asia, where the diversity of national economies will likely dictate a lower average fare, ancillary revenue development and overhead mitigation will play a more prominent role. In any case, Airsavings will continue to provide these crucial services to the airlines shaping the future of air travel, allowing LCCs to flourish and recast flight for the 21<sup>st</sup> century.