

Despite cutting costs in many areas, airlines have still had to contend with ever-rising fuel prices and weakened passenger yields. It is only in recent years that a minority of operators have been able to fully exploit the potential of ancillary revenues.

The bonanza of ancillary revenues

The importance of ancillary revenues to an airline's revenue and operating profit performance has increased as a result of record fuel prices. Airlines have experienced reduced passenger demand, weaker yields and higher costs - a situation that would normally see them reporting record losses. Some airlines have been able to offset recent economic pressures by generating increased levels of ancillary revenues, although most have only developed a minimal amount of capability. Ancillary revenues provide airlines with a revenue bonanza they cannot afford to ignore.

Ancillary revenue evolution

The concept of ancillary revenues began in the 1950s when petrol stations started selling refreshments, but airlines mainly kept to the traditional business model of a full-service product even beyond 2000. This traditional model included the following items in the price of a ticket: baggage check-in; seat assignment; meals; a few other standard items; and lounge access for business- and first-class passengers. Travel insurance was the only additional item that passengers could generally buy when purchasing a ticket. Airlines also managed to sell a small quantity of on-board shopping.

The advent and growth of low-cost airlines in the late 1990s followed Southwest Airlines' basic approach of unbundling the full-service product. This simplified the traditional airline product by first excluding items such as meals and seat assignment, mainly to reduce costs in an effort to boost passenger demand.

The growth of the internet made the boom in low-cost airlines possible. With

their own websites airlines had the channel through which they could generate ancillary revenues.

Nevertheless, despite the internet's growing use as their prime distribution and sales channel, airlines were slow to develop ancillary revenues for some years. The most obvious streams of ancillary revenues came from the various types of insurance that could be included in the booking process. Next came hotel reservations and car hire, which were generally only possible via advertisements on airline websites, resulting in buyers clicking through to the websites of these third-party service providers. The technology that allows the purchase of tickets and other third-party ancillary products to be combined in a single transaction has only been available for a few years.

Airline products

In addition to third-party ancillary services, airlines have also been slow to realise the full potential of offering their own ancillary products. The only source of revenue they exploited for many years was on-board shopping, which accounted for only a small volume of sales because it was time-consuming and required a lot of manual paperwork by cabin crew.

Further in-house ancillary revenue streams began with low-cost carriers unbundling the traditional product. Ryanair was one of the first when it started charging additional fees for baggage check-in and manual check-in. The advent of self-service kiosks has allowed airlines to avoid the costs of check-in and passenger handling, so Ryanair introduced charges for passengers that still wanted to check in manually. An increasing number of

passengers now avoid checking in baggage to reduce their airport transit times, while the baggage handling incurs additional costs for airlines. Ryanair therefore introduced separate charges for checking in baggage.

Some airlines have introduced a wide range of in-house products in recent years, such as adding commission charges for the use of credit cards on their reservation sites. Airlines have to pay commission to credit card companies on each sales transaction, and for many years have had to deduct this from gross ticket prices. Adding charges to the gross price of tickets has allowed airlines to pass the cost of commission on to passengers. Airlines incentivise passengers to use debit cards, which have lower or no commission, by clearly displaying the different charges they will pay for each type of card they use.

easyJet, which has been one of the pioneers of ancillary revenues, offers several products. "One we have introduced in recent years is speedy boarding, where passengers can pay for priority boarding. Another is hold-baggage check-in," says Peter Gerstle, product development manager at easyJet.

Airlines can offer a wide range of other products, related to the market segments they are targeting. Traditional full-service carriers are, for example, starting to offer business-lounge access to economy passengers. Virgin Atlantic has recently introduced payment of a premium for the extra leg room of an exit-row seat, which is particularly attractive on long-haul flights.

Co-branded credit cards have also been introduced by some airlines. Flybe in the UK, for example, recently launched its credit card.

"On-board sales have recently been



transformed by electronic point-of-sale (EPOS) equipment,” explains Simon Lilley, director of marketing at Flybe. “This reduces the time cabin crew need for each transaction, and allows them to generate more sales for each flight. EPOS equipment also provides real-time data and information on the number of sales, their value, and revenue for each flight. This also avoids paperwork.”

