

Commissioned by

amadeus

The evolution of airline merchandising

A perspective from Martin Cowen,
Freelance travel journalist





Foreword

Moving towards an intelligent and dynamic global travel ecosystem

Buying travel is arguably a more complex process than ever before and also one that is evolving to reflect not only the rapid change we are seeing in technology and communications tools but also the growing breadth of the offer and an increasingly sophisticated traveller. Of course all of this demands a corresponding evolution in the way the shopping experience is delivered to travellers, to ensure that they have an efficient, effective and ultimately enjoyable experience from beginning to end.

And that's why we have commissioned experienced travel journalist Martin Cowen to reflect on this and to provide some context and perspective for where our industry stands today. Indeed, the next few years will undoubtedly bring continued change as our industry seeks to further unlock the opportunities presented by merchandising, retailing and the changing distribution landscape.

At Amadeus we believe that merchandising could represent as much as \$130 billion of additional annual revenue for airlines by the year 2020, which would in parallel enable the delivery of a richer experience for the traveller. Industry estimates show that airlines are already earning \$51bn in annual revenues through the sale of ancillary services, primarily through their direct channels. Amadeus research indicates that a further \$55bn could be secured by 2020 by adopting an omni-channel strategy for these ancillary sales. In addition, new innovation in travel technology can bring a further \$78.5bn in the same time frame.

We encourage you to read Martin's entertaining, educative and thought provoking analysis of the merchandising evolution thus far but also to digest Amadeus' own vision for how a dynamic, intelligent global travel ecosystem could unlock \$130 billion in additional revenues for airlines - contained at the end of this short paper.

Holger Taubmann SVP, Distribution, Amadeus

Julia Sattel, SVP, Airline IT, Amadeus



About the author

Martin Cowen is an experienced travel industry journalist having covered the industry for over 15 years. He has written for a range of industry titles including Airline Business, Buying Business Travel and Travolution. Whilst editor of online travel news site e-Tid.com Martin was awarded a Business Travel Journalism Award for industry news journalist of the year, while e-Tid.com won the electronic news publication of the year award. Martin is presently a freelancer writer for TNOOZ and a range of other publications.

Martin has been commissioned by Amadeus to prepare this short paper examining the historical evolution of airline merchandising as a platform for discussion. The views expressed here are based on his own individual research and investigation.

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THE EVOLUTION OF AIRLINE MERCHANDISING

How it all began

The aviation industry has been around for longer than many other global industries operating today. The Wright Brothers' first flight took place in 1903 and the first ever commercial flight took place just over ten years later.

The airline was the St Petersburg-Tampa Air Boat Line and the passenger one Abram C. Pheil, the former Mayor of St Petersburg, a small town in Florida. The route was from St Petersburg to Tampa and the ticket was sold through an auction, with Mr Pheil paying \$400 for the privilege of becoming the world's first ever paying passenger.

The trip took 23 minutes and flew across the Tampa bay. At the time, the alternative journey, by what passed as roads, would have taken 20 hours by car. The journey would have taken between four and twelve hours by train.

Mr Pheil was a businessman, and the purpose of this trip was to visit a supplier. It is believed that he was able place an order for his wholesale business before taking the return flight about an hour later.

Being able to return the same day significantly enhanced his work-life balance. He also avoided an overnight stay, helping to lower the total trip cost.

IATA, which was founded in 1945, has been promoting 100 years of commercial aviation through a number of consumer-facing media initiatives, including dedicated micro-site www.100yearsofflying.com. The timeline of aviation development over the period shows how the industry has advanced.

In terms of technology, distribution and merchandising, the timeline is less clear. Computers were used as part of the booking process from 1960; Amadeus was founded in 1987; Microsoft launched Expedia in 1996.

However, it is possible to draw on a number of sources and say that 2007 was the year in which merchandising became part of the aviation vernacular. The speed at which the theory and practice of merchandising evolved over the next seven years was breath-taking. As the aviation industry enters the next 100 years, it is worth reminding ourselves how we got here.

A new era: merchandising emerges into the spotlight

The tragic events of 9/11 cast a shadow over the aviation industry for a number of years, but by the time 2007 came around, normal service was starting to resume. The global economy had had a good few years, and while there were some rumblings about the US sub-prime mortgage market coming unstuck, generally the feelings were good. The collapse of Lehman Brothers and the following global slowdown were some way off.

