

The background of the entire page is a photograph of a person's silhouette standing on an airport tarmac, holding a rolling suitcase. In the distance, an airplane is visible in the sky. The scene is backlit by a bright light, creating a strong silhouette effect. The person's reflection is visible on the wet surface of the tarmac. The overall color palette is warm, with oranges, yellows, and blues.

A NEW FORMULA FOR AIRLINE SUCCESS:

Why Customized Offers Are the
Future of Airline Marketing and
Revenue Management

Presented by

Skift + **amadeus**

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ABOUT SKIFT

Skift is a travel intelligence company that offers news, data, and services to professionals in travel and professional travelers, to help them make smart decisions about travel.

Skift is the business of travel.

Visit **skift.com** for more.

ABOUT AMADEUS

Amadeus is a leading provider of advanced technology solutions for the global travel industry. Customer groups include travel providers (e.g. airlines, hotels, rail and ferry operators, etc.), travel sellers (travel agencies and websites), and travel buyers (corporations and travel management companies). The Amadeus group employs around 15,000 people worldwide and does business in more than 190 countries. The company has central sites in Spain (corporate headquarters), France (development) and Germany (operations), and offices in 70 countries around the world. The group operates a transaction-based business model. Amadeus is listed on the Spanish Stock Exchange under the symbol "AMS.MC" and is a component of the IBEX 35 index.

To find out more about Amadeus please visit **www.amadeus.com**, and **www.amadeus.com/blog** for more on the travel industry.

A NOTE FROM AMADEUS: THE NEXT LEAP FORWARD

Evolutionary leaps in the airline business have always made the industry stronger. Consider the early use of airmail to support passenger travel in the 1920s through to the creation of global distribution systems and the start of revenue management in the 1980s. Since the turn of the 21st century, we have seen more gains thanks to consumers fully embracing the internet, and now their use of mobile devices.

In this paper, Skift describes the airline sector's next leap forward. That leap, already in progress, encompasses the data-driven creation, pricing, placement, and promotion of customized offers relating to airline flights. At Amadeus, we group those activities under the heading of **Offer Management**.

We hope the vision explored in "A New Formula for Airline Success: Why Customized Offers Are the Future of Airline Marketing and Revenue Management" will help you. Skift asked leaders from across the worlds of airlines and academia, including several minds from outside our industry, to elevate the sector's thinking. They remind us all of the strategies we're aiming for, why we strive to resolve the challenges of right now, and how we aspire to shape things to come.

It's a lofty ambition. Contained in this paper are ways your airline can **increase customer satisfaction, competitiveness, and revenue – all at the same time**. Benefits flow from customers to management to investors. We're committed to even more effective partnerships with our airlines, given that we are all working toward robust, winning strategies.

Skift's report adds to an existing set of papers that have been highlighting a growing industry consensus. For further reading, we recommend "**Embracing Airline Digital Transformation: A Spotlight on What Travelers Value**," in which Amadeus shares the broader context of how airlines are analyzing their customers' behavior, and "**A Spotlight on Total Offer Optimization**," which previews the future of customer-centric revenue management.



amadeus.com/Airline-Digital-Transformation

We hope Skift's take on the subject will stimulate productive conversation, too.



Meg O'KEEFE

Director, Offer Suite Solutions
Airlines, Amadeus

EXECUTIVE SUMMARY

This report investigates why providing customized offers could soon take a commanding lead as the way airlines interact with travel shoppers. By customized offers, we mean how airlines can intelligently price, position, and promote their products and services so that those offers are more likely to meet individualized customer needs.

This trend matters. More than half of the airline executives who Skift surveyed expected this evolution to increase passenger revenue by 15 percent or more.

A key element supporting offer creation is the better-known concept of dynamic pricing — where an airline adjusts the pricing of components of an offer in real time based on relevant factors, such as known customer preferences, inferred customer intent, product availability, the competition, and timing.

Customized offer creation is an evolutionary step away from the old days when the typical airline presented all potential customers with a total fare, and the customer could take it or leave it.

As airline ambitions expanded, a few core realities emerged. These new realities remain underappreciated by many industry leaders.

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More than half of airline executives Skift surveyed expect the evolution to customized offers will increase passenger revenue by 15 percent or more.

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- **Customized offers can be beneficial for customers and airlines at the same time**, even though that might seem a little counterintuitive. Customers can benefit from pricing that more closely fits how they value goods and services. They have more choice and can see and understand those choices more easily. Airlines can benefit from increased revenue and a move away from a decades-long push to commoditization.
- **Customized offers are more complex than the current norms in selling**. Pricing, designing, and presenting customized offers require airlines to take an interdisciplinary approach.
- **Customized offers are possible today**. The technology and knowledge is there today for airlines to keep moving forward with the development of their offers.

Skift's research has led it to conclude that customized offers can provide both airlines and customers with several benefits. For airlines, these gains include increased revenue and competitiveness. For travelers, gains may include greater satisfaction of their true wants, more empowerment to make choices, and greater clarity about the offers they see.

In this report, we will make the case for airlines to consider adopting customized offers based on our research, including interviews with nearly two-dozen industry leaders and leading academics, a structured survey of airline-only practitioners, and the original application of some theories proven to have efficacy in other sectors. (See our Methodology for details.)

After listening to how industry stakeholders think about key questions, Skift drew a handful of conclusions about the full potential for customized offer creation:

- 1. Heterogeneity: there is no single customer.** Airlines have long known that different passengers value things differently based on who they are and why they are taking a specific trip. Airlines have also long talked about segmenting customers. New data science enables airlines to embrace these differences and move beyond the vague “business or leisure” distinction of airline yesteryear.
- 2. Dynamic pricing will be the new normal.** New technology lets airlines change prices for offers in response to real-time information. This technology leaps ahead from yesterday’s typically slow updating of prices for total offers only. Dynamic pricing will support customized offers.
- 3. The end of commoditization?** Adopting customized offers could reverse or at least reduce a decades-old trend toward commoditization — the misleading perception that all airlines offer identical service and only price matters. Airlines can make the offer clearer to customers, by better describing what is actually included. This could better present the branded uniqueness of their offers, differentiating on service rather than price.

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Airlines are starting to move toward an interplay between revenue management, ancillary revenue, and customer analytics. Those airlines that can integrate these three components together under a unified model will have a clear competitive advantage in the future.
—Michael Farrugia, Planitas Airline Systems

