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An investigation into traveler preferences and acceptance levels of airline ancillary revenues

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ABSTRACT

This study determines traveler preferences and acceptability levels for a range of airline ancillary products and services by employing an on-line passenger survey to examine booking preferences as well as attitudes toward a selection of air and non-air travel components sold by the airlines. The survey results are combined with expert opinions collated from a recent international conference, along with secondary data, to generate an acceptance ranking which can be used by a range of airlines to formulate their ancillary revenue strategies. It is found that airport car parking and checked baggage charges proved to be the most accepted commission based and unbundled products for airlines to sell respectively. Despite the recent focus and successes in ancillary revenues, however, it can also observed that none of the ancillary products and services examined in this study achieved a high take up rating suggesting that airlines can do much more to convince travelers of the benefit and value in airlines selling non-core products and services to them.

1. The growing importance of airline ancillary revenues

Profitability is becoming increasingly difficult for the airlines across the globe. With 0.1% average net profitability over the past decade, airlines went through one of the most challenging periods in the aviation history (International Air Transport Association, 2011). Almost ten billion dollars were the losses accounted by world's carriers in 2009 alone (International Air Transport Association, 2011), while a further $49.1 billion were lost between 2000 and 2009 (International Air Transport Association, 2009 cited in O'Connell, 2011).

Several factors affected airline financial performance during the past decade. Firstly, due to the global economic recession, revenues fell 15% or $85 billion throughout 2009, which is significantly more than the 7% or $23 billion drop experienced after the 9/11 terrorist attacks (International Air Transport Association, 2010).

With the continued liberalization of air services, high levels of competition, rising fuel bills and volatile operating environments, yields continued to decrease, despite the constant drives to reduce operating costs in the recent years. This has forced airlines globally to seek opportunities to generate additional revenues from secondary sources such as "unbundling" the airline product, dynamic packaging, retailing and advertising (see Fig. 1 for types classified by O'Connell, 2011). IdeaWorks (2011) describes ancillary revenue as "revenue beyond the sale of tickets that is generated by direct sales to passengers, or indirectly as a part of the travel experience". Furthermore, ancillary revenue can be divided into three categories: a-la-carte, commission-based (also called third-party) and frequent flyer activities. The focus on ancillary revenue was initiated by the Low-cost carriers (LCCs), when airlines in Europe such as Ryanair and easyJet started to adopt a concept of optional fees. Nowadays the model of "unbundling" the airline ticket is used by both LCCs and full-service airlines (Onboard Hospitality, 2011).

Bejar (2009) traces the beginning of the airline ancillary revenues movement with the Low Cost Carriers, which were first to recognize the importance of internet as a facilitator of revenue generation. Ryanair, in year 2000 first launched hotel bookings and car hire on its website, which was good enough reason for many other airlines to follow. In the early years, ancillary revenues were mainly associated with the Low cost airlines. Nowadays, it is becoming a necessary activity increasingly adopted by all types of carriers, including traditional, full-service ones. Airlines did not solely rely on earning commission from third-party providers such as hotel, car hire and insurance, but they went a step further by beginning to "unbundle" their fares. IdeaWorks (2012) provides a breakdown of full-service carrier revenues by geographical region (US and non-US), which is shown in Fig. 2. In percentage terms, both US and non-US legacy carriers have now developed a diversity

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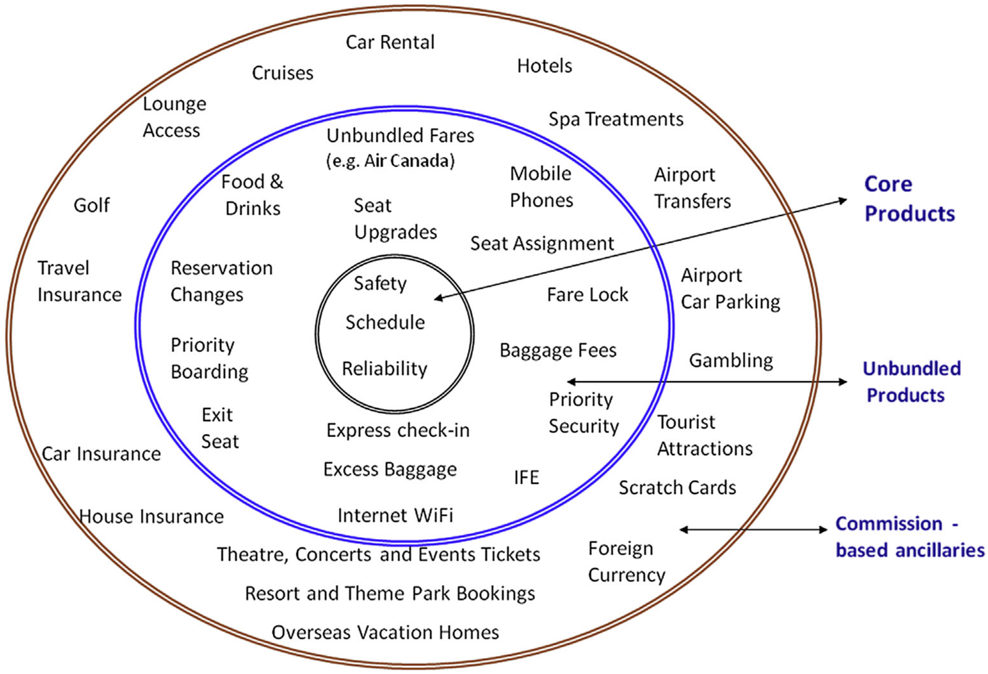

