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Ancillary Revenue Soars Globally

By Andrew Compart

This article is based upon a report issued by IdeaWorks.

Ancillary revenue increased dramatically among carriers worldwide in 2009, primarily driven by the spread of checked bag fees, a new analysis concludes. And there are signs of new trends that could boost airline coffers even more.

The Amadeus-sponsored analysis by U.S.-based IdeaWorks, which advises airlines worldwide on ancillary revenue strategy and tactics, found a 43% year-over-year jump in reported ancillary revenue to €11 billion (\$13.5 billion) among 96 airlines that included the information in their financial filings.

The report's estimates include revenue from a la carte features, such as fees for checked baggage, assigned seats and premium economy seats, charges for inflight snacks, meals and beverages, commissions from hotel and car rental bookings, sales of travel insurance and partner revenue generated by frequent flyer programs.

An unidentifiable portion of the 43% increase can be attributed to better airline reporting of ancillary revenue amounts, rather than an actual increase in the amounts. That's because some airlines stopped lumping all their ancillary revenue with other revenue categories in financial reports, and instead began breaking out at least some of the revenue into a separate line item that now can be identified and included in the totals. That included more disclosure of credit card-related revenue from the sale of frequent flyer miles to card-issuing banks, which is a major revenue generator IdeaWorks President Jay Sorensen says.

Sorensen, however, says he believes the increased reporting of ancillary revenue only accounts for a small portion of the 43% increase. (He also notes that most airlines still are not disclosing ancillary revenue as a separate category.)

For the amount that can be identified, the vast majority of the year-over-year increase of more than €3 billion can be attributed to higher ancillary revenue collections, especially from baggage fees, Sorensen says. Charges for a first or second checked bag have been spreading — and continue to spread—because it is an attractive revenue source attached to a tangible service, and other airlines have been so successful with it, he says.

According to the report, the biggest collectors of ancillary revenue in 2009, ranked by total amount, were United Airlines and American Airlines, both at about €1.5 billion (\$1.9 billion), followed by Delta Air Lines at €1.1 billion (\$1.4 billion)—all primarily on the strength of their baggage fees and frequent flyer mileage sales.

The rankings are much different, however, when looked at from another perspective: the percentage of total revenue attributed to ancillaries. On that basis, U.S. low-cost carriers Allegiant Air and Spirit Airlines ranked first and second, at 29.2% and 23.9%, respectively. Ryanair, EasyJet and Tiger Airways rounded out the top five, followed by Jet2.com, Aer Lingus, Alaska Airlines, Flybe and AirAsia.

Baggage fees continue to spread, Sorensen says, but that will not be the only factor that continues to drive ancillary revenue higher. One area for growth, he predicts, will be charges for inflight meals.

Sorensen expects snack and meal charges to spread to longer-haul flights, perhaps at first, by continuing to serve the standard meal for free but letting customers pay extra to preorder a premium meal. KLM already is testing the concept this summer, and Sorensen says airlines larger than KLM also are considering it. Over the longer term, Sorensen believes airlines will begin charging for all meals in coach, as long as it fits with the airline's branding.

Another emerging trend is yield management of fees for optional services, such as paying for preferred seats in economy, with the amount of the fee adjusted based on the demand for seats on any particular flight.

JetBlue, for example, says it recently began using its new SabreSonic system to offer 11 different price points for its "Even More Legroom" seats in economy, based on customer demand for a particular route. Previously, the only price differences were based on flight length, and JetBlue expects the demand-driven pricing method to generate an additional \$10 million in revenue for the second half of this year.

There are some technical challenges in yield-managing fees, however, so Sorensen does not believe it will spread to many more carriers until 2011 or later.