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With a Fee for Everything, Airlines Jet Toward a New Business Model

This article is based upon a report issued by IdeaWorksCompany

Who knew that the hotel minibar would serve as such an inspiration to an entire industry? Saddled with rising fuel costs and the demands of recession-weary consumers that fares not skyrocket, airlines have taken to add-on charges in a big way.

And it's not just fees for baggage checks anymore. Inspired by the captive audience-meets-a la carte concept of the hotel minibar, airlines of every stripe are finding new and creative revenue streams. Last year, 53 of the world's airlines reported a whopping \$27.1 billion in ancillary revenues, according to a new report by the consulting firm IdeaWorks Co. That's a significant rise from the \$2.45 billion in add-on revenues that 23 airlines reported in 2008, back when sales from ancillary items were relatively new.

"I think the ancillary revenue movement - or shall I say a la carte fees - goes beyond mere revenue," says Jay Sorensen, CEO of IdeaWorks. "It offers the potential for an airline to better tailor service to the needs of individual customers. They can click and buy the amenities they want rather than the airline deciding what is bundled in the base fare."

For years, discount carriers like Ireland's RyanAir (RYAAAY) and the United Kingdom's EasyJet (OTCMKTS:EJTTF) have relied on ancillary fees for a large portion of their overall revenues. Last year alone, RyanAir racked up nearly \$1.4 billion in add-on revenues, some 22% of its annual revenues that account for more than \$17 per passenger. This year, the title of Grand Poobah of Ancillary Revenue goes to Spirit Airlines (SAVE), whose half-billion dollars in add-on sales accounted for more than 38% of its annual revenues. Spirit got each passenger to fork over nearly \$49 in extra fees last year.

Baggage-check fees marked the beginning of the add-on trend. But passengers quickly responded to those fees by refusing to check their bags. In turn, airlines tweaked the add-on business model to make customers perceive many of the new fees as adding value to their trips, says Sorensen. IdeaWorks estimates that "economy comfort" seating, for example, contributed some \$88 million to AirFrance/KLM's (OTCMKTS:AFLYY) transcontinental routes in 2012.

What surprised Sorensen most in this year's revenue survey is the extent to which full-service airlines in America and even Europe have embraced the a la carte trend. "Air France/KLM is rapidly going down this path and offers many optional extras, such as fees for better seats, premium meals, and holding - but not buying - a reservation," he says.

According to IdeaWorks, America's largest airlines like United (UAL) and Delta (DAL) generated most of their ancillary revenues (more than \$6 billion worth) by selling frequent flier miles, especially in conjunction with credit card companies. Baggage fees still account for 20% of their add-on sales. European carriers are following suit. In the case of Norwegian Airlines, the company owns a portion of Bank Norwegian, which paid the airline commissions of \$6.9 million from Visa (V) card fees last year.

The major US and European carriers are offering an ever-growing list of products like food, drinks, Internet access, and commissions from hotel bookings. Plus, they're monetizing things like priority security screenings, exit row seats, early boarding, and even one-time access to booze-filled airport lounges. The "EarlyBird" boarding program made Southwest Airlines (LUV) more than \$160 million last year.

The cost of jet fuel rose by more than \$0.25 per gallon this summer, prompting many non-discount airlines to join the race for add-on fees. Some high-end carriers, like the UAE's Emirates and Germany's Lufthansa (OTCMKTS:DLAKY), however, continue to make less than 1% of their annual revenues from ancillary fees.