The aviation industry was at a critical juncture. In Europe it was the age of the low-cost carriers. Ryanair was the driving force. In 2002, it had placed an order with Boeing for 125 brand-new 737-800 aircraft (with an option for a further 125) and the arrival of these planes, coupled with an aggressive network development, to say nothing of extremely competitive pricing, boosted its passenger numbers. It shot up from carrying less than 16 million in 2002 to more than 50 million in 2007, the vast majority of whom booked directly with the airline. The business managed to stay in the black during this period too.

Its big rival easyJet was also growing strongly. It too placed a massive order for new planes in 2002, booking 120 brand-new Airbus A319s (with an option for a further 120). It also expanded its network, bolstered by the slots it took over via its acquisition of British Airways' wholly-owned, no-frills carrier: Go. And, like Ryanair, it too was able to stay in profit.

But 2007 was also the year in which easyJet made a decision; the implications of which far outweighed its significance at the time. In November of that year, it opened up its inventory and allowed business travel agents to book easyJet flights in the GDS. It was the first time that the airline had allowed third parties to sell its seats. easyJet's shift away from its low-cost roots had begun.

Other low-cost carriers started rethinking their distribution strategy as a result of this, and over the next few years many low-cost carriers started to sell through travel agents. This year, even Ryanair has started to sell its seats via corporate travel agents in a bid to capture more business traveller bookings.

At the same time, the full-service carriers also started to have a rethink. Commissions paid to travel agents have been trending towards zero since 2001, and in 2007 very few airlines were rewarding agents directly and many were ramping up their own direct channels such as websites and mobile. Business and leisure travel agents alike also needed to face up to a new business environment. Amadeus recognised this and produced a white paper for its travel agent customers with the self-explanatory title: *Service fees and Commission Cuts - Opportunities and Best Practice for Travel Agents*.

The shake-up in the low-cost and full-service models alike reached its zenith in 2007. The result was that there was no longer such a clear distinction between the two, and the idea of the hybrid airline took hold. Hybrid airlines could pick and choose which low-cost or full-service principles they wanted to adopt. This blurring of the lines had many consequences, and arguably the most important of these was that airlines now needed to rethink and evolve how they were selling their product.

Unbundling, or “à la carte pricing”, has its roots with one of aviation’s pioneering airlines, Laker Airways and its SkyTrain brand. In the late 1970s the airline flew low-cost flights between the UK and the US. People could only buy a seat direct with the airline and if they wanted a meal, they had to pay for it.

It wasn’t until 2006 that a full-service carrier fully embraced this concept. Air Canada introduced unique “à la carte” pricing in 2006, claiming in its full year results that enabling customers to choose the features and services they wish to include in their fare was an industry first.

Amadeus’ e-commerce solutions helped Air Canada to offer this service, and in 2007 the word “merchandising” made its first appearance in the Amadeus corporate lexicon. In March, a release entitled “Aircanada.com revolutionises airline merchandising with Amadeus solutions” explained how Amadeus was powering Air Canada’s new approach.

Many of the commercial drivers of this deal are still applicable today. “Air Canada’s customers can add on more options to the purchase of their ticket with respect to changes and refunds by selecting greater levels of frequent flyer points accumulation, and/or choosing to purchase lounge access. Travellers can also decrease the price of their ticket by not checking baggage or declining to change their ticket”, the announcement said.

Elsewhere, other stakeholders were starting to sing a similar tune. US research group Forrester launched its 2007 US Airline Website Rankings with the following synopsis: “As the industry moves into a new era where airlines must become retailers, Forrester... provides a benchmark to measure how well airlines’ websites are optimised for selling.”

Another example of how merchandising emerged into the aviation mainstream comes from IdeaWorks, the US-based research business which produces the Ancillary Revenue Yearbook. Amadeus has sponsored this a number of times. Its first ever detailed analysis of ancillary revenue based on airline responses was published in 2007. The following year, the research was branded as the Ancillary Revenue Yearbook. Based on financial analysis of 31 airlines, the inaugural report put the value of ancillary revenues at \$2.45 billion, or \$6.99 per passenger.

