

American Airlines Borrows Ryanair Fee Tactics - An Ancillary Revenue Report from IdeaWorks

American's recent implementation of checked baggage fees, which appear to have been accepted by passengers, will likely generate annual revenue in excess of \$458 million.

American Airlines broke with its brethren among legacy airlines when it announced on May 21, 2008 it would charge \$15 for the first piece of baggage checked by passengers on US domestic flights. This second part of its “revenue growth effort”¹ followed an earlier move when it announced on April 28 it would match other airlines by charging \$25 for the second piece. The concept of “free” was relegated to the baggage heap of history; domestic checked baggage on American would now be assessed a fee of \$15 for the first piece, \$25 for the second, and \$100 for the third bag.

Prior to these announcements, fees for checked baggage were only associated with low cost carriers such as Spirit Airlines and Allegiant Airlines in the United States, and Ryanair and easyJet in Europe. American blames “record fuel prices, growing concerns about the economy, and a difficult competitive environment” as the causes behind its unprecedented move. But these new fees merely support a continuing trend in which major US airlines are readily adopting an “a la carte approach” that assesses fees for services provided by an airline beyond the bare bones of a seat on a plane.

This approach is called “ancillary revenue” and it has long been the practice among low cost airlines in Europe and elsewhere in the world. IdeaWorks offers the following definition of ancillary revenue:²

Revenue beyond the sale of tickets that is generated by direct sales to passengers, or indirectly as a part of the travel experience.

IdeaWorks further defines ancillary revenue using these categories: 1) a la carte features, 2) commission-based products, and 3) frequent flier activities.

The Need for Ancillary Revenue

American Airlines can hardly be blamed for taking these drastic measures - - ancillary revenue represents one of the few factors that are within management's control. The May 21 press release also circumspectly announced year-over-year flight reductions of 11 to 12% and plans to retire 75 aircraft from its mainline and regional fleet. Employees were recently advised the carrier would cut nearly 7,000 jobs by the end of 2008, or about 8% of the total workforce.³ This drumbeat of declining fortunes likely suggested that management should consider new methods to generate more revenue.

Ryanair has long benefited from the profits generated by ancillary revenue activities. The Dublin-based airline recently announced 20% higher year-over-year profits for the fiscal year ended March 31, 2008.⁴ Ancillary revenue grew by 35% - - almost double the rate of traffic growth - - to more than 488 million euros (equivalent to \$775 million). No doubt American, and its legacy airline peers in the United States, have been envious of Ryanair's ability to generate a profit and higher revenue during a period of extreme financial challenge.

The following table lists Ryanair's various ancillary revenue achievements for the most recent period in which the airline provided details for specific categories. Ryanair has not yet released revenue details for fiscal year 2008, the most recent details are from fiscal year 2007.

Ancillary Revenue Activity Reported by Ryanair for 2007 Fiscal Year		
Categories	Total Revenue	Per Passenger \$
Non-Flight Scheduled: Activity that is tied to the sale of air travel to include bus and rail tickets, hotel reservations, and excess baggage fees (checked baggage fees are counted as passenger revenues).	\$385 million	\$8.90
Car Hire: Ryanair has an exclusive relationship with Hertz.	\$37 million	\$0.85
In-Flight: Onboard sales of beverages, food and merchandise.	\$95 million	\$2.20
Internet Income: Comprised of revenue from Ryanair.com, such as online gaming, and does not include airline ticket sales or car rental commissions.	\$59 million	\$1.36
Totals	\$576 million	\$13.31

Source: Ryanair annual report for fiscal year 2007 (ended March 31, 2007). Ryanair results were expressed in euros, which were converted at the rate of 1 euro = \$1.56 and rounded up to the next whole dollar amount. Ryanair carried 42.5 million passengers during fiscal year 2007.

A La Carte Pricing Comes to American Airlines

The change from "bundling" services and perks into the price of an airline ticket began slowly in the United States. At first, food service was chosen as the initial sacrifice - - meals simply disappeared from the economy cabin. Pillows, blankets, peanuts and call center cuts followed with late night talk show hosts telling jokes about the installation of pay toilets on aircraft. Legacy airlines slowly began to develop retail activities to replace the amenities lost to cost cutting. The sale of sandwiches and other onboard food treats provides a recent example. However, American and other legacy airlines still struggle to deliver a buy-on-board experience that offers a consistent product and profit.

