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Budget Fliers Should Love Airline Fees

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Air travelers love to gripe about fees: \$25 to check a bag; \$34 for early boarding; \$129 for a few more inches of legroom. In the name of protecting passengers, Sens. Ed Markey (D., Mass.) and Richard Blumenthal (D., Conn.) have proposed the Fair Fees Act to ban upcharges that are not “reasonable and proportional” to airlines’ costs. But the bill would wind up hurting budget-minded travelers, who would lose the ability to make trade-offs while facing higher base airfares.

Airline pricing hasn’t always centered on extra fees. Before the Airline Deregulation Act of 1978, fares were set by the Civil Aeronautics Board, a government agency. Since airlines couldn’t compete on price, they lured customers with amenities. Western Airlines provided free champagne. After deregulation, airlines found that passengers wanted cheap flights. So the companies cut costs and unbundled services. The result is today’s two-tier structure: a low base fare, with extras that can be tacked on.

The challenge for this kind of model is managing perceptions. A gas station, for instance, has two options for recouping credit-card fees. It can implement a surcharge of five cents a gallon for customers paying with plastic. Or it can raise the price slightly for all customers, and then offer a cash discount of five cents a gallon. Psychologically the latter is better, but financially the effect is exactly the same.

Apply that to airlines. Customers may feel nicked and dined, but the a la carte model gives them the option to save money. Theoretically airlines could bake the cost of amenities into the base fare and then offer “discounts” for giving them up. But that isn’t intuitive: Take \$9.95 off if you don’t use in-flight Wi-Fi?

It is fair to ask why prices for some add-ons are so high. American Airlines recently charged \$22 for “preferred” seating in the front of the cabin—but with no added legroom. Internet access on some flights costs \$40. Is this gouging? No, travelers who pay for these extras are subsidizing low fares for the rest.

Think about movie theaters, where the profit comes from the concession stand. Theaters mark up popcorn 1,000% or more. Should Congress pass a Fair Salty Snack Act to crack down on buttery windfall profits? This is simply price differentiation. Moviegoers who buy popcorn are subsidizing patrons who only want to see the show.

In 2014 airlines generated \$38 billion in ancillary revenue, according to a study by IdeaWorks. That money keeps base fares low. And airline profits are far from outrageous. The average net margin for all scheduled U.S. carriers was 4.4% in 2014. Even in the first three quarters of 2015, after oil prices had plummeted, the average net margin was only 14%.

If Congress bars airlines from selling a la carte extras, they will be left with no choice but to raise base fares. There may be less griping about fees, but only because budget-minded travelers will find themselves unable to afford a flight in the first place.

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