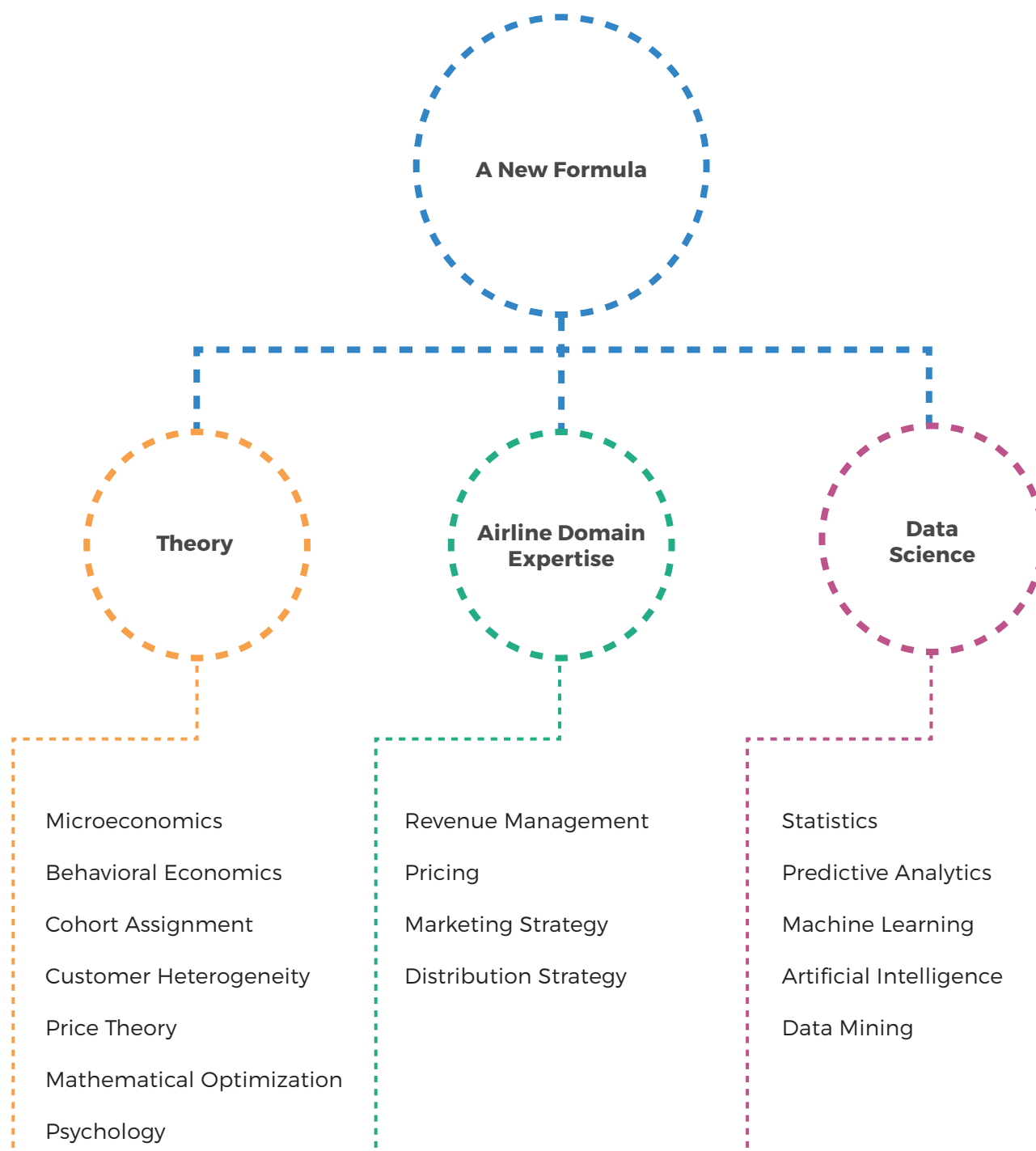
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- 4. Many airlines recognize they must address a talent gap and (in the words of a few airline leaders) their outmoded organizational structures.** Airline commercial teams are built around core functions that have matured over many years and that, to an extent, operate independently. But now, with the evolutionary change in how airlines can create customized offers, teams will need to adapt. It’s a great opportunity, but many airlines will need to recruit, retrain, and reorganize to seize it.
- 5. The time is now.** The technology and thought already exist to create customized offers. Some airlines are already seizing this opportunity.

After highlighting aspects of customized offer creation, we’ll note how some airlines are rethinking their approaches to revenue management and à la carte ancillary pricing. We’ll also touch on how a few carriers are experimenting with three pricing concepts: subscriptions, bundles, and bidding.

Staying in a practical mindset, we’ll look at how airlines measure and predict customer intent and how they can tell when, and to whom, they should serve each offer. We’ll review the approaches some carriers are taking to more aptly decipher how a customer will value add-ons at different times and in different situations.

To bring these concepts to life, we’ll share insights from industry leaders about how they are already leveraging data to derive greater insights into passengers. We’ll learn how they’re using those insights to inform the design of their customized offers.

In this report, we’ll also aim to make it clear how the work on customized offer creation draws on an interdisciplinary approach across airline departments and technical disciplines.



Sophisticated offer creation thrives on an interdisciplinary approach that incorporates learnings from academic theory (such as microeconomics, behavioral economics, cohort assignment, customer heterogeneity, price theory, mathematical optimization, and psychology), airline domain expertise (such as revenue management, pricing analysis, marketing strategy, and distribution strategy), and data science (such as statistics, predictive analytics, machine learning, artificial intelligence, and data mining).

We'll bring a layman's overview of some of the foundational theories, and we will cover some of the data science techniques available to airlines to apply those theories practically — from grouping customers based on similarities to optimizing prices. We'll discuss the critical step of understanding how customers make choices so that airlines can help guide customers to make the best decisions for both themselves and the airline.

We'll also go deep on how pricing and revenue management teams need to change to make rapid progress with customized offer creation.

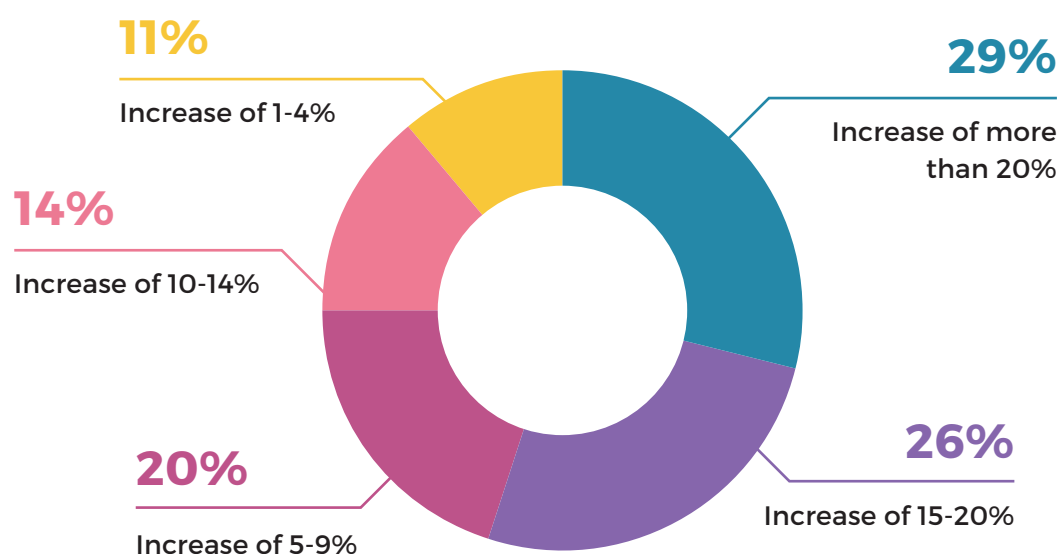
In the report, we also highlight some of the challenges of distributing customized offers through many different channels. The business and distribution systems preferred by both travel sellers and corporations account for a major share of many airlines' sales, and it will require additional technologies and standardization to make customization work in multi-airline channels where comparison and price transparency are paramount. Advances are being made though, through cooperation among stakeholders at the industry level to develop technical standards that work for all parts of the distribution value chain.

In the end, we aim to leave readers with a sense of the industry-wide impacts of customized offers, including how they can combat commoditization and help avoid the impact of fare wars. Along the way, we will explain why we're optimistic about the speed at which airlines will adopt customized offers.

We hope this report will be as energizing to read as it has been for us to research. Executives swept us up in their enthusiasm for the revenue and customer satisfaction opportunities at hand. They persuaded us that the tools and techniques exist to unlock benefits immediately.

In summary, Skift predicts that the rise of customized offers will turn out to be a new formula for success for airlines and customers alike.

How Much Do You Estimate Better Customized Offer Creation Will Increase Your Airline's Total Passenger Revenue?



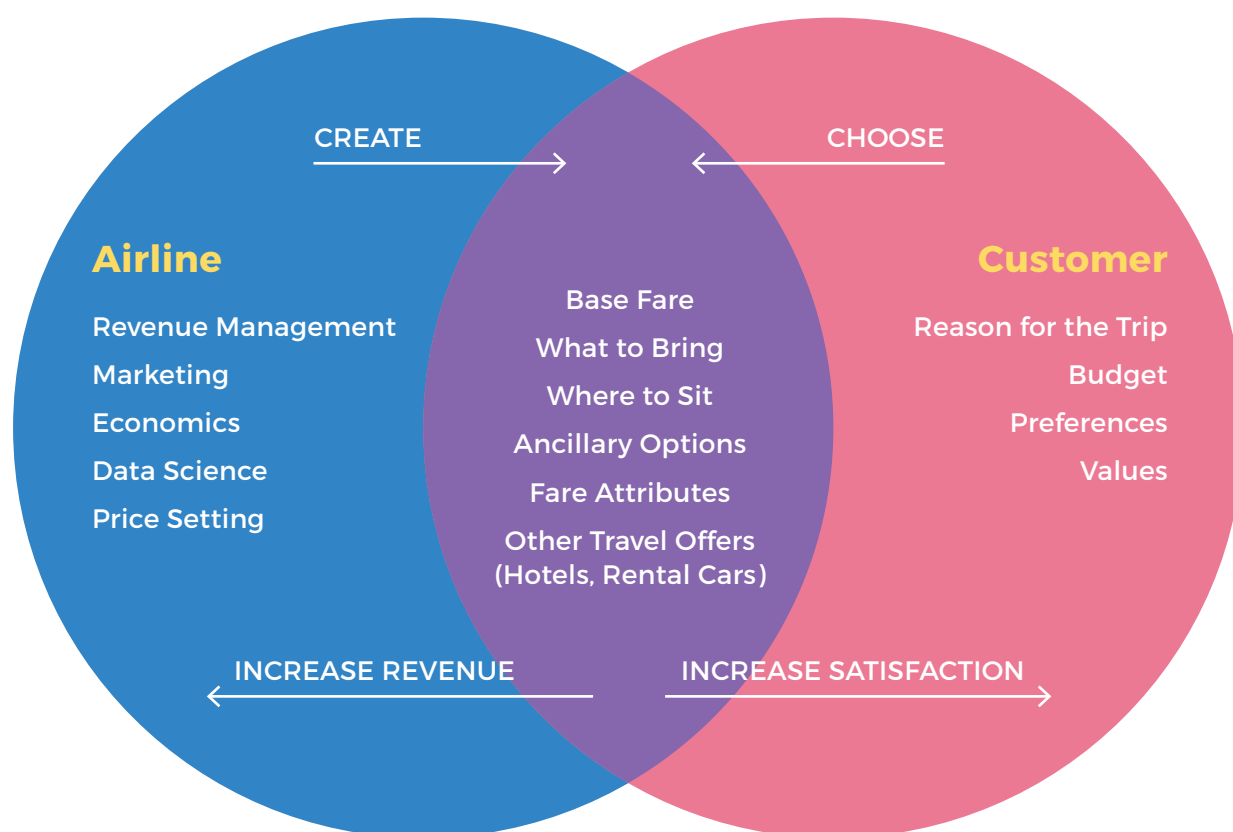
WHAT IS A CUSTOMIZED OFFER?

