Ancillary Revenue: It’s Not Non-Core Anymore

Airline industry conferences these days are rather surreal. There’s something odd about nicely dressed people in luxury hotels sipping on wine and nibbling hors d’oeuvres, all gathered to discuss a bloody mess: demand collapse, fuel shocks, labor strife, mounting losses, angry investors, rising airport costs, outdated infrastructure, high taxes and tight credit. In short, industry conferences are nice affairs about miserable things. Unless, that is, it’s an ancillary revenue conference, where the mood can be as rosy as the setting—and for good reason.

While revenue from pure ticket sales fell dramatically in 2009, revenue from non-ticket sales soared. For the U.S. Big Five airlines alone, the “other” line of their revenue accounts jumped 19% from 2008, despite a 17% y/y drop in total revenues. And the ancillary revolution is certainly not confined to the U.S. Almost every week, Airline Weekly’s marketing page is filled with new initiatives to raise money—from charging for things once included in the ticket price to selling all-new products and services that travelers may want. And it’s not just the airlines that are celebrating. Third-party vendors of such products and services, drooling over plane-loads of consumers with higher-than-average incomes, are feeling bullish these days too. So are technology providers and consultants helping the airlines execute the initiatives. There is no downturn in this small but increasingly vital corner of the giant airline industry.

Of course, not all of this is completely new. Airlines have long earned non-ticket revenue from ground handling, maintenance, logistics, duty-free shopping, consultancy, charters, catering and other activities. But these are generally separate businesses distinct from the core task of providing passenger air service. Even within the core passenger business, airlines have long generated modest amounts of ancillary income by selling inflight alcohol, for example, or by applying fees for itinerary changes and excess baggage. Frequent flier programs, too, are huge money makers for airlines (see article that follows).

Ancillaries: Just the Beginning, Or Beginning to Plateau?

More than one airline executive has described checked bag fees as the “holy grail” of ancillary revenue. The hundreds of millions of dollars some are collecting make the word “ancillary” seem paradoxical.

If they are indeed unlike any other revenue stream, does that mean nothing like them is forthcoming? What kind of initiative might be as exciting?

Tim Jeans, managing director of U.K. leisure airline Monarch, once categorized ancillary initiatives into two broad groups: internal and external. Internal measures like bag fees involve more risk, such as upset passengers, but airlines get all the rewards. External initiatives involving partners have less risk—no one is likely to complain about the availability of inflight internet or the ability to book a rental car on an airline website—but these initiatives generally have more marginal benefit, and while suppliers may take some of the risk, they also enjoy much of the upside.

Some LCCs that are otherwise bullish about ancillaries still don’t have frequent flier programs (see page three), and those could provide an important new source of revenue for them. And ever-falling costs of technology could make existing initiatives far more profitable. In just a few years, inflight wi-fi went from commercially unviable (Connexion by Boeing) to viable (AirCell, Row 44 and OnAir). Five years from now, could it be a major moneymaker for those suppliers and airlines alike?

Or is there yet another undiscovered and unimagined “holy grail” yet to be found, more substantial even than checked bag revenue? In the airline industry, anything is possible.

One Airline’s Ancillary Growth Story

easyJet’s ancillary growth per seat, 2009 vs. 2008, overall and by category

See also:
- Ancillaries: Just the beginning, or beginning to plateau? p. 1, below
- Onboard retail data becoming more widely available, p. 2
- Frequent flier programs: from cost center to profit machine, p. 3
- Airline Weekly/GXI Benchmark preview, p. 4
- Checked luggage: Is Southwest not so crazy after all? p. 5
- Ancillaries by the numbers at selected carriers, p. 6

High loads, low profits

Perhaps the biggest reason ancillary initiatives have taken off is the extreme financial pressure airlines have faced. It was after 9/11 that many...
Who’s Buying the Sprite on the Night Flight?

