

SPECIAL REPORT: ANCILLARY REVENUE

With the growing popularity of ancillary revenue in the European and North American airline markets, is the Middle East missing out?

With pressure on the aviation industry to expand its revenue streams, a recent study by IdeaWorks has predicted that airlines will make around US\$22 billion in ancillary revenue this year. The forecast – a staggering 43% increase on 2009 figures – was announced at last month's Horizons 2010 conference at The Westin St. Francis hotel in San Francisco after detailed research into the financial performances of 46 airlines throughout the world.

“Ancillary revenue is defined as revenue that is beyond the sale of tickets and generated by direct sales to the passenger, or indirectly as part of the travel experience. During 2009, it became a crucial component of the revenue mix for all types of carriers – from major to small, worldwide to regional, LCC to full service,” observes Jay Sorensen, president of IdeaWorks and author of the *2010 Guide to Ancillary Revenue*, which was published in partnership with global technology specialist Amadeus.

The growing popularity of ancillary revenue has resulted in a diverse range of options for airlines to consider, which can be split into four main categories, according to the IdeaWorks report. “The first category– titled ‘a la carte features’

– includes the onboard sale of food and beverages, assigned seats, checking of baggage, onboard entertainment systems and wireless internet access. The second category is ‘commission-based products’ and refers to the commission earned by airlines on the sale of hotel accommodation, car rentals, travel insurance, airport parking, and the like. This primarily involves the airline’s website, but it can include the sale of duty-free and consumer products onboard aircraft,” states Sorensen.

“The third category – titled ‘frequent flier programmes’ – largely consists of selling points or miles to programme partners, such as co-branded credit cards, hotel chains and car rental companies. The direct sale of miles to programme members also qualifies. Our final category is ‘advertising sold by the airline’, which includes any advertising initiative that is linked to passenger travel, such as revenue generated from the in-flight magazine and advertising messages sold in or on aircraft,” he adds.

US-based carriers have remained at the forefront of this revolution, with the highest amount of ancillary revenue in 2009 reported by United Airlines (\$2.12 billion), closely followed by American Airlines in second position (\$2.09 billion) and Delta in third position (\$1.55 billion). Much of this monopoly can be attributed to a stronger emphasis on baggage fees in

THE DEFINITION OF ANCILLARY REVENUE, ACCORDING TO IDEAWORKS

- **A la Carte Features:** These represent the items on the ancillary revenue menu and consist of the amenities consumers can add to their air travel experience. The list continues to grow and the following are typical activities: 1) onboard sales of food and beverages, 2) checking of baggage and excess baggage, 3) assigned seats or better seats such as exit rows, 4) call centre support for reservations, 5) fees charged for purchases made with credit cards, 6) priority check-in and screening, 7) early boarding benefits, 8) onboard entertainment systems and 9) wireless internet access.
- **Commission-Based Products:** Ancillary revenue activities also include the commissions earned by airlines on the sale of hotel accommodation, car rentals and travel insurance. The

- commission-based category primarily involves the airline's website, but it can include the sale of duty-free and consumer products onboard aircraft.
- **Frequent Flier Programmes:** The frequent flier category largely consists of the sale of miles or points to program partners such as hotel chains and car rental companies, co-branded credit cards, online malls, retailers and communication services. Sales of miles or points made directly to program members also qualify.
- **Advertising Sold by the Airline:** This is a new category for and includes any advertising initiative linked to passenger travel. The following are typical activities: 1) revenue generated from the in-flight magazine, 2) advertising messages sold in or on planes, loading bridges or gates.

the North America market, together with robust partner revenue from frequent flier programmes. However, when looking at ancillary revenue as a percentage of total revenue, it's actually low cost carriers that lead the market, with US-based Allegiant and Spirit Airlines making 29.2% and 23.9% of their total revenue from ancillary services, respectively. Next on the list are Europe's Ryanair (22.2%) and easyJet (19.4%), followed by Singapore-based Tiger Airways (19.4%).

"By every measure, the ancillary revenue movement is growing. More airlines are switching on a la carte fees and disclosing financial activity. Existing practitioners are boosting revenue streams by adding services, testing price limits, and becoming better marketers," continues Sorensen.

Middle Eastern carriers are a notable omission from the IdeaWorks report, which Sorensen attributes to the fact that ancillary revenue has not been embraced by carriers in the region and financial reporting is somewhat scant in the Middle East. "Should these carriers seek ancillary revenue?" he asks, rhetorically.

"I would argue most airlines do, but the Middle East seems to be the least aggressive in this regard. It's only a matter of time, as ancillary revenue is too tempting to ignore, although I don't believe this will change dramatically within the next three years."

