LOW COST & REGIONAL airline business

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Levelling the Field

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Southwest Airlines, one of the world's most successful low-cost carriers, reported its 40th consecutive profitable year in January – despite maintaining strict policies on its ancillary revenues. Airlines the world over have persistently attempted to imitate the successful ethos of the American carrier, but few have achieved either the profitability or the customer loyalty. And fewer still have limited their ancillary offerings.

Maintaining its passengers' enthusiasm for the brand, however, could be strained this year with the announcement of increases to its existing ancillary fees. Low-cost travel is already littered with $10 check-in fees and $50 luggage allowances. Southwest, however, has become famous for adopting a 'bags fly free' approach – one that it hopes will sustain loyalty. The airline is unique because it restricts its fee activities to those that add convenience and comfort for travellers above current levels. Southwest has not, so far, filed fees that represent an unbundling of its core product.

But things are changing at – arguably – the world's most-loved airline. Chief financial officer, Tammy Romo, told reporters recently that the passenger revenue for every seat flown one mile would rise by a low single-digit percentage in the first quarter compared with the same period in 2012. This followed the carrier's announcement that it plans to increase revenue by up to $1.3 billion in 2013 over 2012, when it enjoyed revenues of $17.09 billion.

Southwest revealed in December it would begin charging fees for no-show passengers with the cheapest fares, calling the initiative 'Wanna Get Away'. The increases are expected to bring in an additional $100 million for the Dallas-based company in a bid to further boost profits. Southwest's other plans include selling selected boarding positions at the gate and a significant tightening of flexibility on its most restricted fares. Fines will be incurred if a passenger fails to cancel a reservation, while the airline will also raise fees for early check-in and oversized bags.

Jay Sorensen, president of IdeaWorksCompany, believes that the changes made by Southwest will not alienate its customers, claiming: "[It] certainly has built a huge portion of its marketing message on the 'no fees' promise. But I think a change would create far more internal angst than it would for consumers. This company's ethical emphasis and promise to consumers is a core employee

belief. With bankruptcies, mergers, impending government shutdowns and recession, the American consumer seems prepared for anything."

With the increases however, come attractive new services within its rewards programme and in-flight à la carte services. Southwest is trying to tap into a wider market, including a range of corporate customers. It claims that the revised programme makes its co-branded credit card offer much more attractive and, as a result, its cardholder base and charge activity have swelled. Sorensen also says: "Look for more in 2013 and 2014, especially services that make the airline more attractive to corporate travellers."

Chris Mainz, a spokesman for Southwest, claims that the increases are a result of not reaching financial targets. In particular, the company aims to reach a 15% return on invested capital. "This will allow us to consider growing again, adding airplanes and hiring employees. The increases we made were a move to be more in line with the rest of the industry, so it doesn't put us at a disadvantage."

Southwest's merger with AirTran, however, has perplexed some analysts, concerned over the distinct lack of ideological integration when it comes to ancillary incomes. If Southwest believes its policy of 'two free bags' is the best, why has this not been integrated into its new subsidiary airline, AirTran? It's possible that the company has yet to decide on its future direction.

Mainz says: "AirTran and Southwest continue to operate independently under each respective brand. We have harmonised almost all of our policies, and we will harmonise our baggage policy once we are fully integrated by 2015. So it is coming."

For now, however, the two policies are markedly different. At AirTran, the fees for checked bags have increased from \$20 to \$25 for the first bag, and from \$25 to \$35 for the second.

Some observers have queried the pace of the integration, since the \$3.4 billion merger happened in September 2010. Despite Southwest operating hundreds of flights under the AirTran brand, its policies, as do many systems, remain different. A passenger is unable to connect between the two entities with a single ticket, preventing Southwest from achieving any form of revenue synergy.

However, progress is still underway, according to the airline. In February, Southwest announced that a codeshare agreement had been tested and would be rolled out to another 34 cities. And by 2015, the airline's true beliefs on ancillary revenues will surely become clearer.