Data on inflight sales is building, and transaction enablers are making it more available

For trend-watchers in the realm of airline ancillaries, there’s bad news and good news. On one hand, detailed information about the subject is limited: most carriers are reluctant to provide an itemized look at how much money they earn from their ancillary sources. At best, an airline might lump all of its non-ticket revenues together and give it a separate “ancillary” line item on its income statement. A few provide a more detailed look at certain areas like bag fees, which the U.S. government, for one, requires its carriers to disclose. But rarely do any airlines regularly provide revenue data on, for example, who’s buying what aboard their flights.

On the other hand, information is becoming more widely available—not less—from other sources, notably in this area of inflight sales. At least two leading providers of onboard credit and debit card readers are now publishing or preparing to publish aggregated data collected from their transaction history—undoubtedly useful for airlines and merchandise providers eager to identify what exactly passengers are buying.

One of these companies, U.K.-based Onboard Retail Solutions, says 2009 saw record sales through its flight attendant-held transaction devices, highlighting the industry’s growing clout as a retailer in its own right. Onboard works with about 15 different airlines including business-oriented carriers like SAS, leisure-based ones like TUI’s Thomson Airways, longhaul ones like Malaysia Airlines and LCCs like Air Arabia.

Onboard’s larger competitor, Toronto-based GuestLogix, works with most major carriers in the U.S., where inflight selling is most active, and airlines carrying 35% of worldwide traffic. Ryanair—an ancillary pioneer—is a customer. In total, GuestLogix users collectively represent about 800m passenger trips a year. And the company, incidentally, is one of Canada’s fastest growing technology firms, again symbolizing the magnitude of the airline ancillary trend.

Much as global distribution companies long ago realized that the data they gather through their core business was itself valuable—that data become the basis of a lucrative secondary business called MIDT, which provides airlines and other stakeholders information about bookings on competitors—onboard technology providers have realized that the data they gather via the transactions they enable is itself marketable.

GuestLogix and Airline Weekly will soon publish an industry-level benchmark report based on aggregated sales data (see page four). It groups transactions into three broad categories: buy-on-board (food, beverages, IFE, pillows, etc.), duty-free sales (alcohol, tobacco, jewelry, etc.) and what both GuestLogix and Onboard Retail Solutions refer to as “virtual” goods. These are services like theater tickets, ground transportation, catalogue shopping and mobile phone credits. Not only can these services be targeted with precision—selling Disney tickets aboard a flight to Orlando, for example—but they also involve none of the weight, handling, inventory planning, waste or theft risk associated with physical products. All it takes is a printed receipt, which itself is prime real estate for inflight advertising, another source of new revenue for airlines.

For companies providing inflight transaction enabling capabilities, the future seems boundless. GuestLogix says that about 65% of the worldwide passenger market is “relatively untapped” in terms of its exposure to goods and services aboard flights. In fact, GuestLogix and Onboard see themselves as more than just passive transaction enablers, but also market makers, bringing together sellers and a prized demographic of potential buyers: airline passengers.

The data on inflight sales will naturally become even more meaningful as time passes and transaction histories lengthen. The ancillary trend is still young, but the trail of insightful information it’s leaving behind is becoming more and more valuable—and more and more available.

Disclosure: GuestLogix and Airline Weekly have a marketing relationship. This special report was produced independently by Airline Weekly.
In December, 2008, in exchange for assured continued revenue extend “loans” or “invest” in the airlines, regard-
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tion to say that some once-struggling and still-struggling airlines exist today because of their relationships with credit card issuers. Several times during the past decade, U.S. airlines in particular were in bankruptcy and on the brink of liquidation, only to be rescued by key suppliers who were willing to extend “loans” or “invest” in the airlines, regardless of how wise that was in pure investing terms, in exchange for assured continued revenue streams. Manufacturers did it, regional carriers did it and—especially—credit card issuers did it. Delta’s partnership with American Express is legendary, but almost every major airline has an important and often exclusive relationship with a card issuer.

