



Ancillary Revenue
Solutions For Global Carriers



Whitepaper

The Ancillary Evolution:
In a Shifting Landscape, a New Way
Forward

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November 2008

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The Ancillary Evolution: In a Shifting Landscape, a New Way Forward

By Raphael Bejar, CEO Airsavings, SA

Ancillary revenues have grown and changed significantly over the past few years. What was once the exclusive purview of European discount carriers is now *de rigueur* for nearly every airline across the globe. Airlines – regardless of size – are looking for new opportunities to increase revenues. The meteoric rise of fuel prices from 2006 through 2008 has rapidly accelerated the adoption of ancillary revenue development strategies among even the stolid American legacy carriers, though the recent drop in crude prices accompanying the current economic slowdown has slightly dampened the collective buzz surrounding such initiatives. And yet ancillary revenues remain central to the overall operating strategy of almost every airline, a universal trend unimaginable outside of the most forward-thinking LCC circles just a few years ago. But the inevitable consequence of such broad integration is the realignment of the ancillary industry. If what was once innovative is now commonplace, a new idea must arise. And this volatile and uncertain environment cries out for fresh perspectives and bold advances- and ultimately, a new way forward.

The state of ancillary revenues

The unbundling of the standard airfare has been successful by most accounts. Airlines have discovered that passengers are willing to pay, and handsomely in some cases, for goods and services previously included in the ticket price, including onboard entertainment, a live-ear reservation process, even a checked bag. While this unbundling has been central to the rise of ancillary revenues, the *bread and butter* of the ancillary industry continues to be value-added services that enjoy a unique symbiosis with air travel - the proverbial “Big Three” of hotel reservation, car hire and trip insurance. In fact, 72% of airlines worldwide currently derive ancillary revenue from commissions earned on rental car and hotel room bookings, and the Big Three account for the majority of the total worldwide market for ancillary revenues, estimated to be in excess of €1.7 billion.

These three main ancillaries share a significant trait: they are all centralized around the online booking process. Whereas the headline-grabbing ancillaries consist of in-cabin charges or service-specific fees (like entertainment or checked baggage) the true engine of the ancillary movement is the web-based booking path. As a result (and indeed, as a cause) airline websites become increasingly integral to the booking process: 20%-30% of all passengers industry-wide use the internet to book flights, and individual airline sites can get between 5 million to over 100 million page views per year. Airline websites have become more effective at capturing consumer attention for longer periods, and employed ever more sophisticated technology and techniques, including white label microsites and dynamic packaging to optimize conversion rates. All of this underscores the importance of the website as well as the potential of the channel as a fertile ground for additional ancillary revenue solutions.

The problem with trip insurance

In spite of the ubiquity of the Big Three among airlines, the staying power of the ancillary trio has come under question.

So what is the weakest leg of the tripod, the most threatened ancillary? Trip Insurance.

This may seem counterintuitive, particularly as trip insurance represents one of the lowest-overhead (and highest margin) ancillary options available to airlines, and as trip insurance is a \$1.3 billion industry in the US alone. Airlines have entered into partnerships with established insurance agencies, and devoted resources to maximizing the offering's presence in the booking path. But while trip insurance has long been considered a central part of many airline's ancillary strategies for all of these reasons, its prominence is waning in the face of impending European legislation, and due to declining demand growth for the product.



Both EU and UK regulatory bodies have already adopted regulations curtailing airlines' ability to offer trip insurance as a seamless aspect of the booking process, and that legislation is slated for enforcement in early 2009. At the same time, while the industry that topped £670 million in 2007 continues to grow, it has shown some abatement in its rate of growth from more than 30% increase post- 9/11 to less than 20% in 2007. These figures indicate the decline in the perceived importance of trip insurance by travelers and though it will continue for some time to be central among ancillary revenue generation, it is on the wane. Therefore, the air travel industry should be exploring new options to supplement and surpass this revenue stream.

Private event retailing

One of those new options is being shaped by a retail trend taking hold across Europe - private event retailing. Also known as *spot sales* or *private sales*, private event retailing evolved from private sample sales once held in warehouses or store basements, which offered designer fashions over a very short time (one day, four hours) at a substantial discount. Online private event retailing of the sort embodied by industry leader Vente-Privée.com is almost exactly the same, but without the bare concrete walls and unruly hordes of couture-crazy discount hunters. Instead, the exclusive membership is notified of an upcoming sale by email without much lead time (the week prior to the sale, in most cases), and the sales only last for a day or two. This creates a sense of exclusivity that, when combined with the steep discounts offered (often 30%-70%), continually attracts new members, as well as a sense of immediacy that creates an optimal situation for sales conversions.

