

AIRLINE ANCILLARY REVENUES

Top aviation consultant and business coach Patrick Murphy maps out the ways an airline can increase revenue from non-ticket sources.

Critical Questions

With record high fuel prices, weakening economies and competitive pressures, airlines all over the world are looking at the idea of adding revenue from sale of ancillary products and services. They see the reports of Ryanair, with 16% of its revenue coming from ancillary revenues, and those of many other low-cost airlines showing impressive results from sales of ancillary activities. Senior airline executives are asking: “What could it be worth to my airline?”; “How does it fit with my image and reputation?”; “Are my customers willing to be subjected to hard sell of products and services they have traditionally had included in the price of a ticket?”.

These are not easy questions to answer and in fact will depend on who your customers are, their needs and your competition. In the past, the more established low-cost airlines started off with a clear goal of earning revenue from ancillary products and making the airfare as low as possible. Legacy carriers stood by the principle of a price that included everything. More recently, there have been new entrants into the market with the hybrid approach of offering a higher standard of services at a premium but one still lower than that of the legacy carriers.

So, how should an airline respond? What is the right approach? This article sets out what is involved in introducing the various elements of ancillary revenues. Armed with that knowledge, airline executives will have a better basis on which to make their decisions.

Unbundling Air Fares

The foundation for an airline seeking the new ancillary revenues is a totally new approach to pricing. No more restrictive fare rules such as minimum stay, Saturday night rule, advance purchase or inclusive tours and suchlike conditions. Just one-way fares that were capacity controlled and based on time of booking. It meant using sophisticated revenue management systems that would optimise revenue per passenger from the fare but, more importantly, the fare paid was solely for transport of the person. The passenger had to pay extra for such things as changes to bookings,

checked baggage, seat assignment, in-flight meals, snacks or beverages, credit card fees and so on.

That meant fares could be advertised and promoted as being significantly cheaper than the traditional legacy-carrier competition. It meant attracting customers to these new airlines' websites and stimulating new travel with significantly lower fares.

à la Carte Pricing

With this new pricing approach, airlines would now let the customer choose what else they wanted to pay for. They could buy meals, snacks and drinks on board. They could pay to change their original booking. They paid more if they chose to take baggage. They could select their seat of choice, but that too would cost more. And more recently all of this has been extended to offer frequent-flyer miles, lounge access, priority boarding and even fast track through security.

Travel Add-Ons

We know that most travelers are going to hire a car or book a hotel when they go on a trip. In the past they made that arrangement themselves, or had their travel agent do it. The new breed of airlines recognised that and started offering these services as part of the booking process, which of course meant commission from the car and hotel suppliers. And now in recent times that has been extended to travel insurance, where significant commission revenues can be earned.

And the options just keep growing. Airlines are offering airport parking, airport-city transport, lounge access, currency exchange, telephone cards, city tours, tickets for events, and even ski rentals. Innovative airlines are coming up with new add-ons every day.

On-Board Sales

Traditionally, on-board sales meant duty-free liquor and tobacco, perfumes and cosmetics, plus possibly watches and jewelry. Today, low-cost airlines continue to sell these items but the list is extended to include all kinds of gifts and electronic games or devices, as well as credit cards, discount cards and direct-marketing catalogues. Nowadays, interestingly, the main source of revenue is sale of meals and beverages that traditionally were included in the price of a ticket. And the next wave of on-board sales will most likely be from use of phones, laptops and other wi-fi devices on board the new-generation aircraft.

All this has meant a crisis for the cabin crew. This needs to be addressed by employee involvement in the process of implementation and by suitable incentive schemes that will motivate staff.

Advertising Sales

Traditionally, airlines only sold advertising through their in-flight magazines. Now, though, for progressive airlines it is their website which offers considerable opportunities for advertising revenue. Hotels, car-rental companies, travel-insurance providers and the like are all anxious to reach travelers, and what better place than on a website where potential travelers browse for travel options. Today the list of potential advertisers just keeps growing, as restaurants, museums, department stores and so on are looking to reach visitors to their town or region.

Another new development is in advertising on board – on meal trays, on tray tables and on overhead bins. And many airlines are now offering advertising space on the exterior of the aircraft, giving advertisers great exposure. The next development must surely be audio/visual on demand as new-generation aircraft come pre-equipped with in-seat screens. This is an excellent new opportunity for TV spot ads, sponsorship and rental of headsets.

Customer Loyalty Programmes

Whilst originally designed to ensure the loyalty of frequent flyers, today these programmes are a worthwhile source of new revenue by facilitating partners such as hotels or car-rental companies to offer airline miles, wherein the partner acquires the miles issued – for a charge. Another recent development is the facilitation of the purchase of additional miles by existing participants, to enable them to reach a higher status, get free trips sooner or upgrade to business class; or to offer miles as gifts or awards.

In the past, many airlines have avoided going down the customer-loyalty programme route because of the administration cost and/or lack of expertise. Today, however, this can all be outsourced, which can prove very cost effective.

Co-Branded Credit Cards

Credit card companies are always searching to expand their card members and co-branding with airlines is a very attractive proposition. For the airline it offers another source of revenue from joining and annual fees as well as sale of miles to the credit card companies. This has growing appeal to members of loyalty programmes which are often perceived as having less value today, as air fares decrease and the hassle of

travel increases. Association with credit card companies offers new and alternative ways of using miles.

Other Revenue Sources

Many airlines actively pursue revenue from sale of services to others which they already provide for themselves. Ground-handling services, engineering and maintenance services are traditional sources. But airlines can also offer short-term aircraft leases and the operation of sub-services and charter flights. Some low-cost airlines have even chosen to sell all their belly-hold cargo space to specialist freight-forwarder companies, rather than use it themselves.

Guidelines to Note

To be successful in ancillary-revenue generation, airlines need to be careful how they proceed. They need to ensure that their charges, once the fare is paid, are reasonable and justifiable. Passengers must know what to expect. A surprise charge will alienate a customer forever and will become known to many more potential customers. A key to success has to be employee involvement and the certainty that what is offered is in fact available and can be delivered. All this demands the commitment of time, money and management resources at corporate level.

Conclusions

Before an airline gets that far it needs to ensure that it understands its customer needs and wants, as well as what its competitors can and will do in response. Difficult choices have to be made. Are you seeking to stimulate the market or to gain market share? This is critical to your decisions on pricing. Airline managements must remember that much of what has to be done affects costs as well as revenue. Being low cost means just that – not low fares. Finally, there must be recognition of the principle that success often depends on being the lowest-cost provider. If that is not possible then you have to differentiate and obtain a premium for a higher standard of service.

None of which detracts from the real and considerable opportunities that exist today in the ancillary revenue area for airlines to improve their financial performance.

It used to be that legacy carriers sought to maximise average fares but that's all changing. Nowadays low-cost airlines and more progressive traditional airlines are seeking to maximise revenue per flight, which implicitly includes all ancillary revenues as well as the airfares paid.

About Patrick Murphy

Patrick Murphy is on the International Advisory Board of Performance Consultants International and is Chairman of Aviation Performance Consultants. Patrick has over 30 years experience with the airline industry including as Chairman of the Board of Ryanair; as Director, Corporate Development with the International Air Transport Association (IATA); and managing commercial operations at Aer Lingus. He has been a speaker at airline conferences and has been engaged by a number of airlines to advise on competing against low cost airlines, future trends in air transport, environmental sustainability, and improving performance. A full background is available at:

<http://www.performanceconsultants.com/aboutus/patrickmurphy.html>

Contact: patrickmurphy@performanceconsultants.com