Even before its merger with Northwest, which created the world’s largest frequent flier program, Our frequent flier program was profitable from day one. If it weren’t, we wouldn’t have it. —Spirit Airlines CEO Ben Baldanza

Airline Weekly, June 8, 2009

Delta earned more than $1b annually from selling SkyMiles to Amex and other partners inside and outside the travel industry. That’s the revenue Crandall and other loyalty pioneers probably never envisioned, in addition to the annual $1b in loyalty-driven revenue (customers choosing Delta over other airlines because of the program) that was the original point of loyalty programs.

Perhaps the event that made clear the value of loyalty programs more than any other was when Air Canada spun off its Aeroplan program in a bankruptcy-era effort to raise cash. By market capitalization, standalone Aeroplan is more valuable than the airline itself and is sometimes more profitable than even Air Canada’s always-profitable competitor WestJet, which is incidentally launching its own loyalty program. Aeroplan’s ability to influence consumer behavior in Canada is remarkable: when Esso began awarding a modest amount of miles to its gasoline purchasers, it experienced significant share shift in the high-margin premium fuel market away from other gasoline retailers. Other global airlines from Qantas to United considered spinning off their own programs before the global financial meltdown killed the IPO market. As the economy recovers, so too, undoubtedly, will the interest in such transactions. Aeroplan, believing its loyalty expertise far exceeds what airlines can do in house, will likely be involved.

As with all ancillary initiatives, it’s fair to ask whether this is all too good to be true. After all, while not only carriers like Southwest but even ultra-LCC Spirit embrace their programs, the world’s largest ultra-LCC Ryanair doesn’t have a program. It does have a co-branded credit card, believing it can get the milk without buying the cow (it sells “free” flights to the card issuer to award to card holders but doesn’t want to manage a full loyalty program). But also as with all ancillary initiatives, while frequent flier programs may not be a panacea for all that ails, they are most likely to grow, not shrink, in importance.

From Cost Center to Profit Machine

Loyalty programs, once a necessary cost for airlines that offered them, now more profitable than some airlines themselves

When former American Airlines CEO Robert Crandall launched AAdvantage, the world’s first frequent flier program, in 1981, he couldn’t have predicted how ubiquitous such programs would someday become. He also couldn’t have predicted that what seemed like an acceptable cost to drive loyalty would someday become a major money-maker of its own for American and other airlines.

It quickly became clear just how much customers liked accumulating miles. Airlines formed partnerships with other travel providers like hotels and rental car companies, who were happy to leverage airline customer loyalty to drive their own sales. Other retailers that seemingly had little to do with the airline industry followed as partners, becoming big customers for airlines without even flying—they, like travel industry partners, purchased miles from airlines to award to their own customers.

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From the Archives

With 16% of its revenue now derived from non-airfare sources like advertising, sales commissions and inflight product sales, Ryanair’s breakeven load factor is absurdly low. As a result, the airline was able to give away a fifth of its seats for free in 2003. Not only does this boost its load factor, but it also allows the airline to sell more onboard items.

—Airline Weekly
March 3, 2005

Since then, the percentage of Ryanair’s revenue coming from ancillary sales has continued to rise, topping 20% by the beginning of 2010 as fares dropped to an average of €34 from an average of €40 back in 2003.

Back then, Ryanair was the exception. Now it’s been joined by dozens of other airlines that saw ancillaries rise from negligible levels just a few years ago to double-digit percentages of total revenue today.

Frequent Flier Facts
From a selection of carriers

In December, 2008, Delta used its beefed-up post merger SkyMiles program to win incremental liquidity and contract enhancements worth more than $2b from American Express. In 2009, Delta’s net loss was $1.1b ex special items. Delta’s FFP is now the world’s largest by membership with about 70m members, followed by 60m for American’s AAdvantage and 47m for United’s Mileage Plus.

In 2008, more than 50 percent of Lufthansa’s passenger revenue was generated by the carrier’s 16m Miles & More members.