It seems the carriers most likely to make the list in future years are Emirates, Air Arabia and Royal Jordanian. Indeed, Emirates was ranked the eighth top airline for total ancillary revenue in 2008, but was nudged out of the 2009 list by the entry of Air Canada and TAM Airlines.

"There are multiple ancillary revenue activities at Emirates and using information from its 2009-2010 annual report, for the period ended 31st March 2010, we calculated approximately \$304.4 million in ancillary revenue. This represents around 2.3% of its total revenue," says Sorensen, while admitting that Emirates does not disclose any specific information about ancillary revenue, which means IdeaWorks looked at qualifying activities in the annual report, such as the sale of consumer goods and revenue from excess baggage charges. In comparison, the ancillary revenue of low cost carrier Air Arabia has been calculated at \$10.3 million, which is around 1.7% of its total revenue. Over at Royal Jordanian, the ancillary figure

1.52
United's ancillary revenue in last financial year (in US \$ billions)

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Jay Sorensen, president of IdeaWorks

is \$9.58 million, approximately 1% of the national carrier's total revenue.

"Carriers in the Middle East have traditionally exhibited a tremendous amount of pride in regards to high service standards. Many of them have solid reputations within the business traveller market for providing a first class service," explains Sorensen. "Creating an 'a la carte' oriented product in economy class could be more difficult under this scenario, as the airline would risk creating a big branding gap between the different classes. Although it's difficult to solve this dilemma, it's not impossible."

The situation is unlikely to change for at least six years, he continues, with much work to be done on the issue of branding gaps. "My advice to Middle Eastern airlines? Maintain an exceptional product for business travellers and become known as a low fare solution in coach, through the application of a la carte pricing. Virgin Atlantic was once very successful in these methods until they felt the need to compete with British Airways and lost their original image for thrift in coach."

Another successful case study is the UK-based low cost carrier Ryanair, which many believe has pioneered the concept of ancillary revenue. In fact, during a well-publicised competition last year, the carrier asked European passengers to suggest ideas on ancillary revenue, with a cash prize on offer for winners. Responses from passengers matched the tongue-in-cheek style of the competition, with suggestions including a charge for the use of toilet paper, safety cards and oxygen masks, with some suggesting the low cost carrier could charge a premium for bikini-clad cabin crew.

"As the largest low fares airline in Europe, our costs and fares will continue to be reduced by stimulating ancillary revenues," comments Ryanair's head of communications Stephen McNamara. "We have always provided passengers with choice. If you don't want to pay for food – don't buy it.

"If you don't want to pay checked in bag charges – don't bring checked in bags. If you don't want to pay handling charges – then just use Visa Electron entirely free of charge."

“Airlines are only now beginning use the high-yield travel agency channel to sell their range of ancillary services...”

Philippe Chérèque, executive VP, commercial, Amadeus

ANCILLARY REVENUE ACTIVITIES FOR MIDDLE EAST AND AFRICA AIRLINES

Air Arabia	
Source and Type	Multiple ancillary revenue activities
Ancillary Revenue	€ 7,394,444
As a % of Revenue	1.7 %
Euros per Passenger	€ 1.80
Reporting Period	Calendar year 2009
Total Revenue	€ 437,776,182
Passengers	4,100,000

Information Source: Annual Report 2009 for Air Arabia

Comair (South Africa)	
Source and Type	Partner activities associated with the frequent flier program
Ancillary Revenue	€ 873,976
As a % of Revenue	0.3 %
Euros per Passenger	€ 0.24
Reporting Period	12-month period ending 30 June 2009
Total Revenue	€ 326,219,674
Passengers	3,600,000

Information Source: Annual Report 2009

Emirates	
Source and Type	Multiple ancillary revenue activities
Ancillary Revenue	€ 218,448,000
As a % of Revenue	2.3 %
Euros per Passenger	€ 7.96
Reporting Period	Fiscal year ended 31 March 2010
Total Revenue	€ 9,647,010,000
Passengers	27,454,000

Information Source: Annual Report 2009-2010 of The Emirates Group for the period ended March 31, 2010

Royal Jordanian	
Source and Type	Checked baggage fees
Ancillary Revenue	€ 6,880,212
As a % of Revenue	1.0 %
Euros per Passenger	€ 2.61
Reporting Period	12-month period ending 31 December 2009
Total Revenue	€ 687,400,740
Passengers	2,641,000

Information Source: Quarterly and Annual Consolidated Financial Statements for 2008



