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Taking your airline to new heights

## *JET STREAM*

A conversation with Wolfgang Prock-Schauer, the chief executive officer of Jet Airways.



### Special Section

#### FUELING UP

A look at the rising cost of fuel and its effect on the industry.



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# THE X FACTOR

More carriers are taking an “X” factor approach to generate additional revenue, but could such initiatives negatively impact customer loyalty and satisfaction?

■ By Tom Bertram | *Ascend Contributor*

Not so long ago, buying a ticket on an airline was a pretty straightforward transaction. Travelers paid their fare, and any additional financial commitment from that point on was minimal. Their fare entitled them to an assigned seat, a soft drink, and a snack and/or meal. Their bags were loaded on the plane, and they earned frequent flyer miles. They paid for all of these services, even if they had no intention of eating a meal or had no baggage to check. Movies, alcoholic beverages and on-board duty-free purchases were about the only things requiring additional payment.

As airlines around the world feel increasing pressure on profit margins, airlines are developing new and innovative ways to generate supplemental revenue. These “X” factors roughly fall into three major categories: attribute pricing, unbundled pricing and ancillary services.

## Attribute Pricing

The concept of attribute pricing is fairly simple: there are certain attributes of the air travel experience that customers would be willing to pay extra for. For example, if Airline A charges US\$20 higher than Airline B for a flight with comparable departure and travel times, an elite frequent flyer might still select Airline A. Why? Because it would be worth it to pay slightly more to earn the frequent flyer miles and maintain

Flight	Origin	Arrival	Departure	Class	Fare	Service
AC 800	YYZ	YYZ	08:00	Y	\$117	Y
AC 801	YYZ	YYZ	08:30	Y	\$117	Y
AC 802	YYZ	YYZ	09:00	Y	\$117	Y
AC 803	YYZ	YYZ	09:30	Y	\$117	Y
AC 804	YYZ	YYZ	10:00	Y	\$117	Y
AC 805	YYZ	YYZ	10:30	Y	\$117	Y
AC 806	YYZ	YYZ	11:00	Y	\$117	Y
AC 807	YYZ	YYZ	11:30	Y	\$117	Y
AC 808	YYZ	YYZ	12:00	Y	\$117	Y
AC 809	YYZ	YYZ	12:30	Y	\$117	Y
AC 810	YYZ	YYZ	13:00	Y	\$117	Y
AC 811	YYZ	YYZ	13:30	Y	\$117	Y
AC 812	YYZ	YYZ	14:00	Y	\$117	Y
AC 813	YYZ	YYZ	14:30	Y	\$117	Y
AC 814	YYZ	YYZ	15:00	Y	\$117	Y
AC 815	YYZ	YYZ	15:30	Y	\$117	Y
AC 816	YYZ	YYZ	16:00	Y	\$117	Y
AC 817	YYZ	YYZ	16:30	Y	\$117	Y
AC 818	YYZ	YYZ	17:00	Y	\$117	Y
AC 819	YYZ	YYZ	17:30	Y	\$117	Y
AC 820	YYZ	YYZ	18:00	Y	\$117	Y

One of the leaders in the move to “X” factors, Air Canada has divided its fares into distinct offerings, each giving the traveler a specific level of service. The fares, clearly distinguished on the airline’s Web site, enable customers to choose — and pay for — the desired level of service.



premium status. In effect, the traveler values the ability to earn frequent flyer miles at US\$20.

Does a seat assignment have value? Many airlines are starting to charge extra for seat assignments. With Air Canada's lowest Tango fares, an advanced seat assignment costs an additional C\$15. When Southwest Airlines allowed customers to get a coveted "Group A" boarding pass through its Web site after midnight on the day of departure, multiple online services sprouted up to check in passengers while they slept, charging up to US\$6 for the service. Clearly, many customers think getting a seat assignment is something worth paying extra.

To see how this all works in practice, look at Air Canada's fare structure, which has five basic types of fares: Tango, Tango Plus and Latitude in the coach cabin; and Latitude Plus and Executive Class in the business cabin.

When searching for flights on Air Canada's Web site, the customer is presented with a matrix displaying the price and availability for each of the five products. In a recent search in the Toronto, Canada, to Vancouver, Canada, market returned Tango fares between C\$179 to C\$219, and Tango Plus fares of C\$259. What does the additional C\$40 to C\$80 for the Tango Plus fare buy?