For these reasons, along with the general prevailing retail trends in Europe, private event retailing has grown into a €500 million industry in France alone, last year from nearly nothing in 2005, and is projected to grow another 30% by the end of 2008. Indeed, Vente-Privée.com's projected 2008 revenues alone- 378 million pounds- represent more than half of the entire European travel insurance industry for 2007. Beyond the sheer size of the market, and beside the tremendous growth potential of this burgeoning industry, private event retailing is a viable successor to trip insurance because there is a natural demographical overlap - frequent air travelers are also attractive retail consumers - as well as low overhead, few barriers to entry and increased partnership possibilities. Most importantly, it is a retail phenomenon that dovetails very nicely with some of the existing infrastructure in place at many airlines, particularly existing loyalty programs.

Where loyalty lies

Airline loyalty initiatives, generally manifested as frequent flier programs, are at once an airline's greatest asset and stickiest liability. The programs are representative of an airline's most loyal, and hence most lucrative customers, often business travelers that are less price-sensitive than their leisure counterparts. In addition, they are direct avenues of communication between this core contingency and the airline, allowing for marketing message dissemination, preference management, and revenue opportunities. And in an age of declining loyalty - particularly among mid-sized and low cost carriers, who are often competing on price alone - frequent flier programs can help stem the rampant outflow of repeat customers.

On the other hand, customer perception of loyalty initiatives are historically dim; redemption processes are perceived as complicated and stacked in favor of the airline, and some consumers see no value in the measures at all. As a result, loyalty programs are often choked with unredeemed miles or points, effectively becoming black holes of balance sheet liability. The simple solution is to encourage loyalty unit redemption, though to unilaterally ease the conditions under which an airline grants free rides would undermine important price structuring and scheduling strategies. The correct solution, then, is to create new ways to encourage mile redemption, new ways to mine the rich depths of existing loyalty programs, new ways to reach out to those most valuable customers - the ones that express a willingness to return time and again.



This necessity forms the momentum for a new way forward - a marriage between loyalty programs and ancillary revenues, through the unique new avenue of private retail sales.

The way forward- Privilege Outlet

Privilege Outlet is our company's foray into the new way forward for ancillary revenues and loyalty programs. It is a standalone website that offers private retail sales to invited guests, primarily selected airline passengers. Like other private event retailing initiatives, a passenger (for example, a frequent flier, or a prospective loyalty member) is sent an invitation to an exclusive, limited-time online sale featuring items by high-profile brands and designers. The passenger receives the invitation via email, and must register or 'opt-in' to participate, providing the airline with valuable customer preference information. The passenger gets exclusive access to their favorite brands at prices between 30% and 70% off.

Privilege Outlet adapts the private sale concept to the unique needs of low-cost and mid-sized carriers by integrating the offers into an airline's existing booking engine and attaching 'points' to each purchase or friend recommendation. This transforms what might be a simple incentive into a self-reinforcing loyalty initiative, which has the capability of spreading virally and provides added value to the end user. Additionally, as with other ancillary revenue initiatives, the airline receives a commission on every purchase made through Privilege Outlet, while Privilege Outlet is also capable of selling surplus seats packaged with popular ancillaries through its own website. Ultimately, the program aims to reduce an airline's loyalty program liability by channeling unredeemed units into net-revenue offerings, and to allow an airline greater potential for additional sales within the booking process by intuitively presenting customers with high-adoption-potential options.

Privilege Outlet- and other similar programs- represent a new way forward for airlines experiencing some stagnation in the realm of ancillary revenue development. As a potential replacement for the trip insurance sector, private event retailing in conjunction with existing loyalty initiatives still needs to establish itself, though it is perhaps the most promising confluence of ideas to emerge out of the current landscape.

At any rate, airlines must take the next leap forward. The industry needs innovation, a new solution to an old problem, and importantly, it needs to act quickly. The challenges facing the airline industry leave no time for hand-wringing and equivocating. Innovations must be tested and implemented with the appropriate urgency, and every new avenue of ancillary revenue development must be explored fully. Programs like Privilege Outlet present a unique opportunity to leverage existing loyalty programs and exploit a burgeoning trend in the concept of private event retailing, and should be at the top of any airline's list of initiative to examine.

Raphael Bejar is CEO and founder of Airsavings, based in France with offices in Singapore. Bejar has more than 15 years airline industry experience and founded Airsavings in 2001 to meet the unique and growing needs of low cost and mid sized airlines, combining innovative group buying techniques with web services technology to provide ancillary revenue solutions to those airlines. Its group buying expertise, combined with the knowledge of airline internet booking engines, has uniquely positioned Airsavings in the area of ancillary revenues - now a vital lifeline for airlines. Airsavings proprietary industry platform called Air-linePlus, enables carriers to deliver a multitude of ancillary services found most useful and with the greatest potential for mass adoption and profitability.

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