AIRASIA X

A bottle of unpasteurised milk has two components: an inch or two of cream on top, and a vast reservoir of whole milk beneath. Both are excellent foodstuffs of great utility in human nutrition and cuisine, and dairy operators recognise the importance of both to their livelihoods. This picture is analogous to AirAsia X's rapidly growing long-haul business. The first successful long-haul LCC has found a la carte revenue a crucial part of its profit picture. But it never loses sight of the fact that its basic, unbundled service is the foundation of its business. "The size of these a la carte revenue streams is bigger than our net profit and will continue to be a significant portion of net profit, so it's vital for our financial viability," observes Azran Osman-Rani, CEO of AirAsia X. "But equally important is that a significant percentage of our long-haul customers do not opt for these features, so there's value in continuing to provide them with a choice that lowers their cost of travel and lowers our cost of service."

With routes from its Kuala Lumpur base to London, India, Australia and most recently Tokyo, AirAsia X uses wide-body aircraft to offer the unbundled travel service most often found on shorter routes operated with narrow-body planes such as 737s. Customers who purchase a minimum-price fare get few-frills transport to their destination. But they are exposed to ample opportunities to add services as they shop, book and fly, and these revenue side-streams are vital to the airline.

Rather than extravagantly expand these offers, Osman-Rani says the focus right now is on increasing existing sales. "For example, we've always had our flight attendants taking on sales roles (with onboard food, etc.) and sales commissions have always been a material part of their compensation," he says. "We hope to improve this in two ways: electronic point-of-sale devices to better manage onboard transactions and inventory; and second, improving our sales commission structures to provide even more incentive for performance. As well, we can certainly improve how we package the look and feel of our products sold onboard, and we can enhance the menu/catalogue to make it more enticing for impulse purchases. We can also learn how to better integrate supply chain management from suppliers right up to point-of-sale," Osman-Rani explains.

But the bottom line for AirAsia X will remain undisturbed, he vows. "Offering consumer choice is a positive attribute that is welcomed by almost all customers, especially price-conscious segments. The a la carte/unbundling model works."

As this approach becomes more popular with other airlines around the world, aviation technology specialist Amadeus, which sponsored the IdeaWorks report, has developed three flagship solutions to enable ancillary revenues – Amadeus Airline Ancillary Services, Amadeus Cross-Sell Ancillary Services, and Amadeus EMD.

“At Amadeus, we expect to see ancillary revenues grow significantly as airlines are only now beginning use the high-yield travel agency channel to sell their range of ancillary services,” says Philippe Chérèque, executive vice president, commercial, Amadeus.

“Amadeus is talking to a number of airlines to help them with this. If all airlines were to catch up with the ‘Ancillary Revenue Champs’ identified in this report, we believe that ancillary revenues could increase by more than 300% to as much as \$104.2 billion.”

Amadeus has already worked with a growing number of airlines to develop their technological capabilities for ancillary revenue, including the likes of Finnair, which implemented the Electronic Miscellaneous Document Server, and Corsairfly, which has piloted Amadeus Ancillary Services.

“As ancillary services represent an ever larger proportion of revenue, and add more and more layers of complexity to the airline offering, it is vital that airlines consider the end-to-end process of selling, fulfilling and delivering ancillary services. This is difficult even when

things are going smoothly. But when a flight is cancelled

due to bad weather, an airline has to re-accommodate a plane full of passengers, each with their own combination of assigned seats, in-flight entertainment,

additional bags and preferred meals. Successfully

translating ancillary revenue into additional profit rests on an airline’s ability to manage such situations efficiently,” adds Chérèque.

“Looking to the future, we expect the mobile channel to emerge as a significant platform for ancillary services sales as it offers the ability for airlines and travel agencies to push context-sensitive offers to clients. Travellers arriving early at the airport might be offered an hour in the Premium Lounge, for example. For a price, of course...” **AVB**