Fig. 1. Types of airline ancillary revenues. Source: O'Connell (2011)

in ancillary revenue streams with unbundled products and services now representing between 15% and 25% of all ancillary revenues made by legacy carriers. For the selected US carriers there is clearly more or a reliance on FFP related sales to date (average of 50%) whereas for non-US carriers, there is more of a balance between FFP sales and other commission based product sales.

Ancillary revenues have now become an integral part of airline accounts following the tremendous growth during the past few years. In 2007 IdeaWorks discovered that only 23 airlines around the world disclosed revenues from ancillary activities, a total of $2.45 billion. Four years later, the ancillary revenue reported by carriers globally has grown to $21.46 billion (IdeaWorks, 2011).

Underlying growth in ancillary revenues be approximated if the reported amount of ancillary revenues in any given year is divided into the number of reporting airlines for that year. The result is that the average underlying intake from ancillary revenues grew from around $100.6 million per airline in 2007 to around $456.6 million per airline in 2010.

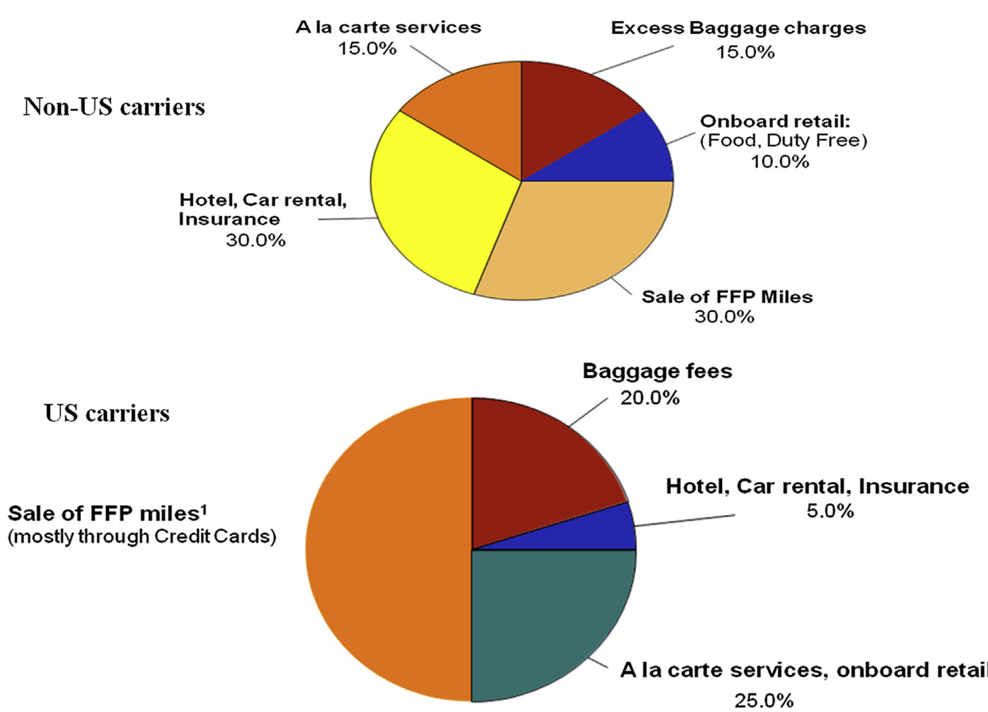

Fig. 2. Key ancillary revenue components for US and non-US carriers.