Michael Cunningham, director of passenger portfolio integration at SITA, comments that airlines have been slow to take advantage of potential ancillary revenue streams. “One example is advertising on their websites, which some have only started to do in recent years. It is even possible to get revenues from advertising on the e-mail confirmations that airlines send to passengers that have made bookings via websites.”

Third-party ancillary revenues

Ancillary revenue products offered by third-party providers account for the largest percentage generated by most carriers. “The big three are insurance, car hire and hotels,” says Gerstle. “There are many other categories, and the list is growing. Some airlines only offer a limited number of third-party products, but besides the big three we also offer ground transportation, lounge access through a partner, and ski chalets on the appropriate routes.”

Other third-party products include theatre and museum tickets, sightseeing tours, and even electricity bills.

Ancillary revenue impact

The importance of ancillary revenues is illustrated by the percentage of

revenues they now account for at some of the airlines that led the way in developing them. Ryanair, for example, had operating revenues for its year ended 31st March 2008 of Euro 2.7 billion (\$3.8 billion), and Euro 488 million (\$880 million), of which 18% came from ancillary revenues. This compares to an operating profit of Euro 547 million (\$985 million), indicating that revenues from passenger tickets barely generated an operating profit. The portion of total revenues generated from ancillary revenues were also about 2% higher than the previous year. Ryanair’s ancillary revenues are also growing faster than sales from passenger fares, illustrating their growing importance as a revenue stream.

easyJet has also seen the rapid rise of its ancillary revenues. “Ancillary revenues have become particularly important in the past three to four years,” says Gerstle. These have steadily increased from an average of £2.14 (\$3.80) per seat in 2003 to £3.85 (\$6.90) per seat in 2007.” EasyJet’s revenue for its year ended 30th September 2007 was £1.8 billion (\$3.2 billion), of which £171 million (\$308 million), equal to 9.5%, came from ancillary revenues. This compares to 8% of total sales coming from ancillary revenues the previous year. Ancillary revenues themselves grew by 30% from 2006 to 2007, with its speedy boarding product being the biggest generator of easyJet’s ancillary revenues.

Even more interesting is that easyJet made an operating profit of £298 million (\$536 million) in 2007, and £278 million (\$500 million) in 2006. This clearly illustrates that ancillary revenues are generating most of its operating profits.

Flybe has similarly used ancillary

Ryanair was one of the first to fully exploit the potential of ancillary revenues. One of its own products its launched was charging passengers that want to check in baggage. Surprisingly to all other airlines it has succeeded in generating appreciable volumes of revenue.

revenues to subsidise its passenger ticket sales. “In the 2007/08 financial year we generated £8 (\$14.5) per seat from ancillary revenues, which was a total of £55 million (\$99 million) for the year. Given our operating profit of £35 million (\$63 million) for the year, this clearly shows how important ancillary revenues are to us,” says Lilley. “The added attraction of ancillary revenues is that generating them incurs low incremental costs. The initial costs of developing and implementing the technology have to be taken into account, but thereafter the only major costs incurred are those that relate to managing the information on the website sales channel, and revenue accounting.”

“Going forward we see ancillary revenues growing in importance, and estimate that they will reach £10 (\$18) per person in 2008/09, equal to £80 million (\$144 million) a year. It has therefore become a critical source of revenue,” continues Lilley.

Gerstle adds that each ancillary item offered by easyJet has reached saturation point, but there remain other ancillary products that can be added. “We are still trying to increase the revenues generated from ancillary sales as a percentage of total revenues. It is just a case of identifying what products are appropriate on different routes, for example excursion and sightseeing tours, theatre and museum tickets, or products aimed at business passengers.”

Ancillary revenue generation

Ancillary revenue generation has evolved with the development of airline websites. The process of packaging airline and third-party products is complex. Buyers would clearly prefer to be able to combine the purchase of air tickets with insurance, car hire, hotels or other products in one transaction. The technology to do this has only been available for the past few years, and many airlines still lack this capability.