In researching this report, Skift developed a definition of a customized offer as a set of products or services proposed by an airline to its customers.

Customized offers:

- **Are data driven** — Customized offers rely on patterns gathered from data mining. They are built on insights from statistics, economics, marketing, and mathematical optimization.
- **Can empower customers** — Customers could have more choices as airlines have more ways to meet their specific needs.
- **Are dynamic** — Customized offers fit into an e-commerce trend toward adjusting prices and offers dynamically based on a variety of factors, such as inventory levels and customer demand.
- **Are clear** — A customized offer clearly shows what is in and what is out of the offer to clearly represent the value proposition.

The Components of Customized Offer Creation



UNDERSTANDING CUSTOMER HETEROGENEITY TO CREATE CUSTOMIZED OFFERS



Customers have different values and needs from one another — and from one trip to another. Embracing those differences can increase airline revenue and customer satisfaction.

Airlines have already made some progress toward customized offers. How can they make more progress, faster, given that they face multiple challenges?

Considering that airlines need to become more customer-centric, it makes sense to start this report by talking about customers — and how airlines can get to know them better.

Customers have meaningful and predictable differences from one another, and from themselves, between one trip and another. Understanding and embracing “customer heterogeneity” is a first step to realizing the full benefit of customized offers.

CUSTOMER HETEROGENEITY IN PLAIN ENGLISH:

Heterogeneity refers to the idea that each individual in a larger group exhibits some uniqueness. Customer heterogeneity applies this idea to the domains of retailing and merchandising.

The point is to find differences that matter to what the customer is trying to achieve and indicators of how customers can be grouped around similarities.

Many airlines use some form of customer segmentation, as practiced in other industries, to group customers on persistent demographic traits, such as household income. And airlines have acknowledged that customers travel for different reasons, but — to exaggerate for clarity — they have usually just grouped those reasons into a general “business or leisure” distinction.

Thanks to new research, airlines can take advantage of a concept of customer heterogeneity. Airlines can use this concept to explore the nuances that define traveler preferences, behavior, and intent.

New statistical techniques enable airlines to assess the degree to which customers differ on observed characteristics such as demographics, past travel behavior, and inferred shopping intent. The techniques also enable them to group customers in meaningful ways and create offers for those groups that are individually relevant.

This effort matters to airline leaders thinking about revenue. According to Skift’s survey, many airline executives recognize the importance of making better use of purpose of travel data to customize the offers they make to passengers. **More than half of airline leaders said doing so was either a “critical” or “very important” priority.**

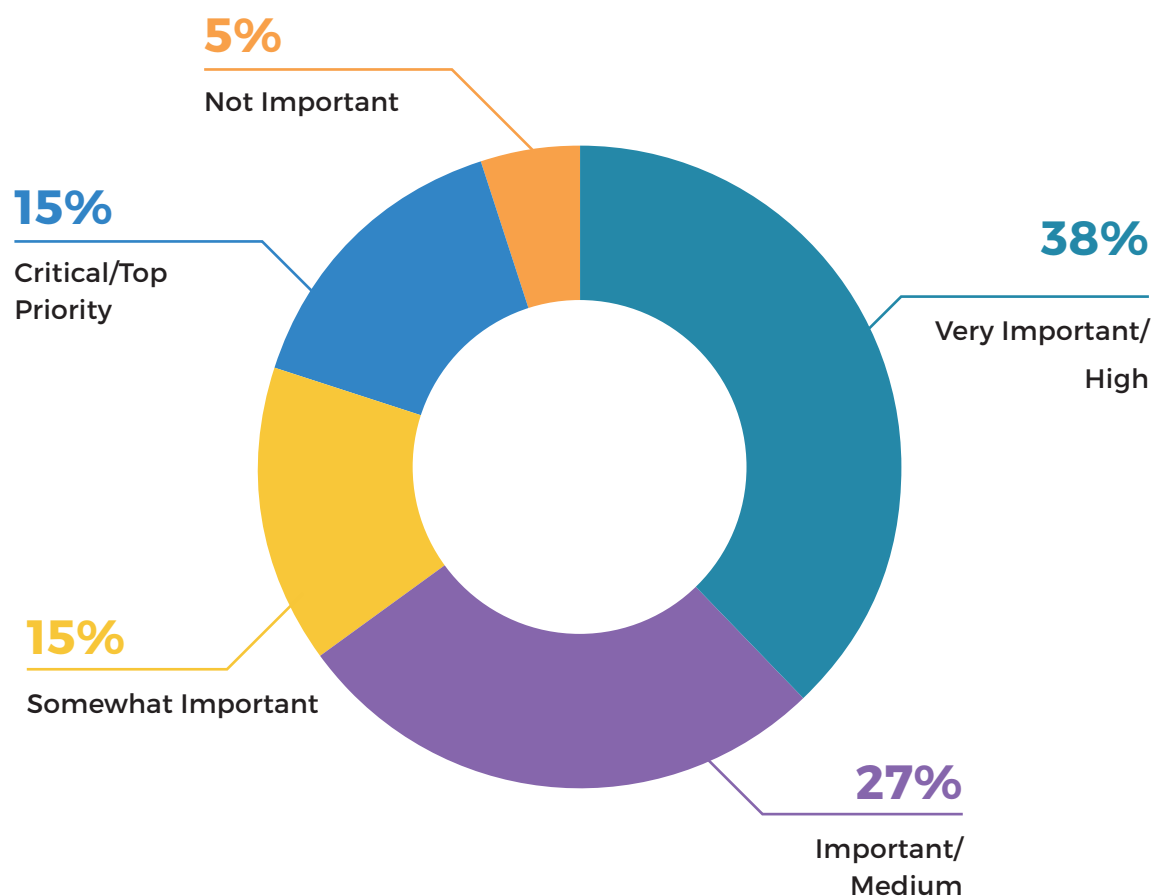
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The customer does not exist. Because every customer is different. Customer-centric firms acknowledge the heterogeneity among our customers. More than that, we celebrate it because we understand that heterogeneity offers us opportunity.

—Peter Fader, The Wharton School

”

How Important to Airline Executives Is Customizing Offers Based on Predicted Purpose of Travel?



Source: Skift's 2017 Airline Survey on Leadership in Ancillaries, Revenue Management, and Marketing

KEY LEARNINGS FOR AIRLINE LEADERS

Customer segmentation as the industry has known it has evolved. It now has the potential to become dramatically more sophisticated by embracing customer heterogeneity – which underpins customized offer creation.

Carriers can now push beyond broad and vague generalizations about customers to design services, set prices, and promote offers that address each customer's unique needs and situation.

Customizing offers for airline flights could be beneficial both for customers and the airline. Customers can get offers that are better tailored to their needs on a specific trip or in a given situation, while airlines can enjoy the revenue lift of better matching their customers' needs with their services and pricing. Airlines naturally benefit when their customers feel the airline has optimally served them.