The decision to assess fees for checked baggage likely caused huge internal debate at American Airlines. The change probably represents a tipping point from which American went from being a traditional airline to something of a hybrid - - a major airline serving economy passengers in an a la carte fashion while retaining the luxuries of first and business class. The following table lists major a la carte fees charged by Ryanair and the equivalent offered by American on its US domestic network.

Ryanair a la Carte Fees Compared to American Airlines		
Categories	Ryanair (Intra Europe)	American (Domestic USA)
Call Center: Reservations made through an agent at the airline call center. Calls to Ryanair also incur higher telephone charges such as \$0.40 (UK) and \$1 (Germany) per minute.	\$31 per person	\$20 per person
Debit Card Fee: For payments made with a debit card. As a negotiated offer with Visa Electron, there is no fee for payments made using a Visa Electron card.	\$8 per person, per one way flight	Free
Credit Card Fee: For payments made with a credit card. Ryanair does not accept American Express.	\$8 per person, per one way flight	Free
Priority Boarding: Be among the first to board the aircraft. Ryanair does not offer advance seat assignment.	\$8 per person, per one way flight	Free advance seat assignment
Airport Check-In Fee: Each passenger checking in at the airport is subject to an Airport Check-In fee. Check-in completed online in advance is exempt from this fee.	\$8 per person, per one way flight	Free
Infant Fee: Child must be under 2 years for both outbound and return flight, and seated on an adult's lap.	\$31 per infant, per one way flight	Free
1st Checked Bag: Per bag, per one-way trip. Ryanair also requires payment of Airport Check-In Fee. Allowable weight varies by airline. * First, business class, full fare economy, and elite status passengers are exempt from this fee on American.	\$16 booked online \$31 at airport	\$15 *
2nd and 3rd Checked Bag: Per bag, per one-way trip. Allowable weight varies by airline. See * note above.	\$31 for 2 nd bag \$31 for 3 rd bag	\$25 for 2 nd bag * \$100 for 3 rd bag
Onboard Food and Beverages:		
• Soft drinks and other non-alcoholic beverages	\$3	Free
• Beer	\$6	\$6
• Wine split	\$9	\$6
• Potato chips such as Pringles	\$3	\$3
• Cold sandwich such as chicken and cheese	\$8	\$6
<i>Source: Review of fees listed at airline websites during July 2008. Ryanair fees were expressed in euros, which were converted at the rate of 1 euro = \$1.56 and rounded up to the next whole dollar amount.</i>		

The table is not intended to create a price comparison, but rather to depict American's swing toward more a la carte pricing. The boxes under the American column marked "free" represent some of the remaining perks offered by the airline to its economy passengers in the domestic US market. IdeaWorks anticipates these boxes will eventually be filled with fee amounts in the near future. The most likely candidates are onboard beverages, advance seat assignments, and premium seats such as exit rows. Similar to Ryanair, US-based airlines would probably like to reduce the merchant fees paid for the processing of credit card payments. This expense can range from 1.5 to 3% of the transaction amount.

The Success of Checked Baggage Fees

The airline did not reveal how much revenue its checked baggage fees are projected to generate. However, United Airlines estimated it would receive \$275 million annually from its similar baggage fee activity.⁵ Applying United's per passenger result to American's approximate annual traffic of 100 million domestic passengers yields total revenue in excess of \$458 million. American will undoubtedly find this cash very helpful as it battles the rapidly rising cost of fuel.

American appears to have introduced its checked baggage policy in a well-executed manner. Recent travel experience by IdeaWorks staff on American and American Eagle provided ample evidence of good technology planning and effective employee training. The carrier's reservation system, to include self-service kiosks, has been programmed to administer checked baggage fees for appropriate reservations. For example, economy tickets purchased before the fees were publicly announced, and tickets purchased by travelers having elite frequent flier status, are not assessed the fee. Self-service kiosks charge the fee using the traveler's credit card or direct the customer to the counter to pay by another method.

The trip on American offered IdeaWorks staff the opportunity to have conversations with American's check-in counter employees, gate agents, and flight attendants. These conversations revealed consumers have largely accepted the new fees. The following summarizes the overall employee response: ***I am surprised by the level of passenger acceptance for the new baggage fees. The vast majority of passengers accept the change, rarely do we have someone who is irate about it.*** Flight attendants noted that carryon baggage has not dramatically increased since the fees were applied.