During its fiscal year that ended last June, Qantas saw revenue at its 6m-member Frequent Flyer Plan unit grow 33%. The unit’s operating profit margin, ex special items, was 20%, compared to 2% for the airline as a whole.

In 25 years, Air Canada Aeroplan members have accumulated approximately 821b miles, or 3.7m trips to the moon.

Since the inception of Southwest’s Rapid Rewards in 1987, approximately 16% of all fully earned awards have expired without being used.
If you’re going to turn an airline cabin into retail space, how do you do it? Like the rest of the retail world, business models can vary as wildly as Walmart, Tiffany’s, a movie theater, a café, a bar, and a hot dog stand. Will more money be made selling chateaubriand or a bag of chips? Will giving away soda and water kill a cabin’s alcohol sales? Will giving away food increase beverage sales?

The Airline Weekly GXI Onboard Retail Benchmark 2009, the world’s largest collection of aggregated data for onboard retail sales, has been partly released. What does the data from 2009 reveal?

Some snapshots from the benchmark:

Regional Differences

Onboard retail service can mean very different things depending on where a carrier is based. According to the benchmark analysis, while North American carriers have shifted their models to selling food, drinks and so-called comfort items—blankets, pillows, headsets etc.—the Asian market remains resistant. Only 10% of passengers boarding Asian carriers can purchase food or beverage on board. That figure compares with 68% in the Americas. In Europe, the Mideast and Africa (EMEA), 32% of carrier traffic has made the leap. The numbers are almost opposite when it comes to duty free sales. In Asia, 74% of carriers have a duty free onboard retail component on their international flights. In EMEA, it’s 79%. In North America it’s only 54%. Note that these numbers are weighted on total passengers and duty free offerings only apply to international flights.

Measuring Up

Apparently it’s tough to squeeze an extra dollar out of a passenger. Across the industry, the average carrier with an onboard retail component (that is, selling any combination of food, beverage, IFE, and comfort items) earned $0.72 per passenger in 2009. However, when looking at carriers in the top 10 percentile, that average climbs to nearly $2. What are the top performers doing differently? One of the “key differences,” according to the benchmark report, could be that top-performing carriers are making revenue on non-alcoholic drinks.

Giving away sodas, but at what price?

Industry wide, 6% of buy-on-board sales are from soft drinks and other non-alcoholic beverages such as juice, water and coffee. Among top performers, the number rises to 31%. When looking at beverage sales only, top performers earn more than three times the industry average of $0.29. The key factor, according to the report, is that top performers are charging for non-alcoholic beverages.

Getting fresh

Another interesting distinction was what the report calls “fresh food” sales—sandwiches and salads as opposed to non-perishable “snacks” such as a bag of chips or cookies. According to the benchmark, the average per-passenger spend on food items is $3.55. Among the top performers, the average rises to over a dollar. The main difference in the top product mixes is that the top performers get 85% of their food sales from “fresh food”, while the industry average is 58%. Of course, increased sales do not always translate to increased profits.

The Airline Weekly GXI Onboard Retail Benchmark 2009, to be fully published in April, contains analysis of aggregated data based on nearly 800m passenger trips in which airlines worldwide used GuestLogix’s onboard store technology. This benchmark report is a unique comprehensive data sample and provides benchmarks and performance indicators both globally and regionally across all facets of the current onboard sales industry.

Disclosure: Airline Weekly and GuestLogix jointly publish and market the Airline Weekly GXI Onboard Retail Benchmark. However the reporting of benchmark data and news about GuestLogix is done independently by Airline Weekly editors.
Sometimes the question is more interesting than the answer.

During the first few earnings calls after its competitors began charging for bags, analysts repeatedly asked Southwest how it could justify leaving probably hundreds of millions of dollars in revenue on the table by avoiding bag fees.

But then something funny happened: By the last round of earnings calls in 2009, analysts were instead asking every other airline if, perhaps, Southwest was right after all.