The 2014 Yearbook was able to analyse the ancillary activities of 59 airlines and identify \$31.5 billion of revenue, equivalent to \$16 per passenger. The emergence of ancillaries as a stand-alone revenue stream paved the way for merchandising; airlines could see not only how customers embraced the chance to buy the services they wanted, but also the revenues that could be generated as a result. Not checking baggage could be seen as the first stage in the personalisation of the flight experience.

There is one other significant development to mention. At the start of 2007, a struggling computer firm launched a new product. The introduction of a phone from Apple - called the iPhone - was greeted enthusiastically by customers of the firm which, at the time, had a cult following rather than a mainstream footprint.

Not even the most committed Apple fan could have predicted that, within a few years, people would be buying flights and checking in using their phone.



The global recession and beyond: merchandising continues to evolve

At the time of writing, the world's economy is getting back on track, and airlines are in a much stronger position. IATA said that losses of \$9.9 billion in 2009 were turned around over the year, with the industry netting profits of \$18 billion in 2010. Airlines recovered \$72 billion in revenues over a twelve-month period.

At the same time, cost control and efficiencies were established, capacity was more closely aligned to demand, and airlines were starting to listen to what their customers wanted.

Merchandising was playing a direct and indirect role in the industry's ability to recover. Directly, airlines were continuing to increase the sales of ancillary products by creating new ones and enhancing existing ones. Indirectly, merchandising was bringing new commercial disciplines to the fore and forcing airlines to see themselves as part of a new, online, customer-centric marketplace where passengers were more informed and more demanding.

IATA helped this by mandating the use of electronic miscellaneous documents (EMDs), which standardised the sale of ancillaries across all channels, particularly between the airline dotcom and the travel agency. As recently as 2010, PhoCusWright was saying in a research paper that "there are few bookable ancillary services via agents' preferred airfare booking method (the GDS)." The following year, IdeaWorks suggested that travel agent involvement thanks to EMD adoption could see sales of ancillaries reach \$100 billion.

The first airline to adopt EMDs to facilitate sales through travel agencies was Finnair in 2010. Finnair also led the way with interline EMDs, when it struck a deal in 2012 with partner Egyptair allowing both carriers to sell ancillary services on each other's flights.

EMDs are now almost at 100% adoption across the industry.

There were also more passengers. Global overnight visitor flow grew at 5.4 percent per annum over the next decade, according to Oxford Economics. IATA predicts that by 2017 total passenger numbers - domestic and international - reached 3.91 billion, an increase of 930 million on the 2.98 billion carried in 2012.

These travellers will become more demanding of technology. The traditional city pair and departure date search parameters are starting to be seen as restrictive. Many travellers wanted to be inspired by their search engine, not limited. Innovations around searching by holiday type, activity, variable dates or by budget came to the fore. Amadeus won an Innovation Award at a PhoCusWright event in 2009 for its Affinity Shopper product. Inspirational search is another layer of merchandising opportunity.

The emergence of social media as a global phenomenon took hold during this time. At the end of 2007 there were 57 million registered Facebook users. By the end of 2013, there were 1.23 billion. Twitter's growth is even more impressive, seeing as it was only incorporated as a business in March 2007. TripAdvisor gave anyone with internet access the chance to be a travel writer. In June 2007, there were 10 million reviews on TripAdvisor. Currently, Tripadvisor-branded sites have 170 million.

At the start of 2012, KLM introduced social seating, an opt-in tool which allowed passengers to choose who they sat next to based on LinkedIn or Facebook profiles. Meet and Seat - still an option on certain routes- has been used by 50,000 people and is particularly popular on routes to and from Brazil.

The KLM example highlights how some airlines are starting to think in different ways about their inventory. New business models and partnerships have emerged to provide airline members the chance to bid on a range of airline services, from an upgrade to ensuring they have an empty seat. Air Asia X says that it has boosted revenues by millions of dollars as a result and Austrian Airlines received more than 20,000 bids for business-class upgrades in the first year of launching this service..

The past eighteen months have been the most disruptive, while confirming the maturity of the concept of merchandising. The arguments about the theory and practice of IATA's New Distribution Capability (NDC) have ebbed and flowed ever since the announcement about a common set of standards was first made in October 2012.

