The Ancillary Jungle

Airlines adapt their revenue models to leverage extra fees.

By Christine Boynton

The year was 1990 when Ryanair (FR) switched from a full-service carrier to a low-fare model. The next year it made its first profit. Sixteen years later the airline began charging for checked baggage.

Ancillary fees and a la carte options are now an important part of many airline revenue streams. They have prompted criticism from the public and lawmakers, but these types of fees are not unique to the industry.

Companies such as Disney Parks and Resorts, hotels and cruise ships charge ancillary fees—and have been doing so for years. "Good ideas are embraced within an industry; great ideas are adopted by those outside the industry," IdeaWorksCompany president Jay Sorensen said.

He said Disney earns as much as 49.1% of its revenues from ancillary fees, equating to annual ancillary revenue of $3.74 billion, from things such as merchandise, food and early admission options—in other words, charges for goods and service that are not covered by the general admission fee.

"This whole thing really began with Ryanair and easyJet in Europe, selling different a la carte items," Sorenson told *ATW*. "The world that they operated in was very simple. Everything they sold, they sold through their own website. There was no outside distribution system; there was no need for reconciliation with travel agencies or account systems or any of that. If they sold it on their website, there was a charged transaction and the money all stayed within their walled garden. Now you have other airlines, traditional airlines, network airlines, jumping onto this ancillary revenue bandwagon."

Revenue champs

In a report by Amadeus and IdeaWorksCompany, ancillary revenue (earnings gained beyond the sale of tickets and which are generated by direct sales to passengers or indirectly as part of the travel experience) from 176 airlines is projected to reach $36.1 billion worldwide in 2012, or 5.4% of 2012 global airline revenue of $667 billion.

These numbers have grown from $2.45 billion reported by a list of 23 airlines in 2007 and from $22.6 billion reported by 50 airlines in 2011.

The Amadeus Worldwide Estimate of Ancillary Revenue report forecasts "tradi-

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tional airlines" will generate $12.8 billion of ancillary revenue in 2012; "US major airlines," $12.4 billion; "ancillary revenue champs," $5.6 billion and "low-cost carriers," $5.4 billion.

The report categorizes "champs" as carriers that generate the highest activity as a percentage of operating revenue, naming AirAsia, Allegiant Air, easyJet, and Spirit Airlines (NK) as examples.

"The 'champs' work to create a brand where effectively the price becomes a brand or the most important selling point," Sorensen said. "So when you ask [FR CEO] Michael O'Leary or [NK CEO] Ben Baldanza, 'What is your product?' they're going to say price. Having low fares. And [they have] an aggressive entrepreneurial drive to create new ancillary revenue."

These fees bring in additional revenue for airlines and lower the basic fare for passengers who can do without the extras. They have also been used as a way to change customer behavior. NK in October began charging a $100 fee to people who opted to pay for a carry-on bag late in the boarding process, rather than paying the $25-$35 fee during online check-in.

NK president and CEO Ben Baldanza said, "Some might say we've taken a pounding in the press over our announcement of $100 carry-on bag fee. But we're pleased with the publicity, as it assists us in making customers aware of how to avoid paying it. We don't want anyone to pay this fee, but believe this fee will be an incentive for customers to pay for their bag before they get to the gate, which in turn helps us to achieve our goal of a speedy boarding process."

FR, in a similar concept, began charging a €60 ($76) "boarding card reissue fee" to any passenger who does not print their boarding pass before arriving at the airport, the philosophy being to expedite the boarding process.

"Ryanair's optional fees are designed to encourage passengers to travel in a low cost way, which enables Ryanair to save costs and pass on these savings through the lowest possible fares to our passengers," FR head of communications Steve McNamara said in a release. "At Ryanair we don't want your fees, we want to change passenger behavior so that all passengers book their tickets and travel with us in the lowest cost manner."

Other ancillary costs today typically include extra legroom, early boarding, food and beverage, and perhaps the most common, baggage.

Baggage fees began around the start of the latest global economic downturn, and became an essential revenue booster for carriers struggling with weak travel demand and rising oil prices.

"Baggage was an unbelievable gift in terms of revenue," Sorenson said. "It was something that was instant."

According to IdeaWorksCompany, the top five ancillary revenue-generating airlines in 2011 in terms of percentage of total revenue were NK (33.2%), Jet2.com (27.1%), Allegiant (27%), easyJet (20.8%) and Ryanair (20.5%).

Selling extras

Before the Internet, raising airline fares was a more realistic option in combating tough economic conditions. Today, it takes passengers seconds to compare fares online and, struggling to maintain competitive pricing, airlines have embraced the ancillary strategy.

"No one had access to that quality of information at an airline [before] . . . now it's in the hands of the consumer," Sorensen said. "Airlines have been conditioned to not let that pricing get out of line because it would make an immediate impact on booking."

However, as fees and fares become more complex, airlines—particularly network airlines—have run into problems marketing and selling the add-ons in some of the common distribution channels.

"[Network airlines] were more or less duplicating the walled garden approach of Ryanair and easyJet," Sorensen said. "There are a couple of problems with that. You begin to run into conflicts with GDS agreements. You begin to lose the opportunity of selling more through travel agencies. You have consumers who can buy certain things on your website but they can't at expedia.com. Network airlines are learning they can't work in isolation."

The need for a convenient electronic method for tracking these purchases prompted the electronic miscellaneous document (EMD), which IATA is requiring all distribution system (GDS) providers to provide to travel agencies in all markets by the end of 2013.

According to IATA, approximately 60% of tickets by value are sold through travel agencies using GDSs, and this portal may not allow enough flexibility for airlines to create personalized offerings.

To combat this, some carriers—including American Airlines—have set up a "direct connect" feature that allows travel agents to bypass the GDS and instead connect directly with its internal system using an XML link for booking the flight and any optional extras. Others have signed special agreements with GDSs to incorporate the sale of certain ancillary products, using the Airline Tariff Publishing Co. optional services standard, which was introduced early on—in 2008.

The IATA World Passenger Symposium (WPS) in Abu Dhabi in October addressed the growing need to differentiate airline products beyond the lowest ticket price, adopting a resolution on a foundation standard for a new distribution capability (NDC). It expects to complete the definition of standards for NDC in 2013.

The NDC, which will have an aggregator role to allow product comparisons, is intended to allow airlines to offer more options and variety to their customers through the GDS channels, providing tailored offerings—much like a traveler booking a hotel room can see pictures and add options prior to checkout.

"A foundation standard for the NDC is the first step to enabling the development of open XML standards that will be available for all interested providers to work on and develop their own offerings," IATA SVP industry distribution and financial services Aleks Popovich said. "[WPS] participants have agreed that the industry standard is paving the way for the future, and the time is right to move to a new model." ATW