Executive Insights

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Getting to Yes: The New Imperative for the Global Airline Industry

With ancillary revenues now running at more than $50 billion of very high margin revenues per year against IATA's projection of $36 billion in net profits for the global industry in 2016, ancillaries have established themselves as the bedrock of a financially secure airline industry. Further, L.E.K. Consulting's *Aviation Insights Review (AIR): 2016 Global Industry Performance Update* reveals that eight of the top 10 economic profit performers, as ranked by margin, are airlines that have embraced ancillary revenues.

Clearly, ancillaries are no longer simple takeaways; they enhance the customer experience and provide more choices and options. Ancillaries are becoming more like merchandise, meaning that airlines are becoming more like retailers.

For more than 40 years, the airline industry has trained and ingrained in their frontline staff to "just say no" in order to meet two goals: (1) to drive down costs and complexity and (2) to meet operationally focused metrics. Frontline staff has said no consistently, no matter how minor the request, how much customers are willing to pay to enhance their experience (as defined by customers), or how much actual or potential value customers bring to the airline. Moreover, because carriers are nervous that premium passengers will trade down (even in this era of maximum hard product differentiation between cabins), airlines have erected artificial boundaries around their product offerings.

Traditionally, airlines have segmented customers based simply on where they are seated instead of what their needs are. For example, a young, single millennial going on a quick weekend trip has very different needs (and greater willingness to pay for options) from those of a retiree couple traveling to see their grandchildren for an extended stay. Yet historically, airlines have provided the same products and services to these customers and treated them the same, paying no mind to their individual needs.

Ancillaries, which are becoming more like merchandise, are changing the airline industry's traditional model by giving customers the opportunity to choose their specific experience based on their individual needs (for that specific trip). Carriers have begun to break down the model by acknowledging the different needs-based segments on board their aircraft and by developing products and services that enable the customers within these segments to personalize their individual travel experiences.

Getting to Yes: The New Imperative for the Global Airline Industry was written by **John Thomas**, Managing Director and Head of L.E.K. Consulting's global Aviation Practice and **John Nevin**, Principal, in L.E.K.'s Aviation practice, based in Boston.

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Simply offering these products and services isn't enough to capture their full value. Airlines must assume the role of retailers and treat these new offerings as merchandise, making the right product available to the right person, at the right price, at the right time. This requires airlines to know more about all their customers, not just frequent-flyer program members, and not just where they flew over the past year.

Customers expect to interact with airlines in the same way they interact with retailers, so airlines must adapt a retailer mind-set. Retailers that really know their customers — and their customers' needs — are in a strong position to engender true loyalty. Furthermore, they need a single coherent view of the customer, ensuring that every employee at every touchpoint treats each individual customer uniformly.

So how does the global airline industry move from where, for the past 40+ years, frontline staff has been trained to say no — whether explicitly or implicitly — to embracing the notion of saying yes, which drives the financial performance of the airline and improves customer experience by giving customers more choices?

Here's how airlines can get to yes:

1. Have a clear view of your customer base through needs-based segmentation. If you are underrepresented in segments in which you wish to participate, enhance your customer value proposition to go after these segments.
2. With an eye to personalizing the experience for individual customers, determine what information you should — and can — have on each customer and what mechanism will best capture and nurture this information.
3. Develop a suite of ancillary products targeted at meeting different customer segments' needs. (Note: This is typically a longer-term project, with products developed and launched over a multiyear period.)
4. Consider hiring talent with retail experience to lead the charge and offer a different perspective.

Figure 1
Getting to Yes: A New Paradigm to Change the Way Airlines Manage Their Business

Then	Now
• Pure focus on lowest cost	• Win based on cost AND product
• Continued commoditization and "race to the bottom"	• Investing in differentiation is value-accretive
• Large number of cost centers	• Cost centers transformed into profit centers (e.g., checked bags)
• "Complexity drives cost" so just say NO	• Saying YES creates value

Airlines must transition from being operations-driven to customer-centric

5. Invest in technology and — especially important — your technology architecture, ensuring that your operational data model provides a single 360-degree view of your customers. This is a critical step. A number of premium full-service carriers are rolling out (and promoting) onboard mobile devices that enable their crews to improve customer interactions, yet very few of these carriers have a single view of the customer or the right customer information to enable their crews to interact in a meaningful way with customers.
6. Acknowledge that this is a very different way to run the customer-facing aspects of an airline. Understand that to be successful requires a significant change management process throughout the organization.

Given the economic importance of ancillary revenues to the global airline industry, carriers that do not rethink and break down the traditional airline business model risk financial peril. This change management process will take time, but the payoffs will be substantial — and not just in financial terms. The radical redefinition of the future customer value proposition will significantly improve true customer loyalty and, in turn, drive future superior and sustainable financial performance.

About L.E.K. Consulting

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