Commission-Based Products Will Likely Grow

Ancillary revenue is not limited to service fees; opportunities also exist at a carrier's website through the sale of travel-related services and other products. Airlines earn a commission on the items sold. In this regard, Ryanair is unmatched for its aggressive pursuit of revenue. The list of services and products goes far beyond travel and includes improbable items such as online gaming, vacation home sales, and even the distribution of electricity. The more than 16 million customers⁶ that visit Ryanair.com each month are generating sales; Ryanair places a high value on its website and only provides exposure to items that generate robust commissions.

American Airlines has probably noted Ryanair's bold moves and will likely include more retail activity at AA.com. The following table compares the ancillary revenue activities available at Ryanair.com to the current offers made by American Airlines at its website.

Ryanair Online Ancillary Activity Compared to American Airlines		
Categories	Ryanair	American
Activity-Based Packages	●	●
Airport Lounge Access	●	●
Airport Motorcoach / Bus Transfers	●	
Airport Parking	●	
Car Rental	●	●
Co-Branded Credit Card	●	●
Destination & Tourism Advertising	●	
Electrical Utilities and Energy	●	
Foreign Currency Exchange	●	
Gift Card for Airline Travel	●	●
Home Insurance	●	
Hostel / Bed & Breakfast Booking	●	
Hotel Booking	●	●
Life Assurance	●	
Online Gaming	●	
Online Retail Catalog	●	
Overseas Vacation Home Sales	●	
Resort and Theme Park Booking	●	●
Scratch and Win Cards to Buy	●	
Theatre, Concert, and Event Tickets	●	
Tour and Activity Tickets	●	
Train Transfers (Heathrow, Gatwick)	●	
Travel Insurance	●	●

Source: Review of ancillary revenue activities listed at airline websites during July 2008. Excludes those requiring participation in American's frequent flier program, and those not available on an a la carte basis.

The table has some surprising blanks for AA.com such as airport parking, online retail, and bed & breakfast inns. American might argue that its frequent flier program covers these activities. However that would miss the point - - Ryanair's objective is to generate the maximum amount of commission revenue from all website visitors. Participation in American's frequent flier program represents a distinct opportunity to generate revenue.

American's Other Ancillary Revenue Activities

American is already a leader in one ancillary revenue area; the carrier likely generates more frequent flier related revenue than any other airline in the world. The carrier revealed in its most recent annual report that it sold approximately 100 billion frequent flier miles to partners during 2007. Applying a modest price of a penny per mile indicates American generates at least \$1 billion per year from its frequent flier program.

However finding success in newer ancillary revenue areas has been more of a challenge. Where the carrier's large size is an attribute for centralized frequent flier marketing . . . this becomes a handicap for the rollout of operational endeavors such as its buy-on-board food program. The airline continues to finesse onboard menus and the provisioning of flights.

American's current selection of freshly prepared items sold on US domestic flights is displayed on the accompanying menu card. Flight attendants have been equipped with handheld card payment devices that speed the payment process and encourage passenger charge activity. Food quality is good but not exceptional. However, the airline would realize higher sales if it used better retail methods to promote, display, and present the food.

The airline has not yet mastered the anticipatory element of the buy-on-board environment. It is always a challenge to match the supply of freshly prepared items to consumer demand on each flight. Flight attendants report problems with catering shortages and over-catering. Unfortunately, consumers often respond to this uncertainty by making their food purchases at the airport before boarding the flight.

American now accepts credit and debit cards.

Hungry? Snacks and Fresh Light Meals Available.

Domestic Meal Service
We are pleased to offer you a choice of snacks for purchase on flights that are two hours or longer. Fresh light meals are available on flights that are three hours or longer. American Airlines offers you the flexibility to pay for food, beverages, and headsets onboard with your American Express® Card and other credit or debit cards.



Snacks
Available on domestic flights two hours or longer.

Individual Snacks - \$3 each

- MegaBite® Cookie (4 oz.)
- Great Nut Supply, Co. Nut Blend (4 oz.)
- Lay's Stax® Potato Crisps (5.75 oz.)