The reason? Southwest’s year-over-year unit revenue performance was by far the best in the industry.

Now certainly, its refusal to charge for first and second bags wasn’t the only reason for that, if in fact it was a reason at all. All LCCs, including those that charge for bags, had shallower unit revenue declines than their legacy competitors. And most of Southwest’s year-over-year performance could be explained by the fact that its planes were far fuller than a year earlier, which in turn was only possible because it previously had the industry’s lowest load factors. A lot of that was probably thanks to different approaches to revenue management: not holding out for higher-paying customers who never materialized, for example.

Still, even among LCCs, Southwest’s modest unit revenue decline stood out. Bag-fee-charging AirTran, though performing better financially than Southwest by most measures, experienced third quarter RASM decline of more than 10% compared to Southwest’s 2%.

Southwest says it has benefited from share shift—customers choosing it over fee-charging airlines—whereas fee-charging airlines say they haven’t lost any meaningful market share. Who is correct? Maybe both, explained fee-aggressive US Airways: It’s possible that it and other airlines have lost some share, but nothing enough to detect or attribute to the fees, but that those small defections from many airlines add up to something meaningful for Southwest.

It’s also possible that what other airlines are doing is right for them while what Southwest is doing is right for it. Perhaps most significantly, Southwest is the shortest-haul major airline, meaning it competes in many markets not against other airlines but against cars. Bag fees could be enough to keep someone traveling from Dallas to San Antonio on the ground. With that consideration, maybe it’s longer haul JetBlue—the only other major U.S. airline that doesn’t charge for a first bag (though it charges for a second)—that would have less to fear by reversing course.

Philosophically, charging passengers—or customers in any industry—for what they personally consume usually makes sense. Airlines’ largely bundled products were a legacy of the days when pricing was regulated and carriers could only compete on service. Unbundling was probably inevitable and, to one degree or another, wise for most carriers. Southwest’s strategy might not have much wider applicability outside the company. But for itself, at least, Southwest might not be so crazy after all. ☀️
Ancillaries Have Surprised Even Some Who Believed in Them

CONTINUED FROM p. 1

U.S. airlines started charging for meals and during the fuel shock a few years later that they started charging for first and second checked bags. Now that ticket yields have taken a beating because of the recession, the incentive to find supplementary revenue remains. It hasn’t hurt that many of these supplementary products and services have increased in perceived value by flyers because load factors are near record highs, airport hassles more cumbersome than ever and flight delays more common, until the recent downturn in traffic anyway.

Airlines have also come to recognize a bizarre truth about consumers: they seem to be far more price sensitive when buying a ticket than they are when opening up their wallet for add-ons and extras, in some cases to a degree the carriers themselves never anticipated. Spirit Airlines, an early unbundler among U.S. airlines, believed philosophically in a la carte pricing—charging individual passengers for what they use—but expected lower fares to more or less offset ancillary revenue gains. Instead, base fares barely dropped, and almost $30 per passenger in ancillary revenue that Spirit now gets turned out to be highly incrementally, according to the airline. Other carriers too are finding that lowering base fares can be revenue positive because traffic grows and money is recovered through purchases of other items. Revenue management strategies, in fact, are changing in response, with load factors becoming more important than fare yields—the more people you bring aboard the airplane, the more you’ll earn in ancillary income. Airlines are also realizing that they have many opportunities to sell things to passengers, including at the moment they shop for their flights, the moment they book, the time they check in for their flight, the time they spend at the airport and the time they spend in the air. Carriers can also follow up with passengers post-flight.

Finally, airlines are engaged in ancillary activities now more than ever because pioneers have proved their worth. Ryanair, a long-time practitio-

ner, showed just how profitable they can be. Other LCCs like AirAsia, Wizz Air and Tiger became enthusiastic adopters last decade, all rather successfully. A decade ago, remember, the only major LCC that even existed was Southwest. Ryanair, easyJet, WestJet, Spirit and a few others were around but still rather small and nowhere near as influential as they’ve become. During the last decade, they influenced the revenue strategy of the entire industry.