COHORT ASSIGNMENT FOR AIRLINES

There are two grouping ideas airline executives should note. Earlier we mentioned one of them, segmentation, which groups customers by observed persistent traits, such as age, home location, household income, and family size. There is a newer way of grouping that is complementary, called cohort assignment. Airlines often use this new grouping concept when assessing why a customer is traveling.

Just as ancient Romans described a collection of soldiers organized for a specific function as a cohort, **modern airlines can also refer to a set of customers who share a similar purpose in their travel as belonging to a cohort.**

When attempting to understand the purpose of travel of airline passengers, airlines can use cohort assignment as a technique.

Consider how this works with a fictionalized individual named Cory. She's an independent consultant with a three-year-old son.

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We take understanding our customers very seriously. We go beyond demographics. We use research, focus groups, and we're always surveying our customers to understand their values and needs.

— Trey Urbahn, TAP Air Portugal

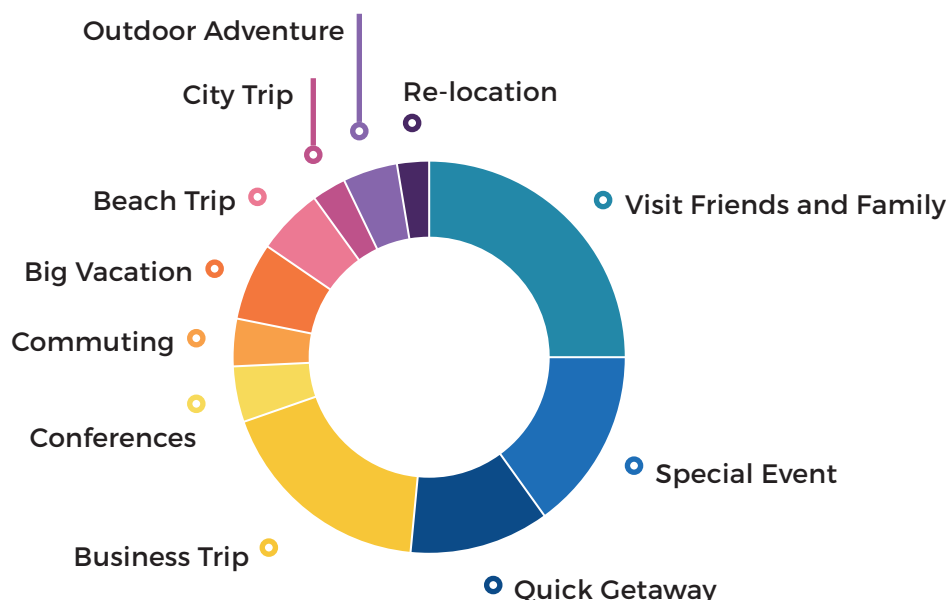
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On Wednesday, she flies to Cleveland to see a client. Out at 8 a.m. and back at 9 p.m.

On Saturday, she flies to Orlando with her son and drives him to the Kennedy Space Center to tour the rockets on display.

Cory's preferences on Wednesday are more like those of other small business travelers. Her needs on Saturday are like other moms'.

Beyond “Business or Pleasure”: Why We Travel



Source: Skift Research

Airlines can do more to identify and cater to differences like those using customized offers. Understanding the customer's purpose of travel is just as important as understanding their demographics.

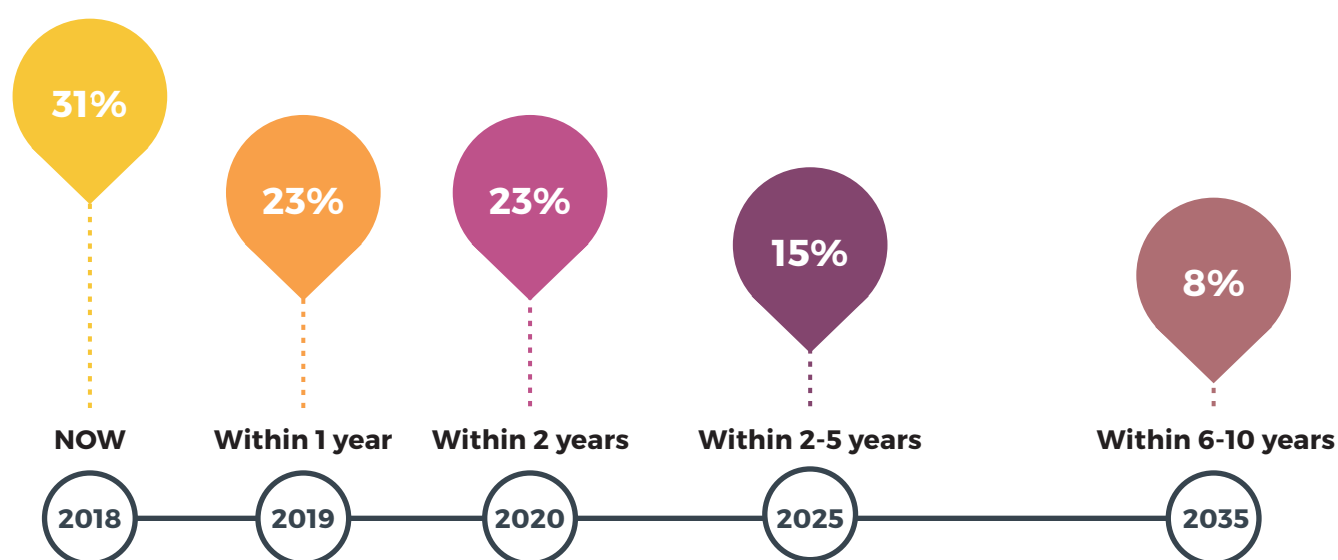
Finding meaningful cohorts can be tricky. Consider the difference between Cory, who works at a small business, and Eva, a road warrior for a large corporation, when each fly for business. Perhaps they belong in different cohorts.

Likewise, a couple considering a "leisure" getaway to a beach – any beach – will consider their options very differently than parents booking a "leisure" trip to see their daughter graduate from a university.

The data science behind identifying and measuring customer heterogeneity, blending past purchases, present activity, and creating associations is discussed later in our paper.

For now, it is critical to understand that airlines must be savvier about predicting differences between customers and their varied needs, allowing them to advance further on the road to customized offers and enjoying the full benefits they can bring.

Timeframe Airline Executives Expect to Incorporate Relevance Into Customized Offers



Source: Skift's 2017 Airline Survey on Leadership in Ancillaries, Revenue Management, and Marketing

HOW AIRLINES WILL PRICE BETTER CUSTOMIZED OFFERS



Source: [Unsplash](#)

For airlines and customers, one of the most important considerations of customized offers is pricing. Better pricing can benefit both airlines and customers. This truth became apparent after airlines led the broader business world with the development of the revenue management discipline, starting in the 1980s. Airlines are poised to move into the forefront again.

Below, we consider how the established practice of revenue management can change to embrace customized offers; how leading airlines are optimizing the choices in offers; and how carriers are experimenting with three emerging new pricing concepts: bundling, bidding, and subscriptions.

RETHINKING REVENUE MANAGEMENT

Traditionally, airlines only optimized for one thing: the revenue collected per flight for the seat. Pricing and Revenue Management departments took the lead in setting and managing those offers. Over the decades, innovation in techniques and technology honed the science and practice.

“The reality is airlines are very good and have developed and led all other industries on the fundamentals of differential pricing and revenue management to control how many seats to sell at different prices,” said Peter Belobaba, a principal research scientist at the department of aeronautics and astronautics at the Massachusetts Institute of Technology.

Today, revenue from ancillary sources constitutes 10 percent of passenger revenue globally and up to 45 percent of revenue on low-fare carriers.

As non-fare choices grow in importance, revenue management systems will have to evolve to incorporate all the products that an airline sells and help the airline bundle those products together optimally.

A story from the hospitality industry may serve as an informative analogy for airlines.

Harrah's Cherokee Casino in North Carolina is adept at balancing revenue gained from room pricing decisions with revenue related to customer gaming. It is focused on generating revenue from two sources: hotel rooms and customer gambling.

These goals are parallel to those of the airline sector. The value of the hotel room booking is like an airline's airfare, while the gambling revenue is akin to non-fare choices that airlines offer customers.

What's unique about Cherokee is that the organization tracks gambling spend to the exact customer. The Revenue Management team can then create forecasts of total revenue to influence how it offers hotel bookings.

The approach allows Cherokee to maximize the total value of both the hotel rooms and gambling expenditures from each guest, rather than looking at each of these as separate line items.