Merchandising and retailing are at the heart of what NDC offers. The launch release spelt out the reasons behind the initiative: "NDC will ... modernise airline retailing by enabling innovation in the way airline products are distributed, and make possible personalised offers to passengers..."

A culmination of sorts was an important piece of research carried out by Frost & Sullivan for Amadeus. *Thinking Like A Retailer - Airline Merchandising* unequivocally showed that by thinking like a retailer and personalising what was on offer, airlines could increase the value of a transaction by as much as €35.

Perhaps that is the key statistic: airlines which embrace merchandising and retailing are the ones who will profit in this new age. But it is also worth noting that customers too will benefit, by getting the experience they want, sold to them in the way that they want and at a price that they consider to be value for money. Win-win situations are rare in business but the confluence of retailing, merchandising and personalisation in the airline industry is one of them.

With merchandising now established as a mainstream activity for airlines, the next couple of years will be vital as airlines look to establish their credentials with customers and reconsider how best to boost revenues whilst delivering a consistent and personalised experience throughout a lifelong relationship with a customer.

Perhaps the most fundamental requirement is the ability for an airline to be able to connect with a customer at every touch point, each of which offers an upsell or cross-sell opportunity. The timing of the upsell needs to be considered, and the best time to reach a traveller depends on the specific offer.

The *Thinking Like a Retailer* report looks at this in great detail, concluding "the booking stage is the ideal time for airlines to approach the traveller with big ticket items that require thought and comparison such as hotels, insurance and entertainment. Two days prior to departure is when travellers begin to focus on airport parking, transfers, luggage and other logistics of their trip."

Check-in is another window of opportunity: upgrades, extra legroom, lounge access, catering, shopping options.

There is a whole new system architecture that now needs to be factored in: big data. Big data, which is much, much more than an extension of good old-fashioned customer relationship management, could

be used to decide which passenger is given the chance to upgrade to business. Would you upgrade someone flying with you for the first time over a regular passenger? Is there a correlation between people who pay for lounge access and on-board spend? How about factoring in someone's social media footprint or other third party data when considering an upgrade?

One caveat about big data is privacy. Legislators and lawyers alike are shouting loudly about this, but there is a growing body of evidence that consumers are willing to share personal data in exchange for personalised offers. Infosys research in 2013 found that 93% of consumers were willing to do so and nearly 60% were doing so. Airlines need to communicate clearly and in a proactive way.

The net result is that, over time, airlines should be able to build up a detailed profile of each customer and be able to merchandise to them in real-time at the appropriate stage. It will be possible to think of each and every passenger in terms of their lifetime value to your airline and to merchandise accordingly.

Extras, extras, read all about them

It is clear that as we enter the second hundred years of commercial aviation, ancillaries are likely to be centre stage, not only for the profitability of airlines but also defining the personalization of the experience for passengers. The great strides in terms of the merchandising and retailing technology is matched by the innovation in product.

FOOD:

The ability to choose your in-flight meal in advance is an example of how merchandising and retailing systems have advanced in a relatively short time. As with many ancillary products, delivery and execution is vital once the retailing has been done. The alignment between the retailing platform and the meal suppliers' inventory management needs to be spot on.

Historically, United was the first airline to offer passenger in-flight food. In 1936 it put a galley onto its DC-3s and served up meals, which had been brought on board and kept hot in a thermos.

ENTERTAINMENT:

In-flight entertainment is usually free of charge, but some airlines are now seeing this as a potential revenue stream, and with in-flight wifi access becoming more common, innovative ideas are emerging. UK charter airline Monarch allows passengers to buy an app before departure, which hosts films they can watch using the onboard server. Southwest charges passengers \$5 a movie, downloaded to their device.

TWA was the first airline to show movies in-flight in the early 1960s - using a 16mm projector and a screen.

LOUNGES:

According to IATA, the first ever airport lounge was opened in La Guardia Airport in New York by American Airlines. It was called the Admiral's Club and the airline still uses that name to this day. Lounge access is big business. Airlines such as Virgin Atlantic and many of the Gulf carriers use airside lounges as part of their brand proposition. Other carriers link up with independent lounge operators to offer access without the cost of having to operate the lounges themselves. Lounge access works well as part of a fare family but can also be used tactically as part of an airline's disruption management strategy.