Merry, merry ancillary

So today, most carriers big and small alike are playing for ancillaries. Spirit may have been the first carrier to charge for all checked bags in the U.S., but the pioneers among the country’s major airlines were the Big Three—United was the first to charge for a second domestic bag, American the first to charge for a first and Delta the first to charge for a second bag on international flights. Europe’s Big Three are now adopting charges, on shorthaul flights, for items once embedded in the base fare. Kings of longhaul premium travel like Singapore Airlines and Qantas are charging extra for exit row seats. Even Southwest, most famous for not charging for bags and not charging change fees, nonetheless imposed new charges for priority boarding, transporting pets and handling unaccompanied minors. It also increased its fees for excess baggage, plans to charge for inflight internet and expects big revenue from soon-to-be unveiled changes to its frequent flier plan.

More generally, the ancillary revolution is happening in all geographies and all segments, if not evenly. Ultra-low-cost carriers like Ryanair and AirAsia are the most aggressive adopters, while the U.S. market is the most active overall.

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The Importance of Ancillaries at Selected Airlines

Ancillary revenue as a percentage of total revenue, and year-over-year ancillary revenue growth

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<th>Airline</th>
<th>% of total revenue</th>
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<tr>
<td>Allegiant</td>
<td>3.0%</td>
<td>46%</td>
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<tr>
<td>Ryanair</td>
<td>18%</td>
<td>21%</td>
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<tr>
<td>easyJet</td>
<td>24%</td>
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<td>AirAsia</td>
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<td>Norwegian</td>
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Source: company reports and Airline Weekly analysis. Figures for June through September except easyJet, which is April through September.

So what exactly are airlines doing? Ancillary initiatives can take many forms, but one general theme is unbundling or decoupling, whereby services previously part of the base fare now carry a charge for those who opt to use them. Bag handling is usually the most lucrative of these services, but the list can also include meals, assigned seating, inflight entertainment or pillows and blankets. Naturally, such unbundling is most prevalent with the cheapest fares, making higher bucket, more inclusive and less restricted fares more valuable. In fact, this has led to another new phenomenon known as fare families or fare branding, whereby a group of fares sharing the same perks and privileges (or lack thereof) are marketed with a recognizable and easy-to-understand label. Frontier, for example, has three fare families: Economy (which carries higher change fees and few perks), Classic (lower fees, complimentary inflight television, advanced seat assignments, two checked bags and extra frequent flier credits) and Classic Plus (all that Classic offers plus no change fees, refundability, priority boarding and an inflight snack). Another common ancillary strategy is add-on “upselling” or charging for extra perks that were never provided within the base fare to begin with, or in some cases never offered at all. A Frontier economy class passenger, for instance, can pay $25 for “stretch” seating. Others might charge for priority handling at check-in, security lanes and boarding gates to reduce ground time. Paying extra for lounge access can make that ground time more comfortable, while paying for extra legroom can enhance comfort in the air. So, too, can paying for inflight entertainment, be it a handheld DVD player, an inflight movie or internet access.

The carrot or…

There are also penalties for “bad” behavior, namely booking through call centers or checking in at the airport. These procedures are more labor intensive then their web-based counterparts, and carriers want to discourage it. Unless that is, they’re like WestJet and see their call center agents as skilled up-sellers who are more likely than a website to get people to book at higher fare levels and select add-on services. A few like Allegiant, on the other hand, charge fees even for booking through their websites.

