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Everything carries a price in this business climate

By Phil Rosenthal

IdeaWorksCompany contributed information to this article - - see italics.

By now, the idea of airline baggage charges, extra legroom at a cost, paying for food and so on, has become for travelers a bit like the preflight safety spiel about how seat belts work.

It may annoy. Or perhaps it has become so common that it no longer elicits much response. But these transactions are helping keep the planes flying, and they illustrate a market reality increasingly faced by a wide spectrum of consumers and businesses.

"Back out that ancillary revenue and some airlines that posted profits would not just have posted losses but significant losses," Henry Harteveldt, chief research officer and co-founder of California-based Atmosphere Research Group, said Friday in an interview.

Efforts by airlines around the world to increase revenue apart from ticket prices have grown almost tenfold since 2008 to $22.6 billion, according to a new study by IdeaWorks Co., a Wisconsin-based industry consultant. And, even with that, the International Air Transport Association is projecting overall global airline profits will be down in 2012 for a second successive year to about $3 billion.

That's a profit margin of just 0.5 percent, so what some see as nickel-and-diming is viewed within the turbulent airline industry as pennies from heaven.

"The whole economics of the business have been an absolute disaster since the fuel crisis of 2008," IdeaWorks President Jay Sorensen explained. "Airlines are just desperate for money."

The economy has ensured that this desperation is not unique to airlines or even the travel business, where hotels may look to charge for a Wi-Fi connection that Starbucks will give you for free, or assess a resort fee on top of the cost of whatever the resort's room rate is and maybe tack on a housekeeping surcharge.

You see this batteries-not-included mentality elsewhere, with customers reeled in by a low introductory price and then given the upsell pitch. Cellphone companies that once touted all-inclusive services look to sell data and voice separately. Banks try to assess new fees to cover costs they once absorbed.

Strap yourself in for more — at least for a while.

"In an industry cycle, in the beginning, when you're in a high-growth period, you tend to see a lot of bundling, giving a lot of things at one price," Jean-Manuel Izaret, a partner and managing director of the Boston Consulting Group, heading their pricing practice, said by phone. "At the other extreme, when you are in the super-mature area, you'll have low-cost providers entering certain markets with no-frills offers.

"If (the legacy companies) price above (the newcomers), everybody goes to the low-price guys, and if you match the price but with the frills, you lose money," Izaret said. "So in a mature market, where low-cost challengers have come in and undercut the prices of established players, the only option for established players is to unbundle and price every little thing separately."

Then after a while, another maverick tries to cut through the clutter and simplify matters for consumers, by offering several a la carte services for one fee. Maybe a carmaker touts simplified pricing. Others follow. The cycle continues.

"Airlines are … going to have to be careful of nuisance fees, like checked bags and seating, and focus instead on inventing services that have not been offered before that people value," Sorensen said.