The process of selling third-party products is made by airline websites having click-through links to third-party websites. A selected hotel chain or car-hire company therefore has an advert or box on an airline’s website at a strategic location. The downside of this is that

easyJet is one of the few airlines to have fully developed its range of ancillary revenue products and its dynamic packaging capabilities. Ancillary revenues now account for 9.5% of its annual revenues.

while an airline just needs an agreement on a commission level with the third-party provider, the process interrupts the passenger's booking, and makes them enter their personal information again. "A major problem here is that buyers wanting to book car hire or a hotel have to re-enter their dates of travel, and then their credit card details and make a second transaction. The buyer also has to accept the car-hire company or hotel chain provided by the airline, or make their own searches of several car-hire companies or hotel chains to get what they think may be the best price," explains Cunningham. "Buyers are therefore unlikely to be encouraged to make a second purchase for a third-party product. The simple click-through technology therefore limits airlines' sales potential from third-party ancillary revenue sources."

Some basic technologies can populate the third-party's website with the buyer's travel dates from the airline's website, particularly the websites of specific hotel chains. Airlines get small fees or commission from this, but the volume of third-party ancillary sales is still limited.

Some airlines have reached agreements with third parties to have co-branded websites. "This also starts with a click-through by the buyer. An example is hotelsiberia.com," explains Cunningham. "This is just a co-branded website between Iberia and a booking engine provider, but it is branded with the originating airline's logo. There is a small box displaying hotelsiberia.com on the Iberia website, and it is reached via a click-through. These are also known as micro sites."

Some low-cost airlines have developed techniques to pass buyers on to other websites when they click for additional ancillary products. This frees up the airline's own server capacity. The other websites to which the buyers have been diverted look like the originating airline's site, and the buyers do not have to re-enter their data and travel dates.

Dynamic packaging

The most attractive option for airlines is the integration of all products in a single transaction at their website. "The ideal situation is for hotels, car-hire



companies and other products to be highlighted on an airline's website when the buyer selects particular dates and a flight. Making all this available on an airline's website allows the purchase to be made in a single transaction. Airlines get higher rates of commission and also tend to get a higher conversion rate because buyers find the process easier than separate transactions with click-throughs," says Cunningham.

This process is referred to as dynamic packaging, and purchasers will get a discount if they buy a group of products and services. "Packaging products like this effectively makes the airline a travel agent. This raises some issues, because travel agents have to be bonded, which involves making a downpayment to the providers of the services," continues Cunningham. "This is not a problem for the airline packaging these services, but it does complicate the issue of revenue accounting. Some airlines are averse to the complexities of dynamic packaging, and prefer to just get the sales commission. Dynamic packaging improves the conversion rate, however, because of the convenience of having a single transaction, so airlines generate more revenue.

Screen scrapers now also pose a threat. "These are independent websites which trawl various airlines for their flights, inventory and fares, in addition to trawling various car-hire and hotel websites," explains Raphael Bejar, chief executive officer at AirSavings. "These services are then combined on the screen-scraping website and sold as a single transaction. They effectively work as an on-line travel agent, and they add their own commission onto the airlines' website fares. The advantage of screen

scrapers is that they dynamically package flights and various products for the buyers. For example, bravofly.com packages flights, car hire, hotels and tourist guides in Europe and the Mediterranean. The problem with screen scrapers is that they cause airlines to lose out on generating ancillary revenues, especially those airlines that do not have dynamic packaging capability and only have click-through technology. Airlines can only maximise the chances of buyers staying on their websites by having dynamic packaging capability, which requires the right technology."

The development and evolution of ancillary revenues is moving fast, so airlines must acquire the right technology to take full advantage. SkyEurope, Smart Wings and Atlas Blue all have dynamic packaging technology, and easyJet has developed its own. Delta Airlines has chosen iSeatz, allowing it to offer more hotel choices than most other airlines.