CONTINUED ON NEXT PAGE
Another strategy is simply raising existing fees for itinerary changes, cancellations, booking through a GDS, using a credit card or redeeming a frequent flier award. Another is commission-based selling for third parties with products and services that are relevant to fliers. Hotel rooms, rental cars and travel insurance are some examples, but the list of items is growing. Some carriers even envision themselves as inflight shopping malls with flight attendants selling everything from tickets for ground transportation and destination attractions to luxury goods from catalogues. Inflight communication companies, meanwhile, are actively partnering with airlines to offer mobile telephony. The selling doesn’t just happen in flight, of course. Airline websites have become like online travel agencies in their own right. Selling ad space, sometimes even on seatback tray tables, is another way airlines are raising supplementary income. Ryanair and AirAsia even sell the outside liveries of their aircraft to advertisers.

Airlines are now experimenting with re-bundling services, creating one-stop, one-price packages for premium perks. United, for example, established something akin to a protection racket, without the negative connotation. It enables travelers to pay a set amount for one-year protection from bag fees. American seems interested in this type of initiative as well, likening it to McDonald’s selling a Happy Meal that includes a number of items for one price. Selling packages of premium services has the added appeal of catering to the growing number of once-pampered business passengers now forced to fly coach. And it might generate loyalty: fliers buying bag fee protection will be more likely to fly United to get their money’s worth. There’s also the notion that consumers will pay a premium for guarantees in life.

But if all of this ancillary revenue raising sounds too good to be true, then maybe it is—or at least maybe it’s not quite as good as some euphoric airline executives claim.

be it protection from fees or the peace of mind of knowing they won’t have to shell out additional money at the airport or on the flight.

Of course, most of these new ancillary initiatives apply to just coach passengers, which is why one airline recently suggested that full-fare coach passengers—who may buy a meal and a preferred seat—may actually be more valuable than a discount premium passenger. But what the ancillary revolution also does is increase the value of premium fare brands that protect fliers from extra fees and charges. Most importantly it increases the value of elite frequent flier status, which has the same protective effect. People may be willing to spend more, in fact, to buy higher fare classes and to stick with one carrier to achieve elite status.

The benefits of aggressive ancillary selling don’t stop there. Customers often like the idea of benefiting from lower base fares and not having to pay for “someone else’s” meal and bag handling. Some welcome the disappearance of aisle-clogging meal carts that block paths to the lavatories and create a sense of clutter. Others like the option of paying for a good meal rather than receiving a bad one free.

Ancillary cost cuts

Best of all from the airlines’ perspective, many ancillary initiatives are just as helpful with costs as they are with revenues. Charging for bags not only brings in money but also discourages people from checking bags, making the plane lighter, which means less fuel burn. There are also fewer bags to mishandle, yielding some operational savings. Taking meals and beverages off flights can lower costs too, while meal wastage becomes less problematic. Airlines like Ryanair even use...
Some Setbacks, Yes, But Ancillaries Are Ever More Important

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ancillary revenue to justify giving away free seats, thereby delivering traffic volume to airports in exchange for lower landing fees and terminal charges.

But if all of this ancillary revenue raising sounds too good to be true, then maybe it is—or at least maybe it’s not quite as good as some euphoric airline executives claim. There are, after all, some hidden and not-so-hidden costs associated with aggressive ancillary selling. Bag fees, for example, can lead to delays and other operational disruptions as passengers bring more and larger carry-on items that slow down security lanes and aircraft boarding. It’s not uncommon for overhead bins to quickly fill up, forcing ground staff to check the bags at the gate without levying a fee, even though those last bags on usually come off the plane first. In other words, some passengers who don’t pay their bags before others that do.

That touches on the larger problem of customer dissatisfaction or confusion. Some feel “nickel and dimed,” a phrase heard over and over again since the ancillary push began. Others feel they’re getting less for their money than they did in the past. Even cabin comfort can be compromised, not just because of excess carry-on luggage but also when neighboring passengers with loud voices and poor etiquette take advantage of new services like mobile phone calls. Aggressive selling by flight attendants can be an annoyance too. Passengers may become confused about who needs to pay how much for what, and when. Two-code-sharing carriers in the same alliance may have completely different ancillary policies, creating not just confusion but also warped incentives to book one rather than the other.