Some specialists in airline revenue management may be familiar with this analogous application. But it's nonetheless an inspiring model for the airline industry, where Revenue Management teams need to work to integrate consideration of non-ticket revenue into their forecasts of overall revenue – and to manage fares to get the best overall revenue.

"It's vital that the price for tickets and the prices for all the other components end up in one place at some point," said Dieter Westermann, vice president of revenue management at Etihad Airways. "The total price must be set in one step and not in separate steps. Today it is under separate steps. There's no connection."

While Revenue Management teams work to develop solutions to take into account total revenue when considering fares, and look to their role in pricing customized offers, airlines are also working to optimize their non-ticket ancillary revenue.

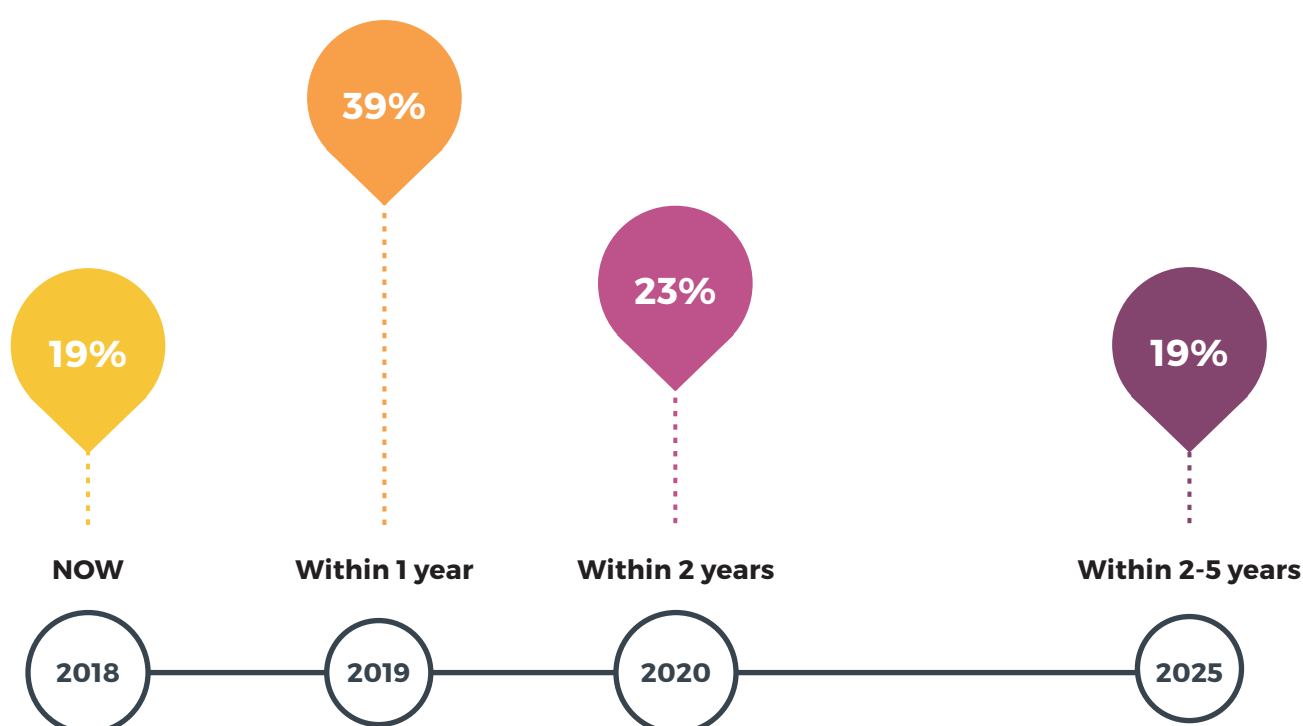
Source: [Unsplash](#)



ADVANCED APPROACHES TO ANCILLARY PRICING

Correctly pricing ancillary choices, like checked baggage options and pre-assigned seats, is already critical to the business success of most of today's airlines. According to Skift's airline survey, 93 percent of airline leaders regarded pricing choices in an offer as very important or critical to their business. Relatedly, 19 percent said they've already started work on ancillary price optimization, and 62 percent responded that they would between 2019 and 2020.

Timeframe Airline Executives Predict to Optimize Ancillary Pricing



Source: Skift's 2017 Airline Survey on Leadership in Ancillaries, Revenue Management, and Marketing

Already airlines are becoming more sophisticated. Lukas Johnson, senior vice president, commercial, at Allegiant, said, "Even two years ago, we would set an ancillary price using our best judgment. But since then, the focus has been on optimization — getting those prices right."

Ancillary pricing activities range widely in scope, complexity, and sophistication. Some airlines have set a single checked bag price, and that's that. Other airlines, as Allegiant's Johnson indicated, are moving ahead with optimization independently of fares, to increase total revenue. For these airlines, ancillaries offer a unique opportunity to adapt ideas from other industries and academic disciplines.

For example, an airline can generally manage the most common ancillary choices, such as checked bags and pre-assigned seats, with what economists call unconstrained demand. That means that the airline can sell the ancillaries without being worried that the inventory will run out before everyone has had a chance to buy.

Setting prices is much easier with unconstrained demand. Airlines can focus on maximizing revenue, utility (how valuable an item is in the eyes of a customer), or a combination of both. Pricing teams estimate how a change in price will impact how many customers will add an ancillary item. They can validate their estimates by running tests on small groups of customers.

At least one airline uses mathematical optimization — a set of methods for determining the best solution to mathematically defined problems — for establishing ancillary prices. The airline's teams lean on this discipline to avoid programming algorithms that seem deceptively promising but will not, in fact, achieve an optimal solution. The discipline can help an airline's teams generate advances in pricing more quickly. Airlines can use the concepts, along with lessons from behavioral economics (which we'll explore later), to make the most money while also ensuring that the minimum number of customers are "priced out" of choices.

Price optimization using data science is a great place to start. But, as airlines continue to evolve their creation of customized offers, pricing can come to embrace customer heterogeneity. That effort is called price segmentation, and it's based on an established microeconomic reality that exists all around us. Airlines can apply this practice to see that different customer cohorts will evaluate the worth of the same choices differently.

It's to the advantage of both the customer and the airline to attempt to match the value of as many customers as closely as possible. If the prices match what customers want to pay, more customers can buy what they want than if those prices were too high. And the airline benefits, because selling even at a reduced price to some customers is often more beneficial to total revenue than forcing those customers to walk away without buying anything.

PRICE SEGMENTATION IS COMMON IN THE WORLD AROUND YOU

The basic concept is to charge higher prices to a customer with a higher willingness to pay, within reason. Companies group customers by their propensities for spending and then offer prices specific to each group. Airline Revenue Management teams practice price segmentation largely by advance purchase period.



Age, Occupational,
and Residency Discounts



Quantity discounts
(bulk buys)



Coupons (in airline speak,
promo codes)



Needs-based
tuition



Price variation by
location of the POS



Insurance rates



Outlet stores



Ladies night

Consider how customer heterogeneity might impact airline revenue in the table below.

A business person and family are both considering buying premium seat assignments on the same flight. The two groups value them differently:

1. The business person wants that premium seat, valuing it at \$54.
2. The family would like the premium seats, too, but they're trying to save a little money on this trip. They would pay up to \$96 for all three of them to sit in the best seats (\$32 per seat assignment).

If the airline offers both the businessperson and the family members' premium seat assignments for \$40 a seat, the businessperson will pay and be happy. But the family will not pay and will instead sit in the back, disappointed. The airline will only make \$40, total.

However, what if the airline offered the businessman the seat assignment at \$50? And what if the airline offered the family a discount for buying three seat assignments on a volume discount — effectively lowering the price to \$30 per seat?

In this case, the businessman buys and is happy. The family buys and is happy. The airline has used price segmentation to get all four passengers what they want and has increased its total revenue from \$40 to \$140. That's a gain of 350 percent!

	VALUE OFFER UP TO	SAME PRICE	CUSTOMIZED PRICE
Businessman 	\$54/pp	\$40/pp 	\$50/pp 
Family of Three 	\$32/pp	\$40/pp 	\$30/pp(x3) 
	Airline Revenue	\$40	\$140

As airlines move from basic pricing to maximization based on data science, and then to better price segmentation, ancillary revenue will become more and more important to customized offer management.



Source: [Unsplash](#)

FRESH PRICING IDEAS: BUNDLING, BIDDING, AND SUBSCRIPTIONS

Tomorrow's customized offer creation isn't just about figuring out the right price based on a given customer's needs at a given moment. Consideration of how to charge, not just how much to charge, may provide airlines an additional opportunity to satisfy the customer.