Cheese and Cracker Trays (3.55 oz.) - \$4 each



Fresh Light Meals

Morning Meals - \$6 each
One of the following is offered on domestic flights three hours or longer.

- Breakfast Bagel Sandwich
- Club Croissant Sandwich



Afternoon/Evening Meals - \$6 each
One of the following is offered on domestic flights three hours or longer.

- Italian Wrap
- Turkey and Cheese Ciabatta
- Asian Chicken Wrap



We continue to review our snack offerings to ensure that you have choice and variety.

American Airlines®
We know why you fly.

 American Airlines Recycles

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American is Enjoying Early Ancillary Success

While some employees of American Airlines expressed anger over the stock-based bonuses recently given to senior management, all employees encountered by IdeaWorks staff universally support management's efforts to generate more revenue through ancillary activity. American deserves congratulations for bold initiatives that have boosted revenue, been effectively implemented, and have captured employee buy-in.

The airline appears to have effectively communicated to consumers the dire need for assessing checked-baggage fees. Of course, the company has faced some of the usual accusations that these fees harass travelers with trivial and capricious charges. American does deserve some of this treatment given the carrier's traditional brand positioning as a "full service" airline. However, the airline has demonstrated a wily willingness to take risky measures to ensure its continued viability.

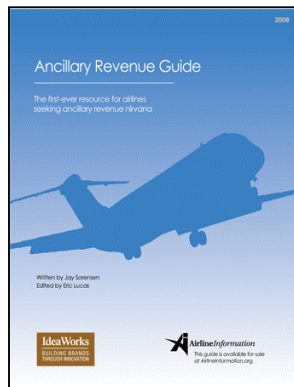
American does face the challenge of marketing its newly formed dual identity. Earlier, this report described the carrier as a "hybrid" with an a la carte style for domestic economy passengers, while delivering pampering to first and business class clients. The carrier is adapting the ancillary revenue model used by Ryanair and other low cost carriers to the legacy airline template. However, a model does not exist for American's larger transformation from a legacy airline to something that is very different . . . and as-of-yet not completely defined.

But perhaps a new entrant airline from Australia may provide the outline for American's template. Virgin Blue has styled itself as a "new world carrier" or an airline that has moved from rock-bottom pricing by adding long haul international routes and a la carte luxury such as business lounges and live television. What's to prevent American Airlines from being labeled in a similar fashion due to its position as an international airline that already offers the luxury of lie-flat sleepers, a worldwide network of lounges . . . and the newfound flexibility of a la carte pricing in coach.

New world carrier - - it has a nice sound and is especially apt for airlines that embrace innovation as a method to survive in a rapidly changing world.

Disclosure: IdeaWorks makes every effort to ensure the quality of the information in this report. Before relying on the information, readers should obtain any appropriate professional advice relevant to their particular circumstances. IdeaWorks cannot guarantee, and assumes no legal liability or responsibility for the accuracy, currency or completeness of the information.

About IdeaWorks: IdeaWorks was founded in 1996 as a consulting organization building revenue through innovation in product, partnership and marketing. Its international client list includes the hotel, airline, marine, railroad, consumer products and health care sectors. The firm is a leading expert on creating ancillary revenue opportunities for airlines. IdeaWorks has worked with airlines on ancillary revenue projects in Europe, the United States, and South America. Learn more at: IdeaWorksCompany.com



Ancillary Revenue Guide: IdeaWorks has created a first-ever 147-page guide on the topic of ancillary revenue. The effort is the result of research, interviews and analysis conducted during 2007 on a la carte pricing, commission-based services, and frequent flier activities. The guide is available at a price of US\$499 per copy, and may be ordered and purchased at the at the MoreAirlineProfits.com website.

Endnotes:

- 1 AMR Corporation, press release dated May 21, 2008 at American.com.
- 2 The Ancillary Revenue Guide by IdeaWorks 2008, The IdeaWorks Company.
- 3 “American Airlines plans nearly 7,000 job cuts” International Herald Tribune article dated July 3, 2008 at IHT.com.
- 4 Ryanair Full Year Results, 2008 Fiscal Year ended March 31, 2008, Ryanair.com.
- 5 United Airlines press release dated June 12, 2009, “United Airlines Announces New Checked Bag Policy for Domestic Flights”
- 6 The Ancillary Revenue Guide by IdeaWorks 2008, The IdeaWorks Company.