Attendants themselves may be put off by their new roles as sales representatives. In addition to whatever adverse impact this has on staff morale, it may also become an issue in collective bargaining. In fact, some carriers pay sales commissions to their attendants, which offsets some of the revenue they earn. Travel agents, too, may be reluctant to do the added work of booking ancillary services unless they’re compensated.

There is the risk of bad publicity. United had to abandon its plan to sell meals on transatlantic flights after it was skewed by the media. US Airways got the same treatment when it wanted to charge for water. And even the well-reputed JetBlue got bad headlines when it began selling pillows and blankets. The advent of social media sites, where an ill-advised move can go viral, adds to the danger. Airlines might receive push back from government too, advising move can go viral, adds to the danger. Airline ancillary selling may even change operational techniques such as the way airlines board their aircraft—Virgin America, for one, is now responding to its bag fee-induced cabin crowding by allowing anyone without carry-on luggage to board first.

There will of course be some setbacks too. Already the new trend of travelers booking late means a lower probability of an itinerary change—and thus less revenue from change fees. The Southwest model may yet prove to be the best one. And carriers may eventually run out of new initiatives and new ways to merchandise what they’re already offering. In a discouraging development, Ryanair—a trendsetter if there ever was one—recently became the first major airline to report a year-over-year decline in its ancillary revenue per passenger. Travelers, it said, were changing their behavior: packing less and checking fewer bags. They may also increasingly bring their own entertainment, their own food and, yes, their own pillows and blankets.

Whatever happens, it won’t erase the enormous amount of newfound revenue already generated by airlines around the world. True, it may not be as much as some claim because of the associated costs or the mere fact that base fares are being lowered in the process. But it’s not a stretch to say that the new way of pricing airline products and services is as profound a development as the advent of yield management was in the 1980s or internet selling was in the late 1990s and early 2000s.

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More costs and risks

More tangible costs of aggressive ancillary selling can take the form of payments to technology providers to make IT systems capable of executing non-traditional sales or investment costs for equipping aircraft with communications technology. There’s a reason so many suppliers and vendors show up at ancillary conferences: airlines are spending lots of money there. In the meantime, selling premium products to non-premium passengers may result in overcrowded lounges and business class cabins, watering down their value for truly premium customers. And most important of all, overselling products and services could present a golden opportunity for rivals to steal passengers. Southwest is trying to do just that by being less aggressive with fees, though part of the reason for its strategy is simply IT driven—it uses older systems with less capability to handle many initiatives. In any event, travelers sometimes have other non-airline options as well, namely taking the car, getting on a train or setting up a videoconference.

These risks and costs may discourage some from going too far. But the future is nonetheless more likely to see even more ancillary selling. That’s primarily because new sales channels, most notably the global distribution systems, are creating new ways for travel agents, travel management companies and corporate booking tools to sell ancillaries in the same way airline websites already can. GDS companies like Travelport, Amadeus and Sabre have already tailored their systems to handle practices debuted by carriers like Air Canada and United, to name but two. And new agency desktops are on the way.

New and better ways of expense reporting will make corporate travel buyers more comfortable with ancillaries and perhaps lead to their inclusion in contract negotiations. A company might, for example, accept higher fares for economy-class travel in exchange for fee waivers or for automatic elite status (which in turn provides exemptions from some fees) for some of their travelers who haven’t otherwise earned it. More data on who’s buying what services may produce more robust revenue management models. Greater use of mobile devices to manage travel may make customers more willing to accept the a la carte pricing model, especially if they can book what they want and change it if necessary on the go. Airlines will surely introduce more unique service packages and sell more items both on their websites and onboard the aircraft. Ancillary selling may even change operational techniques such as the way airlines board their aircraft—Virgin America, for one, is now responding to its bag fee-induced cabin crowding by allowing anyone without carry-on luggage to board first.

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