LOYALTY SCHEMES:

Loyalty schemes, in the widest sense, can offer airlines a number of revenue opportunities. Retail-savvy airlines can offer fare families with enhanced points while redemption partners can be used to enhance brand value and customer loyalty. But perhaps the most exciting use of loyalty schemes in the new age of retailing, merchandising and personalization is using the data which the airlines have about a member. Co-branded credit cards, linked to the loyalty scheme, adds another layer of actionable data which airlines can use and which members will benefit from.

IATA says that the first-ever loyalty scheme was launched by Texas International Airlines in 1979. At the same time, American Airlines was looking at a similar scheme and two years later launched AAdvantage, one of the biggest schemes in the skies.

Amadeus' vision for an intelligent and dynamic global travel ecosystem

Our vision here at Amadeus is to bring the provider and the subscriber together in an open, intelligent global travel ecosystem that matches supply with demand in real-time, providing an enhanced and personalized service to the traveller while optimizing value for all participants in the industry. What we will offer is a unique single consumer view that gives providers and subscribers the ability to access and manage the traveller through every stage of their journey.

With deep collaboration across the travel industry, new business opportunities will be created. By bringing together providers and participants across the travel industry at each key touch point in the traveler's journey, unique customer insights will be leveraged to deliver offers and services that are personalized, relevant and timely.

Three key elements will underpin Amadeus' merchandising vision:

1. The roll out of a new Global Merchandising System that will enable airlines to create their offering dynamically to provide consumers with the most relevant offer at any given time, through any point of sale of any channel, direct or indirect and through any device
2. The evolution of our retailing and distribution systems to enable the efficient and effective delivery of enhanced airline content at the point of sale whether in the direct or indirect channel with a special focus on agents' needs to foster adoption
3. Full integration of both the new Global Merchandising System and Amadeus' evolving retailing and distribution systems with the Amadeus Altéa PSS Suite, delivering a truly joined-up and end-to-end traveller journey across key touch points such as servicing, delivery, disruption management plus ticketing and fulfilment.

In effect the new Global Merchandising System will facilitate the evolution of the industry from distribution to true global retailing by using merchandising as a bridge between retailing and the PSS. Deployed in conjunction with Amadeus' powerful Travel Intelligence tools, consulting and services capability and real-time revenue accounting and loyalty solutions, it will provide subscribers and providers with a single holistic view of the customer, covering the complete travel experience.

Furthermore, the Global Merchandising System will enable airlines to deliver their entire content offering dynamically through our direct and indirect global retailing and distribution systems through all channels and sales points, and on all devices. It will match real-time and intelligent demand that understands the context and profile of the consumer delivering a tailored offer drawn from the widest variety of content through search functionality that is fast, accurate and relevant.

For airlines this means access to a full range of tools to execute their marketing vision for the entirety of their content through both direct and indirect channels, with the ability to execute on product, price, placement and promotion to travellers who are pre-disposed to take it. This can help them to realize additional revenue potential of their services.

This approach facilitates the delivery of the broadest range of rich content to all subscriber segments using the industry's most effective and efficient tools, enabling them to deliver greater value to their customers who are offered more transparency in price and choice. The systems, built on solutions already in place with customers, will work irrespective of channel, customer touch point or device.

Continued overleaf

For travel agencies, search companies, TMCs and Corporations our vision will enable transparent choice over the best and broadest range of content and superior efficiency. It also opens more opportunities to differentiate with value add services and create new revenue opportunities.

The Global Merchandising System and our retailing and distribution channels will be connectivity agnostic, available to Altéa and non-Altéa customers, and will enable the tailoring of airline content in every segment of the subscriber market and through every device, channel and customer touch point. Amadeus envisages that the systems will be aligned to NDC XML industry standards, enabling choice of connectivity for airlines.

Amadeus - with technology that takes the passenger from search to booking, from check in to airport and from baggage claim to hotel - uniquely has the full range of resources to bring this vision together for the benefit of the industry. We have the experience, the resources, the insight and intelligence as well as the global reach and deep customer relationships necessary to bring it to life.

To learn more about Amadeus' merchandising vision please visit: www.amadeus.com/130by2020