AIRLINES POSTING ANCILLARY REVENUE RESULTS FOR MOST RECENT FULL-YEAR PERIOD, LISTED IN ALPHABETICAL ORDER

Carriers	Ancillary Revenue in Euros	As % of Total Revenue	Euros per Passenger	US\$ per Passenger	Region
Aer Lingus	€ 173,900,000	14.4%	€ 16.72	\$20.57	Europe and Russia
Air Arabia	€ 7,394,444	1.7%	€ 1.80	\$2.22	Middle East and Africa
Air Berlin	€ 123,100,000	3.8%	€ 4.41	\$5.42	Europe and Russia
Air Canada	€ 534,143,000	7.1%	€ 17.23	\$21.19	The Americas
AirAsia	€ 102,546,496	13.1%	€ 4.52	\$5.56	Asia and the South Pacific
AirAsia X	€ 17,650,000	9.9%	€ 17.07	\$21.00	Asia and the South Pacific
AirTran	€ 209,455,000	11.0%	€ 8.73	\$10.74	The Americas
Alaska Airlines	€ 368,869,000	13.3%	€ 16.47	\$20.25	The Americas
Allegiant	€ 132,613,540	29.2%	€ 24.89	\$30.61	The Americas
American	€ 1,507,750,000	9.3%	€ 14.43	\$17.75	The Americas
Austrian	€ 9,800,000	0.5%	€ 0.99	\$1.22	Europe and Russia
British Airways	€ 81,351,000	0.9%	€ 2.56	\$3.14	Europe and Russia
Comair S. Africa	€ 873,976	0.3%	€ 0.24	\$0.30	Middle East and Africa
Continental	€ 254,117,000	2.5%	€ 4.05	\$4.98	The Americas
Delta	€ 1,117,120,500	4.9%	€ 6.94	\$8.53	The Americas
easyJet	€ 608,796,693	19.4%	€ 13.47	\$16.57	Europe and Russia
Emirates	€ 218,448,000	2.3%	€ 7.96	\$9.79	Middle East and Africa
Finnair	€ 1,700,000	0.1%	€ 0.23	\$0.28	Europe and Russia
Flybe	€ 89,250,300	13.2%	€ 12.23	\$15.04	Europe and Russia
Frontier	€ 44,955,400	5.0%	€ 4.65	\$5.72	The Americas
GOL	€ 113,209,600	4.2%	€ 3.98	\$4.90	The Americas
Hawaiian	€ 50,774,500	5.3%	€ 6.09	\$7.49	The Americas
Iberia	€ 18,700,000	0.4%	€ 0.89	\$1.10	Europe and Russia
Jet Airways	€ 6,772,480	0.3%	€ 0.61	\$0.75	Asia and the South Pacific
Jet2.com	€ 69,788,547	18.1%	€ 22.51	\$27.69	Europe and Russia
JetBlue	€ 287,695,000	10.7%	€ 12.81	\$15.76	The Americas
LAN Airlines	€ 33,155,015	1.1%	€ 2.15	\$2.65	The Americas
Lufthansa	€ 116,000,000	1.0%	€ 2.09	\$2.57	Europe and Russia
Norwegian	€ 99,370,530	10.8%	€ 9.24	\$11.37	Europe and Russia
Pegasus	€ 19,926,000	6.0%	€ 4.12	\$5.07	Europe and Russia
PIA Pakistan Int.	€ 10,859,000	1.1%	€ 1.96	\$2.41	Asia and the South Pacific
Qantas	€ 782,903,000	7.8%	€ 20.37	\$25.05	Asia and the South Pacific
Royal Jordanian	€ 6,880,212	1.0%	€ 2.61	\$3.20	Middle East and Africa
Ryanair	€ 663,600,000	22.2%	€ 9.98	\$12.27	Europe and Russia
Scandinavian	€ 47,528,000	1.0%	€ 1.91	\$2.35	Europe and Russia
Singapore	€ 17,690,000	0.23%	€ 0.97	\$1.19	Asia and the South Pacific
South African	€ 31,458,000	1.1%	€ 4.56	\$5.61	Middle East and Africa
Southwest	€ 247,678,500	2.9%	€ 2.87	\$3.53	The Americas
Spirit	€ 136,105,000	23.9%	€ 22.35	\$27.50	The Americas
Sun Country	€ 9,535,500	5.8%	€ 7.65	\$10.05	The Americas
TAM Airlines	€ 308,000,000	6.7%	€ 10.13	\$12.46	The Americas
Tiger Airways	€ 54,578,000	19.4%	€ 11.20	\$13.78	Asia and the South Pacific
United	€ 1,527,310,000	11.5%	€ 18.76	\$23.07	The Americas
US Airways	€ 540,589,500	6.3%	€ 6.93	\$8.52	The Americas
Virgin America	€ 21,190,000	4.7%	€ 5.65	\$6.96	The Americas
Vueling	€ 74,314,000	12.4%	€ 9.06	\$11.14	Europe and Russia
WestJet	€ 70,884,100	4.0%	€ 5.05	\$6.21	The Americas

Data source: Research conducted during May 2010 by IdeaWorks on the financial statements filed by 47 airlines worldwide. The airlines in the graph disclosed qualifying ancillary revenue activity in financial statements for the most recent full year period. Please refer to individual carrier listings for details.

29.2
Percentage of turnover
that Allegiant makes from
ancillary revenue