airline passenger experience association

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Low-cost carriers provide food for thought on how to drive ancillary revenue gains

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IdeaWorksCompany contributed information to this article - - see italics.

DUBLIN: An eclectic mix of fast-growing low-cost airlines recently came together in Ireland to discuss how they take different approaches to unbundling services for passengers.

At one extreme, Ireland's Ryanair and the USA's Spirit Airlines charge for everything from soft drinks to carry-on luggage, check-in fees and seat assignments. For instance, if Ryanair's CEO Michael O'Leary had his way, he'd charge passengers to use the loo, too. If you try to avoid checking a bag on Spirit and instead take it to the gate, hoping that the airline will check the bag at no charge, think again. Spirit has a $100 fee it calls a penalty for trying to game the system.

On the other end of the spectrum, the granddaddy of all low-cost carriers (LCC), Southwest Airlines, fundamentally remains a no-frills carrier. But in sticking to its 'Bags Fly Free' mantra it has broken not only with other LCCs but also legacy airlines that have moved toward unbundling. And the peanut-friendly carrier still provides complimentary snacks to passengers.

The Airline Economics: Growth Frontiers conference – held 19-21 January in Dublin – provided LCCs with a platform to share their views of the market.

THAT'S THE SPIRIT

For Spirit, unbundling is a "mindset," producing the lowest advertised airfare and allowing passengers to select what additional services they want to pay for. "The customers are smart and know this up front," says Edward Christie, senior VP and chief financial officer. "We are completely unbundled. We charge for most everything. We advertise that our price is the lowest fare. We charge for seat assignment, charge for bags, carry-on [and more] and the sum of all that is still lower than competitors."

Indeed, on its website Spirit offers membership to the '$9 Fare Club', promoting an average of $75 savings per booking even after all the add-ons compared with competitors, including 55% savings for checked bags versus the fees charged at the airport. A $9 Fare Club member generally saves $10 per bag, whether carry-on or checked. Assigned seating at the airport is free, but fees for advanced seat assignments range from $1 all the way up to $199.

Spirit charges for soft drinks and water, seating preferences and it is one of the only ones in the US to charge for carry-on bags (Allegiant Air is the only other one) as well as checked bags, now a common practice. But Spirit received a large amount of negative publicity when it announced a $100 fee for carry-on bags, a move that Christie says was misunderstood. "There was never an intention to charge a $100 carry-on fee. It's technically a penalty to those trying to avoid a checked bag." The sizeable fee, intended to discourage gaming the system, ends up speeding boarding.

Spirit is frequently rapped in the press for its fees and strict no-refund policy. But you can't argue with success. The carrier will grow by 18%-20% this year and by double-digits the next several years. It's among the most profitable airlines in the US. It had a net profit margin of 7.1% and an operating profit margin of 13.5% in 2011. The operating profit margin for the nine months through September 2012 was 14.3% and the net margin 9%.

Perhaps the greater story, however, is the revenue generated by 'non-ticket' income, or ancillary revenue. Through September, Spirit recorded revenues of $990.1 million; fully $396 million, or 40%, came from ancillary revenue.

Average non-ticket revenue per passenger flight segment (PFS) for the third quarter 2012 increased 11.5% year-over-year to $49.80 while average ticket revenue per PFS for the quarter decreased 12.1% year-over-year to $71.85 as Spirit continued its strategy to offer low base fares while increasing revenue from non-ticket sources," the airline said in its third quarter financial release.

FUELLING VUELING

On the other side of the pond Spain's Vueling Airlines calls itself a LCC that offers full service – or so an executive claimed at an aviation conference in Dublin, Ireland, in January. Surfing the carrier's website shows fee after fee after fee; the carrier is clearly unbundling products and picking up ancillary revenue in the process.

Carlos Jorge, fleet financing and purchasing director of Spain's Vueling, compares his airline to Southwest. "No assigned seats. No connecting flights. No loyalty flights. Not at main airports. It's the original Southwest model. Vueling is breaking all the rules, providing all these services," he says.

That may be, but Vueling has different levels of service for three different fares: ‘Basic’ (which is only the air fare), ‘Optima Fare’ and ‘Excellence Fare’. The fares above Basic provide increasingly desirable seat choices, one checked bag, participation in frequent flyer programs of partner airlines, same-day flight change options, instant check-in, more flexible flight changes, exclusive check-in desks, preferential board and even reserved carry-on space.

Vueling’s financial performance is a far cry from Spirit’s – or Southwest’s. It barely reported a profit in 2011, just EUR 10 million on revenues of EUR 856 million. Ancillary revenue was not broken out. But according to a 2012 study by IdeaWorks, Vueling in 2011 earned EUR 96 million from this source, about nine times its net profit.

INDIAN AMBITION

India’s Indigo Airlines, now the country’s only profitable carrier, is another operator that unbundles services. Buy-on-board meals are an option for the basic fare level and a higher IndoGo ‘Plus’ fare offers meals and assigned seating. “Six years ago, Indigo was on paper. Today it is the largest by market share, with 62 A320s,” says Indigo CFO Riyaz Peermohamed.

India is a notoriously difficult market for local airlines to make money. Still a developing country, Peermohamed notes that there are three million people for every jet in India. Low fares are a must, as is low cost. But, he says, “Low cost does not mean low quality. We offer very good service in the cabin; punctuality and high utilization. Most want to go from Point A to Point B at the lowest fare. Some customers who want full service can go to other airlines. We charge for food. Unbundling remains a feature of LCCs,” he adds.

Unbundling at Indigo has, perhaps, been taken new heights: it charges 50 Rupees per print out of duplicate itineraries at the airport. No data is available for unbundling revenue.

ANCILLARY LEADERS

Long-haul LCC AirAsia X’s ancillary revenue share was 16.5% in 2011, of EUR 77.9 million or EUR 31 per passenger, according to IdeaWorks. The airline receives ancillary revenues from checked baggage, seat assignments and preferences, food and drinks, comfort kits and duty free items, among others.

The IdeaWorks study defines ancillary revenue as not only the traditional unbundled products routinely thought of, but also as branded credit cards and advertising, such as in in-flight magazines. The company’s analysis shows Spirit received one-third of its revenue in 2011 from ancillary revenues; financial results through September 2012 show this has increased to 40%.

Allegiant Air of the USA received 27% of its revenue from ancillaries, trailing Jet2.com by one-tenth of one percent. These three carriers were the leaders in 2011, according to the report. Surprisingly, Ryanair, for all its high-profile nickel-and-diming passengers to death in Europe, obtained only 20.5% of its revenue from ancillaries. Southwest Airlines' ancillary share, meanwhile, was only 7.5% in 2011.

IT'S ALL RELATIVE

Characterising an airline as an LCC is somewhat in the mind of the beholder.

"Low cost is a relative term," says Spirit's Christie. "If your costs are lower than the other guy, then you are a low cost carrier." Furthermore, "you've seen LCCs historically evolve. The best example is Southwest. Now they've layered a little into products to produce a larger revenue base. Not so at Spirit. Our product is the safest, lowest price from Point A to Point B. Our customer experience is all about the cheapest transportation."

Antonio Gomes de Menezes, president of the SATA Group in Portugal, has this take: "We do have a low-cost base, but don't define us as a low cost carrier," he says. "We position the brand as full service, it's the oldest brand in Portugal, but we can't charge for higher air fares. As a full service carrier, we have to be innovative to keep costs down. We're a small airline and marginally profitable. People need to have low fares or they won't fly.

"We have segmentation but it's not the typical unbundling. It's value-added service."