

Merchandising Programs Provide Airlines with a Much Needed Lift

A strong economic headwind continues to hinder an airline industry that is already struggling financially. To offset volatile changes in passenger traffic and operational costs, airlines are using baggage fees and other ancillary revenues to improve their income statements. U.S. revenues from these services grew 42% in 2009 to reach \$7.8 billion, according to the U.S. Department of Transportation. These burgeoning revenue figures spotlight how merchandising is already beginning to support airlines' financial performance.

L.E.K. Consulting believes that airlines must evolve their business strategies to feature sophisticated merchandising programs that can be tailored to individual consumer preferences. As merchandising programs continue to take flight, airlines that are not on board risk missing out on one of the most critical business model shifts of the last 20 years.

Flight Plan For Success

To fully realize these opportunities, carriers will need to draw heavily upon lessons from the retail, direct marketing, and media and entertainment industries who have demonstrated pedigrees in this area. Additionally, an effective merchandising strategy requires a cultural shift in how carriers serve customers.

Airlines will need to enhance their new product development processes, train front-line staff to deliver differential services and present offers to passengers in a way that facilitates the upsell. An airline's customer interface is an inherently complex undertaking; it reaches a broad demographic (albeit, relatively higher-end) and serves captive customers for extended periods of time.

Taxi vs. Takeoff: Advancing Your Merchandising Strategy

As merchandising programs continue to evolve, carriers will also begin to re-package these services in a way that:

- (1) Is simpler for the consumer to digest and buy
- (2) Is more compelling to consumer segments than à la carte items
- (3) Encourages greater levels of trading-up through clever combinations of items within the offer bundles

The key with these new "re-bundles" is that they will emphasize enhancements (vs. takeaways) to the customer. For example, many carriers have instituted new fees for exit-row seating. Passengers acknowledge that the added leg room in exit-row seats makes them more valuable than other economy seats, and some customer segments are willing to pay for this privilege. (L.E.K.'s extensive market research shows that passengers continually cite legroom as the primary aspect of comfort.)

However, if extra personal space is combined with expedited services (e.g., check-in, security, boarding, baggage) and a selection of other in-flight enhancements, then there-bundle begins to clearly convey a "painless" experience. Similarly, re-bundles can be constructed around other themes like "relaxation" and "peace-of-mind." The goal is to create offers that present a collection of features that hang together well as a motif and resonate as a cohesive package with various customer segments.

Merchandising Programs Provide Airlines with a Much Needed Lift was written by **John Thomas**, Vice President and **Dan McKone**, Vice President of L.E.K. Consulting. Please contact L.E.K. at aviation@lek.com for additional information.

A Highly Attractive Destination

In light of the growth opportunity, L.E.K. projects that U.S. airline merchandising revenues will increase 32% in 2010 to reach \$11.5 billion – thereby creating a significant incremental, and highly profitable, revenue stream for airlines. Looking to the horizon, L.E.K. also believes that global airline industry merchandising opportunities will exceed \$50 billion annually by 2015.

Equally importantly, the greater precision of repackaging will allow airlines to move away from the negative consumer

perceptions associated with “nickel-and-diming” to a more auspicious “solution-based” paradigm. To date, much of the airline positioning around ancillary revenue has been aimed at the social equity of only paying for the features that passengers use. However, by repackaging offers with an increasing number of enhancements, airlines will be able to make travel enjoyable again, while simultaneously earning additional revenue. By expanding their merchandising strategies to feature re-bundles that convey positive messages such as “enjoyability,” winning airlines will also reestablish positive brand halos in the process.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded more than 25 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns. For more information, go to www.lek.com.

For further information contact:

Boston

28 State Street
16th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

Chicago

One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

Los Angeles

1100 Glendon Avenue
21st Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

New York

650 Fifth Avenue
25th Floor
New York, NY 10019
Telephone: 212.582.2499
Facsimile: 212.582.8505

San Francisco

100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

International Offices:

Auckland
Bangkok
Beijing
London
Melbourne
Milan
Mumbai
Munich
New Delhi
Paris
Shanghai
Singapore
Sydney
Tokyo
Wroclaw