- Ability to earn 100 percent Aeroplan miles versus 50 percent, non-status eligible,
- No charge for advance seat assignment — a C\$15 value,
- C\$50 fee for day of departure changes versus C\$120.

Will travelers pay the extra money for these enhancements? Probably. Many customers will pay extra for a good seat assignment, and the lure of earning miles and premier status in frequent traveler programs also has some intrinsic value.

At its core, attribute-based pricing is an innovative method of customer segmentation. Historically, airlines have used pricing fences such as advance purchase and minimum stays to separate leisure-oriented customers from business-oriented customers. Low-fare carriers are eroding the use of traditional fare rules and restrictions, and most legacy airlines aren't ready to go totally to restriction-free pricing. Attribute pricing offers these airlines another option to minimize dilution.

The success of attribute pricing faces some challenges, however, the largest being distribution. If customers visit an airline's Web site, the airline can display all information regarding each fare type and allow them to make their decision based on how they value the various attributes. What it doesn't allow a customer to do is compare how these fares compare with those of other airlines. Conversely, Internet booking Web sites (and to a great extent travel agencies) are largely designed to find the lowest fare across multiple carriers, enabling customers to compare on price alone. They don't show customers that for an additional US\$20 they can earn frequent traveler status miles. This creates a conundrum for executives of both airlines and distribution



Photo courtesy of Boeing

**With its new fare structure, Air Canada has been able to extract value by separating previously "bundled" services. Now, travelers can choose to pay extra for items such as assigned seating, meals and frequent flyer credit.**

systems. Airlines may not adopt attribute pricing until distribution systems can handle it, while distribution systems won't invest in overhauling their search logic until a critical mass of airlines use attribute pricing.

Is there a future for attribute pricing? For carriers that already take a high percentage of direct bookings, attribute pricing seems like a logical successor to fare rules for customer segmentation. Other carriers will adopt pieces of attribute pricing, most probably charges for seat assignments, which can fit into their existing business models.

### Unbundled Pricing

While attribute pricing is about creating a series of integrated fare products with different customer values, unbundled pricing goes the opposite direction in that the fare provides only transportation, and any other services a customer requires is subject to an additional charge.

Many low-cost carriers are changing the traditional pricing model by unbundling these travel components and charging customers for the services they require. The two most prominent areas for unbundling include on-board services and checked baggage.

It has become an accepted practice in many sectors of the airline industry that a complimentary meal in coach is no longer

offered. Domestic U.S. carriers charge customers between US\$3 and US\$5 for on-board snacks, and many low-cost carriers in various regions of the world charge for beverages. This is an interesting shift in perspective; airlines have turned catering into a revenue-generating activity and have probably reduced spoilage expenses as well. The easyJet Web site sums the concept up: "Free" onboard meals add to the overall cost of a seat — and we believe that our passengers would prefer to forgo a tray of plastic airline food in order to save money on their fare."

As for baggage, this year some low-fare carriers have adopted charges for checked baggage in the hold and limited the number and size of carry-on baggage. For example, Ryanair allows passengers one free in-cabin bag under 10 kilograms (22 pounds). For each piece of checked luggage, an individual customer pays €4.50 (US\$5.98) per bag one-way if paid in advance through Ryanair's Web site, or €10 (US\$13.28) if paid through reservations or the airport ticket counter. The weight limit was recently lowered from 20 kilograms to 15 kilograms (33 pounds) per customer.

Is this a real money maker? When Ryanair instituted its new baggage policy, it also announced a €4.50 (US\$5.98) fare decrease across the board. At the time, the carrier estimated that the effect of these two actions would



**Ryanair, one of Europe's leading low-cost carriers, has long been a leader in generating additional revenue through ancillary sales. The airline generates nearly €8 (US\$10) per passenger in sales of items such as car rental, hotels, travel insurance and on-board sales.**

Photo by Michael Presh/Airline.net

corporation “value” an advance seat assignment or the ability to earn frequent flyer miles?

For travel agencies, X factors can make it more difficult to communicate travel options to their customers, especially in markets where there are mixture of airlines with traditional and non-traditional pricing. A “low” price on a carrier using unbundled pricing may actually be higher once components such as seat assignments and baggage charges are added.