A few airlines are considering three areas that are already gaining traction in other industries: bundling, bidding, and subscriptions.

Mixed Bundling

Airlines have been offering airfare bundles for years, typically in the form of fare families or branded fares. Those offers generally use pure bundling, a strategy where customers can only purchase from a pre-defined collection of bundle choices. A newer approach to bundling in airlines — one with growing relevance to the field of customized offer creation — relies on the concept of mixed bundling, which provides choices including bundles and à la carte.

Mixed bundling means that customer may choose one or more bundles — or the customer may choose items individually. This approach is not unlike the offer of meal options at fast food chains where customers can buy, say, Value Meal #1, Value Meal #2, or a just a hamburger, or just fries, or a hamburger and fries.

In recent years, a growing number of airlines are shifting toward this mixed bundling approach. One pioneer is Frontier Airlines. When the carrier first launched their mixed bundling strategy in 2015, travel industry analyst Henry Harteveldt of Atmosphere Research told USA Today: "Frontier may raise more than a few eyebrows with this [bundle] offering. But they've included services that travelers appreciate, the savings are quite substantial, and it's a great tool for families and business travelers. [Customized offers] could help Frontier attract more customers to the airline."

There's a roadmap for the economics of mixed bundling — one that explains the fundamentals of why Frontier's strategy has proven effective. It's a paper called "Commodity Bundling and the Burden of Monopoly," by William Adams and Janet Yellen. The authors were not talking about airlines, but their concepts apply regardless. Adapting the paper's concept, an airline can see the economic proof that a mixed bundling offer can be beneficial to customers and airlines at the same time.

In addition to the economics of what to bundle and how to price, a bundle offer also allows airlines to leverage cohort assignment to present the right bundle offer to the customer. In other words, it leverages behavioral economics to help customers consider if the bundle is right for them.

Frontier isn't the only airline that's experimenting with mixed bundling. Other carriers are also starting to see the potential.

"I think that will be the big change in the next few years: you'll see advanced product bundles across the industry," stated Rogier Van Enk, Finnair's vice president for distribution, commercial excellence, and data science. In fact, 70 percent of executives in Skift's airline survey ranked development of ancillary bundling as "very important" or "critical" to their business.

Bidding

Like bundling, the concept of bidding is an effective pricing strategy that just hasn't been much used by airlines. Consider the influential Massachusetts Institute of Technology (MIT) Sloan article, "When Customers Help Set Prices" by Marco Bertini and Oded Koenigsberg. The article highlights the benefits of a model where companies and customers collectively decide on the right price for a given product or service. Bidding is one such collaborative approach.

One bidding model with relevance to airlines is the "name-your-own-price" model, one in which the customer proposes a price to a firm, and the firm can accept, reject, or even counter the offer. Perhaps the best opportunity for carriers to implement this type of "name-your-own-price" bidding is for the sale of upgrades.

In fact, the authors of the MIT Sloan article cite Plusgrade, a technology company that powers bidding services behind more than two dozen airlines, who use it to assist with the pricing of products like seat upgrades. The airlines can use any number of pre-defined criteria to determine if a customer's bid is acceptable, approving the upgrade when conditions are met.

Subscriptions

The concept of subscriptions is yet another time-tested pricing strategy. One forward-thinking airline has had some successes with it already.

Surf Air, a commuter airline based in California, targets business travelers with a flat monthly subscription for unlimited flights. The subscription approach allows the company to offer a straightforward price that's appealing to its most lucrative customers.

"There's beauty in the simplicity of our pricing model — our whole commercial model," said Nick Kennedy, president of Surf Air.

Simplicity is just one benefit of the subscription approach. Another advantage of subscriptions is that they lead to a form of customer “lock-in,” a term used by marketers to describe the situation where customers have a strong incentive to keep using that company and not shop around.

The level of engagement with the customer changes, too. “A subscription model requires customers to be much more closely associated with the airline,” said Trey Urbahn, chief commercial officer of TAP Air Portugal. “It facilitates more customization, and more variation, in how products are offered.”

Subscription pricing strategies could be transformative to the airline industry. “The airline would take a purely non-contractual business, a purely consumer-discretionary business, and turn it into a contractual one,” says Peter Fader, professor of marketing at The Wharton School.

Fader even suggests the success of Amazon’s hugely-popular Prime program could serve as a potential inspiration, in a modified way, for airline subscriptions in the future. Prime includes a discounted price on some consumer purchases (plus free shipping) to encourage customers to purchase those goods from Amazon and not a competitor. In fact, modifications of this Prime-style subscription model now exist at carriers including Air France, Spirit Airlines, and Frontier Airlines.

To be sure, subscription pricing may not have a straightforward application in many commercial airlines. There are two challenges that stem from a common problem: airline usage can be harder to predict than usage in some other industries where subscriptions are common. When usage is difficult to predict, it can be challenging for a customer to weigh the value they’ll get compared to the subscription price. And for the airline, it can be hard to calculate the costs, which are variable and depend on usage, against the flat subscription price.

However, despite such challenges, the benefits of the model make it an area worth exploring.

HOW TO USE CUSTOMER INSIGHTS TO INFORM CUSTOMIZED OFFER DESIGN



Source: [Unsplash](#)

We've now reviewed how customized offer design can benefit airlines and customers simultaneously. These strategies require a detailed understanding of customer behavior to succeed.

"It's critical," said TAP's Urbahn of this work. "We're working on understanding customers better and to use that understanding and their behaviors to create better and more customized offers."

What types of customer insights will airline executives need to use to inform customized offer creation? And how should airlines gather these customer insights? In this section, we'll examine how airlines can use data as the base on which to build a more sophisticated understanding of customers.

AIRLINES CAN TAP DATA SCIENCE TODAY

The process of gathering and using customer data involves a few steps.

The first step is understanding customers' heterogeneity and their different needs — and how to identify which customer falls into which relevant grouping. An airline can take this step by creating customer cohorts.

The second step is to consider what behavioral economics teaches about how customers typically make decisions. If customers are distracted or confused, they can make poor choices — even when presented with offers that are customized to meet their needs.

The final step is to optimize an offer to meet those needs. Today many airlines complete this optimization by means data-driven methods like A/B testing, reviewing historical sales data, and using interdisciplinary concepts pulled from realms like economics.

Behind all of these steps is the application of data science, including techniques such as machine learning and advanced forms of artificial intelligence. **More than 30 percent of airline executives either already use, or say they will implement, machine learning by the end of 2018 to assist with their offer creation and pricing**, according to Skift's 2017 Airline Survey on Leadership in Ancillary, Revenue Management, and Marketing.

Airlines have an amazing amount of very specific and accurate data. They can use that data to gain insights into customer behavior. It's not magic. In fact, they are the same types of insights that humans could find. But modern data sciences allow the airline to manage far more information, handle more complexity, and produce results that are more accurate, precise, specific, quick, and comprehensive. Data science can help address millions of scenarios in a more nuanced and rapid way.

In other words, data science allows airlines to do the same sort of thing a seasoned human could do, but better, faster, and with greater sophistication.

It's an iterative process — one that's getting better and better — as airlines have already started and found success.

"Real models and actual capabilities are available for airlines to use now," reflects Mark Nasr of Air Canada. "And, as we get into the future, airlines will be more and more reliant on them. As the airlines use them, the models and analytics will become progressively more and more complex and sophisticated."

Across industries, the application of advanced data science has supported the heuristics used by the human professionals — while also improving upon them in critical ways.

UNDERSTANDING CUSTOMERS' NEEDS AND DEVELOPING COHORTS

At the outset of this paper, we reviewed the benefits of creating a complete view of airline customers based on the concepts of customer heterogeneity, the purpose of travel, and cohorts. But how will airlines do this?

The truth is that necessary technology, data, and techniques to create these cohorts already exist today. The hardest stage of the process is getting past the inertia of how things have been done in the past.

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Actually leveraging the data will ultimately be the most important factor. Using data analytics to weave together services and choices to drive the creation of a more customized proposition to each customer or to each customer as a part of a customer segment.

—Campbell Wilson, Singapore Airlines

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Businesses have been performing customer segmentation by persistent demographics like household income and number of children for decades. That technique is useful for airlines, too. Several airlines use either their own customer segmentation solution or contract with a provider for a solution. This work helps the airline target promotions, such as by helping to decide which customers receive a certain promotional email.

