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Airlines' Drive To Grow Extra Fees And Services Is Paying Off Big — For Them

This article is based upon a report issued by IdeaWorksCompany.

Sixteen out of every $100 that American Airlines collected from its customers in 2018 came from the sale of something other than seats on a plane, according to a recent study from IdeaWorks. At United it was $14 out of every $100 in revenue. Delta got $12.50 out of every $100 it was paid for things other than a ticket.

Meanwhile maverick Southwest Airlines, the granddaddy of low cost/low fare carriers, outdid its conventional rivals by scoring $18 out of every $100 of revenue last year from the sale of services beyond a basic flight ticket.

In 2007, the world's top 10 carriers collectively took in just $2.1 billion in so-called “ancillary revenue” by selling seat assignments, the right to check bags, seating class upgrades, duty free goods, in flight food and beverages and other “extras” above and beyond the price of their tickets. At the time, travelers not used to paying extra for things that always had been included in the price of their tickets, were outraged, but not so much that they refused to pay those extra charges. Indeed, last year the four largest U.S. carriers all by themselves racked up $22.7 billion in ancillary revenue. That represents roughly two-thirds of their total passenger revenue growth over that period of time, according to the IdeaWorks study, which was sponsored by CarTrawler.

The top 10 carriers globally in ancillary revenue last year took in $35.2 billion beyond what they collected for the sale of seats on their flights.

To say that airlines have found a new vein of revenue would be a gargantuan understatement.

Ancillary revenue, properly defined, is revenue that airlines get for selling anything other than a basic seat on a plane, whether that seat’s a cheap one in the back of their planes or one costing thousands of dollars up in the front. It includes so-called a la carte services like seat assignments, upgrades, in flight food and bag checking rights that used to be included in the basic fare (and which, to varying degrees still are included in the basic fare for travelers to opt to buy expensive business or first class tickets or who meet certain other conditions like heavy participation in a carrier’s loyalty program).

But, importantly, ancillary revenue also includes money that airlines get from banks and other merchants who buy mileage points in the carriers' frequent flier programs. In fact, overall about 55% of airlines' ancillary revenues comes from the sale of frequent flier points to their marketing partners (as opposed to travelers "earning" those miles by actually flying). Low cost and short haul carriers typically get a lot less revenue from the sale of mileage points while big international carriers get an even higher percentage of their ancillary revenues via that channel.

Merchants buy airline's mileage points to give to their own customers as rewards for doing business with those merchants, similar to the way grocers in the mid-20th century rewarded customers' loyalty with trading stamps. But mostly its banks that buy mileage points from airlines to give to customers who use their "co-branded" credit cards with particular airlines to buy not only travel services but everything from entertainment and restaurant meals to groceries, cars and even homes. Banks and merchants typically pay the airlines about one cent per mileage point and award them to their own customers at the rate of around one point for every dollar charged to their co-branded credit cards. Individuals also can buy mileage points directly from their preferred airlines as a way of topping up their mileage accounts before cashing in points from a "free" trip, or to give away as gifts at Christmas or on other occasions.

Because consumers, history has shown, have remained stubbornly resistant to rapid and dramatic fare price increases, even in relatively good economic times, airlines increasingly have turned to selling ancillary services and products, including mileage points, as a way of extracting more revenue from their customers. And that backdoor way of getting customers to part with more of their money has proven to be a wild success for most airlines, both in the U.S. and, increasingly, around the world.

For example, Jay Sorensen, IdeaWorks' CEO and the leading authority on ancillary pricing practices and tactics, noted that Qantas, Australia's primary international carrier that has affinity credit card deals with every major Australian bank, is connected to 35% of all credit card transactions in that nation. Put more simply, 35% of all credit card charges in Australia earn those cards' users miles in Qantas' simply-named Frequent Flyer program.

Nowhere else in the world are consumers so tied into just one airline and so comfortable with using credit cards to purchase goods and services not related to travel or the airline whose points they will earn with their purchases. Still, over the last 40 years airline mileage points in the U.S. have become a popular, even coveted alternate currency, both for those who travel a lot and those who rarely if every board a commercial plane. Indeed, back in the 1990s American, which pioneered both the concept of frequent flier programs and affinity cards linked to them, first reported that more than half the revenue spent using its Citibank AAdvantage co-branded cards went for goods and services not involving a passenger actually boarding an American plane.

It’s not surprising that Qantas leads the world in frequent flier revenue generated per passenger, at $37.51. American, according to IdeaWorks’ research for its annual CarTrawler Airline Ancillary Revenue Report, ranked second at $27.34, followed by United at $26.71, Southwest at $25.26 and Delta at $21.35. Hawaiian, despite it’s smallish, niche-player status, ranked sixth in frequent flier revenue per passenger at $18.50. The final four spots in that top ten went to Aeromexico, Air Canada, Virgin Australia, plus Azul and GOL, two Brazilian low-cost carriers.

As noted previously, American, United, Delta and Southwest topped the list of 10 carriers that posted the most ancillary revenue in 2018. A fifth U.S. carrier, low cost Spirit Airlines, ranked ninth on that list with $1.5 billion in ancillary revenue. But unlike the Big Four U.S. carriers whose generation of ancillary revenues is still a distant second in terms of importance behind the actual sale of seats on flights, ancillary revenue represents nearly half – 45% of Spirit’s total revenue. Spirit was created as a bare bones, low fare airline. It always has charged extra for checking bags, seat assignments and other extras. (Indeed, the big conventional carriers began charging a la carte service fees in part to compete better with low cost carriers like Spirit.)

That top 10 was rounded out by Ireland’s Ryanair, Lufthansa, AirFrance/KLM, Britain’s easyJet and Air Canada.

Despite the apparent success of airlines’ drive to increase their ancillary revenues Sorensen, whose research writing and consulting work has played an important role in the trend’s explosive growth over the last 12 years, warned last week in a report that at some point airlines risk undermining the power of their brands by pushing ancillary revenue opportunities too far. And those that try to position themselves as high quality service brands risk undermining the power of their brands, he said..

“The question to ask,” Sorensen wrote in his report, “is, ‘What is your brand and does it matter?’ Ancillary revenue is best when it aligns with and supports the brand of an airline.”

To emphasize the growing risk of airlines potentially overplaying their ancillary revenue cards, he related the story that one of his bosses told him when he was working in a pizza restaurant in his high school years. The boss cautioned him against adding too much meat to pizzas, not so much as a way to keep product costs down, though that was a factor, but to keep from putting so much meat on a pizza that customers become incapable of noticing the difference, or so much that it overwhelms their taste buds. “He told me “Jay, if you keep adding chocolate powder to a milkshake, at some extreme point it becomes inedible.’

"This was another way of saying too much of a good thing is not a good thing,” Sorensen wrote. “Adding chocolate can be good up to a point, but the best results occur when you have a recipe.”