The jury is still out on how effective these X factors will be. Many low-cost carriers are moving toward the unbundled pricing model, but some customers resent paying these extra charges. The attribute pricing model is interesting, but the number of carriers utilizing this model is not growing dramatically, indicating many carriers are still taking a wait-and-see attitude.

In the end, one thing is clear: pricing and ancillary revenue models will continue to evolve, and airlines will need to evolve their pricing tactics with them. **F**

be revenue neutral. The assumption was that 25 percent of its customers that have only carry-on luggage would actually pay less, 50 percent would in essence pay the same (the cost of one bag pre-paid on the Web site being off-set by the fare decrease) and only 25 percent that checked two or more bags would actually have to pay more.

But consider this — if 20 percent of customers checking one bag do not pre-pay online, the revenue gain would be approximately 1 percent. It may not sound like much, but, given Ryanair's 2005 turnover of nearly €1.7 billion (US\$2.3 billion), that totals €17 million (US\$23 million).

### Ancillary Services

The third “X” factor is ancillary services. In addition to selling meals and beverages, airlines are offering a much wider range of goods and services to their customers. Again, low-fare airlines are leading the charge in this area. Some low-fare carriers sell travel insurance on their Web sites; in fact, they are kind enough to already add it to their customers' fare when it is time to make a booking. (Customers have the option to decline.) Another source of revenue is airport club lounges sold on a per-use basis rather than charging an annual fee. Aggressive marketing of duty-free and other onboard sales is also common. In addition, booking hotels and car reservations are becoming more prevalent on airline booking sites, generating additional revenue from referral fees.

“Ultimately entertainment will be where the money is,” said Michael O’Leary, chief executive officer of Ryanair. “It would transform ancillary revenues and profits.” He also mentioned that implementing in-flight gaming might actually mean the carrier would no longer need to charge passengers a fare for travel.

### The Challenge for Airlines

These innovative pricing models create a real challenge for many airlines. Attribute and unbundled pricing work best for carriers taking a high percentage of their bookings through direct channels; they have the ability to tailor their unique service offerings in a way many mainstream distribution channels cannot. For airlines using traditional pricing rules, will attribute pricing provide the market segmentation necessary to minimize potential dilution? As for ancillary services, the key will be to determine what customers really want and at what point customers become oversaturated with marketing offers.

Another question is, how will airlines be able to provide a consistent product offering to their customers across all their distribution channels? To help address this issue, the *Sabre Travel Network*® business is working to enable airlines to offer ancillary services as well as support attribute and unbundled pricing through the *Sabre*® global distribution system.

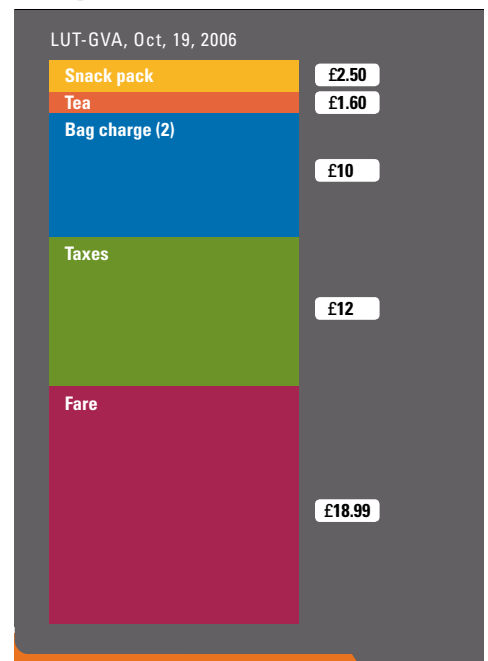
### The Challenge for Customers

While X factors can be an innovative method for generating additional revenue, they do create additional complications for airline customers. First, they add both complexity and uncertainty to the shopping process. The myriad potential charges can vary by airline, both in the amount being charged and what point the charges are revealed in the shopping process. Because of this, it makes it much more difficult for a consumer to comparison shop and determine what the final price will be for the ticket.

Corporations and travel agencies also face challenges in this unbundled pricing environment. For corporate travel managers, X factors make it more difficult to manage travel costs, because the final price can be quite variable depending on the features required. How will a

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### easyJet Fare Breakdown



**On a recent easyJet flight from London-Luton to Geneva International Airport, ancillary revenue constituted 31 percent of the total revenue for the trip.**