Many other operators do not have dynamic packaging capability, including Air Berlin, German Wings, Transavia, Ryanair, Click Air and Sterling Airways.

The level of dynamic packaging capability that many airlines have is still relatively limited. SkyEurope, for example, chose software from AirSavings, and provides buyers with a choice of two hotels, lounge access and insurance. "SkyEurope will later be able to offer a wider range of hotels. Our dynamic packaging technology, as used on SkyEurope's website, lists the cost of the air fare, hotel and other extras separately, but allows the buyer to pay for it in a single transaction. Smart Wings, Atlas Blue, VLM and Aer Arann also use AirSavings' dynamic packaging technology. While some providers of

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technology just provide airlines with the capability, like iSeatz, for example, we provide the technology together with the content. AirSavings has therefore already negotiated commission rates with a range of insurance providers, hotel chains, car-hire companies, and other services so that within two weeks of getting access to airline servers, we can start offering ancillary services. We have negotiated commission rates of 12-14% with some hotel chains and car-hire companies.”

e-commerce

Dynamic packaging requires a strong ability to merge ticket sales and ancillary products. “An airline can exploit two major opportunities,” explains Phillippe Der Aslanian, global director of airline direct channels at Amadeus. “An airline can consider the content of their own websites and also make a good job of merchandising third-party products. Airlines have to act as retailers.”

SITA has developed the capability to collect fees, which is effectively an e-

commerce booking engine. “We develop the front window of an airline’s website, and once a buyer has clicked to search for a flight they are directed to SITA’s booking engine,” explains Cunningham. “With our system airlines can choose what fees they collect. They can be integrated with a car-hire company, and so do not need to have click-through capability. We have an aggregator that has all the inventory for car hire companies, so that a choice of several car-hire companies can be offered. We will also start to offer hotels in 2009. Offering a large number of hotels also requires an aggregator. We can therefore offer airlines the agreements with the car-hire companies and hotel chains, or just the e-commerce technology. Commission rates for airlines will be at least 10%. Our e-commerce and dynamic packaging customers include Malaysia Airlines, Aegean, Aviacsa, VLM and several carriers in Africa.

Air Canada has led the way in dynamic packaging and developing its e-commerce capability. “Even with its own

Air Canada has used e-commerce to elevate its upselling potential. Once passengers have selected flights and fares classes they are provided with a clear selection of ancillary products.

products, Air Canada has unbundled its fares and then offered frills to buyers with a ticket purchase at extra cost in a very clear manner on the booking page of its website. This includes items like coffee vouchers, or additional charges to pay for more return-flight flexibility,” explains Der Aslanian. “Adding back these frills and charging for each one separately actually requires quite complex technology. The first part of the process involves correctly defining the baseline ticket price. Trying to sell too much, however, can make the process too complex for the buyer, and discourage them. If it works, however, it is possible to get a lot more out of the sale of a seat.

Air Canada’s website has elevated its upselling potential. The buyer sees pages that clearly display the available fares in different classes. The website gives buyers the choice of opting out of, or selecting, the frills they want. Once the fare and class have been selected they then have a list of additional items to choose from, including meal or snack vouchers, lounge access, return-flight flexibility, checking in baggage, and other choices. Air Canada has effectively unbundled its full-service fares, and offers each frill back to the passenger at their discretion. The transaction page gives a clear breakdown of the elements of the gross purchase price. These include the fares, surcharges, taxes and various frills selected during the purchase process. Buyers can then go on to select third-party ancillary products.

“We are now prototyping websites where buyers can make a booking in a single click and complete a transaction as fast as possible. The important issue is that it is price sensitive, so it is basically a yield management process. The revenue accounting process is also complex,” continues Der Aslanian. “Amadeus has developed an airline retailing platform through the Amadeus global distribution system (GDS),” he continues. “The GDS interface now looks like a website page with a graphical user interface that makes e-commerce and dynamic packaging possible. The airline retailing platform looks like a web page, and combines the GDS with the internet to provide the content.” [AC](#)

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