The unique opportunity for airlines is to understand why a customer is considering a trip and how that relates to their specific needs for that trip. Then they must create the groups – the customer cohorts—and assign customers into each cohort. At last, they can create customized offers.

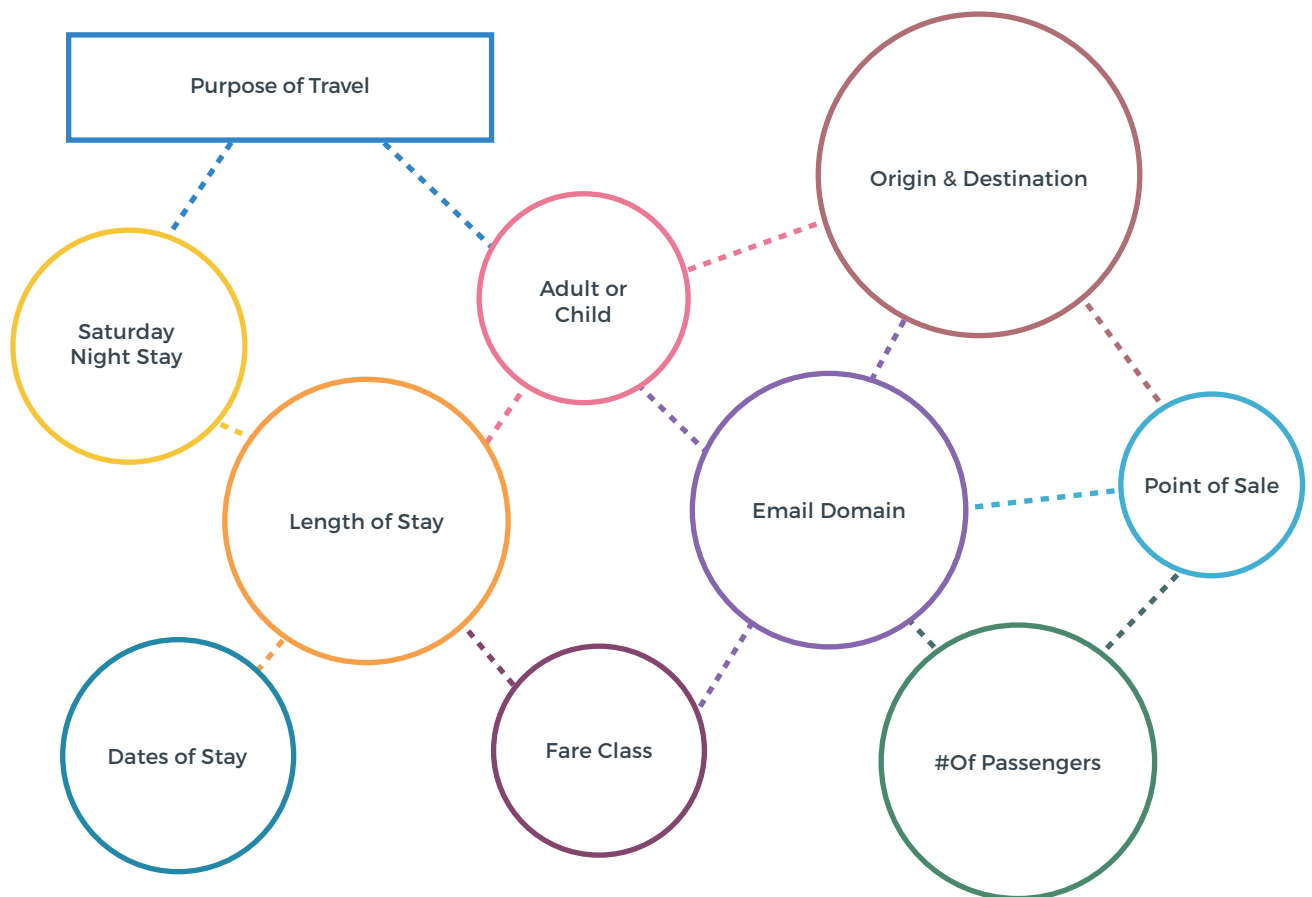
The common assumption with customer data is that more is better. **But when it comes to gathering customer data to create cohorts, relevance is what matters. Identifying even a few important data dimensions, and the correlations between them, will let an airline improve its customized offers.**

Airlines can use their existing sources of data to develop models and create cohorts. Most of the time, the results of these exercises will be intuitive. In a paper yet to be published, Michael Farrugia, chief technology officer for airline business analytics company Planitas, describes a project to predict why customers were taking a trip. He used the passenger name record, which includes information about the flight, ancillaries, and customers. He matched that with survey results of the same customers that asked why they had made that trip.

Farrugia's model confirmed the importance of variables like the advance purchase period and whether or not a customer stayed over on a Saturday. And it weighted the importance of a dozen indicators. But the machine learning algorithm also yielded an unexpected result: the email domain of a customer could be a very strong predictor of some form of business travel. When customers used a company domain name, like “skift.com” or “mycompany.com,” they were overwhelmingly traveling for some professional reason. That makes sense in retrospect, but the airline team had never thought of it.

That's how data science can work in creating meaningful cohorts. By using existing data, airlines can develop associations between groups of customers that will make sense to marketers, but in a more precise and scalable way than ever before.

Using Search Data to Infer Purpose of Travel



Source: Skift Research

USING BEHAVIORAL ECONOMICS TO SHAPE DECISIONS



Source: [Unsplash](#)

Airlines can understand their customers' needs and use that understanding to craft customized offers. But if customers don't understand them, or if they're distracted when it's time to make a choice, customers may not make the best choices.

Behavioral economics provides insights that airlines are starting to use. Behavioral economics is the study of how consumers act with predictable biases that can be measured with experiments that, in turn, can inform models that more accurately describe real-life consumer behavior than older, classical economics models that assumed humans act perfectly rationally.

University of Chicago professor, and 2017 Nobel laureate, Richard Thaler coined the term "choice architecture" to describe how consumer decisions can be structured to encourage choices, and how it has significant potential to be used by airlines as well.

Airline customers make decisions that are influenced by all sorts of cognitive forces. Influencing factors include the total number of choices presented, the way each offer is described, how prices are presented, how scarcity is described, and which option is presented as the default. Behavioral economics attempts to harness these cognitive forces. It looks at how offers are presented and designed to push customers' decisions in a direction that benefits their own best interests.

Applying these insights is not just a challenge for an airline's marketers. Tasks like understanding the value of each customer choice, measuring how each customer cohort responds to that choice, and then estimating how those decisions impact revenue increasingly requires an interdepartmental, interdisciplinary approach.

Those who specialize in behavioral economics note that the practice is already widely used by other industries, and that the lessons learned by these sectors can teach airlines. "There are insights from [sectors like fast-moving consumer goods] or public transit or the automotive industry that apply to how airline customers make decisions," said Kelly Peters, CEO of BEworks, the management consulting firm she co-founded with Predictably Irrational author Dan Ariely.

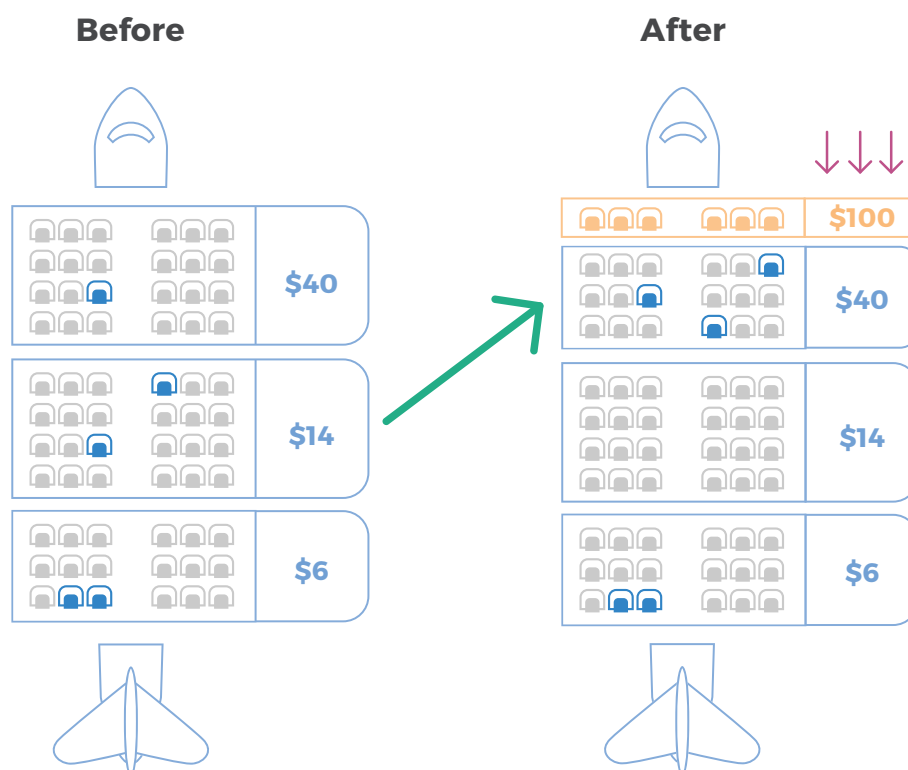
One analogy of applied behavioral economic principles is the design of restaurant menus. A restaurant owner may add an expensive lobster dish simply to encourage customers to select a less expensive pasta dish with much better margins than the lobster.

