The West Australian
thewest.com.au

August 30, 2016

Airfare price revolution

By Clive Dorman, Consumer Editor for AirlineRatings

IdeaWorksCompany contributed information to this article - - see italics.

We pay more for extras but airfares have never been so cheap

We've never paid so much in extras on top of our air fares – yet air fares have never been so low. Even though sky-high aviation fuel prices that led to the revolution in air fare pricing a decade ago have plummeted, a la carte pricing is here to stay.

So-called ancillary pricing – optional extras for everything from baggage to seat selection – continues to grow as airlines slash "core" fares.

Yet, despite initial resistance to paying for items that used to be "free", consumer acceptance has been high. In fact, ancillary revenue specialists have created a whole new industry advising airlines on how they can tap into new revenue streams for extras.

US consultancy IdeaWorksCompany, of Milwaukee, Wisconsin, has become the recognised global expert on ancillary revenue and its annual report, due out on September 20, is eagerly awaited by airlines.

The phenomenon took off in 2007-08, when oil prices had rocketed to a record $US150 per barrel from the regular price of around $25 since the 1970s and airlines desperately needed a new way of recovering costs.

For some airlines, nearly 50 per cent of their total costs was now jet fuel when it used to be nearer 20 per cent and the industry was swimming in red ink as a result.

In its first annual report on the subject, Ideaworks in 2008 estimated airlines around the world were charging an estimated $US13.5 billion a year in ancillary extras.

By 2015, that figure had soared to $US59.2 billion, a rise of nearly 450 per cent, with the figure still increasing by around 20 per cent a year. But now, with the oil price below $US50 a barrel, there's no going back to the old system of inclusive fares. Airlines have sold a la carte pricing to their customers as increasing choice and, in America, customers have responded by awarding airlines with the highest ancillary revenue rates the highest profitability and growth.

In 2016, the International Air Transport Association estimates that global airlines will make $US39 billion in profits – a vast improvement on the mega-losses after September 11, 2001, and the 2007-08 global financial crisis, but still one of the poorest rates of return for any industry – a margin of 5.6 per cent on revenue of $709 billion.

However, without ancillary revenue, it's estimated that airlines this year would be losing around $US30 billion collectively. IdeaWorks' latest analysis of the figures for 2015, published in July 2016, shows that, while full-service mega-carriers are the giants of ancillary pricing in dollar terms, it is the low-cost carriers who are pushing the envelope in the portion of every dollar earned that is optional extras.

In a crazy twist America's United Airlines - which is a "full service airline" - tops the overall ancillary revenue charts raising $6.2 billion from optional extras, which includes the revenue earned from frequent flyer programs.

But only three low-cost carriers – America's biggest domestic airline, Southwest, and Europe's Ryanair and easyJet – made it into that top 10 on dollar value.

But when it comes to reliance on ancillary items, America's ultra-low-cost carrier Spirit Airlines, tops the chart, deriving 43.4 per cent of every dollar of revenue from ancillaries, followed by American holiday airline Allegiant (37.6 per cent) and Europe's Wizz Air (36.4 per cent).

The rest of the top 10 were European low-cost airlines, except for Australia's Jetstar (21.3 per cent) and the Singapore edition of Tigerair (20.8 per cent). Surprisingly, Europe's biggest low-cost carrier, Ryanair, which used to have a reputation for ambushing its customers with ancillary fees, came in at a lowly No.5 on the list (24 per cent.)

The ancillary revenue industry is bullish about the future.

A new company, Seatfrog, which has partnered with booking engine Amadeus to launch a system that allows passengers to bid for seat upgrades in the 48-hour window prior to takeoff, quotes one report that ancillary revenue could surge past $US130 billion a year by 2020 – double the current level.

But even ancillary revenue's greatest fans like IdeaWorksCompany chief executive Jay Sorensen are hosing that down.

"We don't do long term forecasts for ancillary revenue," Sorensen tells AirlineRatings.com. "I'd never go beyond a year or two out. $130 billion . . . well that's well north of my numbers."

However, the old days where you pay a set price up front for an airline ticket are gone.