How can airlines make use of behavioral economics when designing the optimal customized offer? The way they design and present various offers in relation to one another can subtly influence consumer choices. **This principle is informed by a behavioral economics concept called price framing, which may be best explained via the illustration.**

Imagine that an airline offers customers optional, pre-assigned seats. The seats are priced by zones. For illustration, the fares range from \$6 up to \$40 for the best seats.

When the airline creates a new zone consisting only of the first row and prices each seat in it at \$100, all other seat assignment prices appear relatively more attractive though they have not changed. The \$40 price is now at a significant discount relative to the highest priced seat assignment. This makes more customers likely to select the \$40 seat assignments, because their decision on price has been framed in a way to encourage them to value those seats differently. Customers can feel better about their purchase, since they did not choose the most expensive seat, and the airline earns more revenue than it would have otherwise.

Using Price Framing to Influence Airline Seat Choice



When an airline uses a bundling strategy, as described earlier, behavioral economics can also help customers make the best choice. Customers may struggle to figure out if a bundle is a good deal for them; the airline can help by simply telling the customer what each element is worth by listing each one's price and then adding the prices to compute the savings. To help customers choose a reasonable bundle, the airline might add a more expensive but less attractive bundle offer.

Airlines often face "choice overload," the phenomenon when a customer is confronted with a set of options that are so jam-packed with choice that he or she struggles to make a rational choice. It also refers to when customers are asked to make so many choices that they become fatigued and make progressively poorer choices.

Behavioral economics goes a long way toward explaining the trend toward commoditization in airline flights. Consider the old way airlines presented a single, total fare. That presentation of the offer pushed customers to make the misleadingly easy decision of just picking the lowest price and avoiding the challenge of assessing other qualities that make offers distinct.

"Expected comfort, customer service, and quality in general... These things are hard to compare," confirmed Peters of BEworks. When it appears that everything is expressed in the fare, "...it reduces more complex considerations to numerical comparisons. It's easy to see which airfare is less, and we tend to follow that path of least resistance."

From the airfare itself to choices around ancillaries and everything about customers' journeys, behavioral economics provides real and applicable models of how humans make decisions.

OPTIMIZING OFFERS BASED ON CUSTOMER NEEDS THROUGH TESTING



Source: [Unsplash](#)

From grouping customers and their heterogeneity to understanding how customers make choices, airlines can get a picture of what they should change and what they should test.

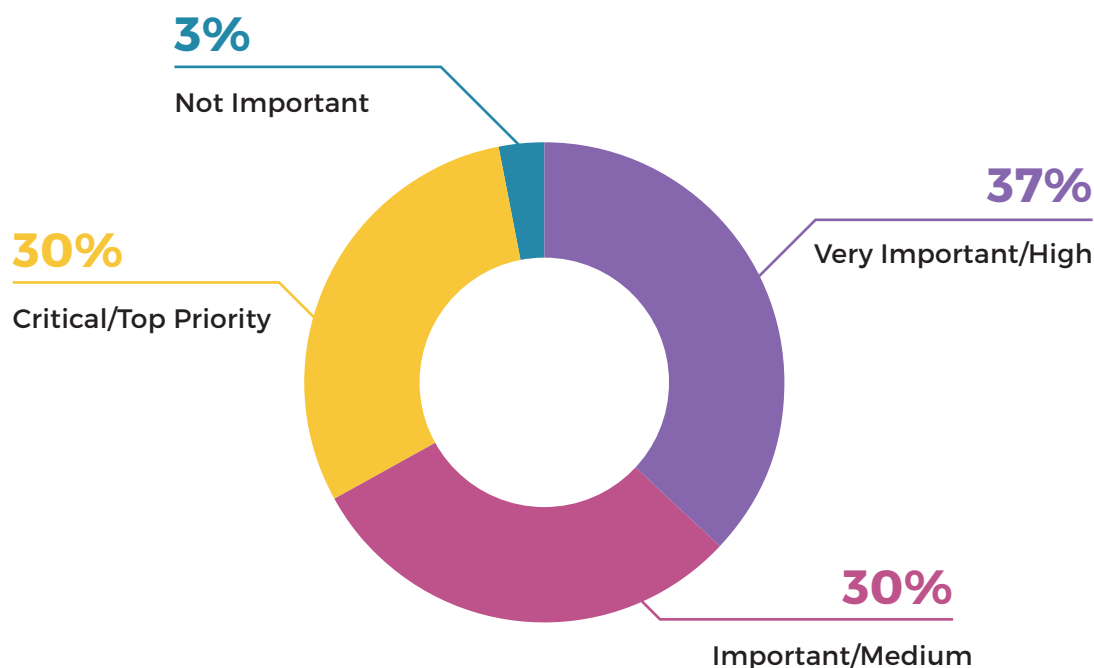
Today that's accomplished with help from a growing collection of marketing and data science techniques that can help airlines further refine the offer creation process. Best of all, the necessary tools to proceed with this process are already available to airlines.

The customer journey map, an established technique in many industries, allows an airline to identify when and why customers are making decisions relevant to their customized offers. With insights from behavioral economics, the airline can consider what cognitive forces are at play at each point.

Then an airline can design smart tests using techniques like A/B testing, wherein one set of customers see an offer presented in a certain way, and another set sees a slightly different way of presenting the same offer.

67 percent of respondents in Skift's airline survey said that such A/B testing was either "critical" or "very important."

How Important to Airline Executives Is the Design and A/B Testing of Their Website, Mobile, and Web Check-In Related the Promotion of Customized Offers?



Source: Skift's 2017 Airline Survey on Leadership in Ancillaries, Revenue Management, and Marketing

A/B testing could be applied by cohort, so a subset of the airline's customers considering a weekend getaway somewhere sunny might see an offer emphasizing ease, including priority boarding. Another might see an offer emphasizing savings (which the customer could use to buy mojitos on the beach).

A/B testing is really the tip of the iceberg. It's relatively easy to run and yields powerful results, but more advanced and comprehensive tools are out there. A/B testing generally focuses on an immediate result: what did the customer do at that moment? Did the customer convert? More advanced models consider more than two possibilities and more comprehensive results, like revenue per action or even Customer Lifetime Value (CLV).

Testing based on consideration of CLV might be the future. Wharton's Peter Fader encourages it: "I'd like to see airlines continue to lead the way, using better and better dynamic [offer management] algorithms to go beyond just short-term revenue management, and to start to take the longer term into account. To build offers around maximizing CLV or customer equity."

For many airlines, that's a long way off. According to Michael Farrugia of Planitas, the most important step for any airline is simply getting started. **"Starting out is more important than getting the perfect product out,"** he noted.

RETHINKING AIRLINE TALENT AND ORGANIZATION TO ENABLE CUSTOMIZED OFFERS



Source: [Unsplash](#)

Starting, or advancing, their customized offer creation and promotion requires airlines to have the right talent in the right internal structure. The wishes of airlines and customers can both be met with new technology and techniques. So why aren't more airlines creating meaningfully customized offers?

Technology can be a stimulus to change. But airlines generally also need individuals familiar with several interdisciplinary areas to make the most of the new opportunities, and they need to reorganize themselves on an ongoing basis to become nimbler.

THE WAR FOR TALENT

Specialization has left talent gaps. Some of the disciplines identified in this report are not represented in airline executive CVs. The result has been a war for talent — where companies fight over a small pool of talented professionals who can fill key positions.

One path toward coping with the labor challenge is to pinpoint the essential skills their companies need and then recruit the right employees to fill those gaps.

"The best people are those who can combine business acumen with data-driven decision making, to understand what actions can be taken from the data," said Farrugia of Planitas. "Those practitioners that can combine the knowledge of advanced analytics, use of technology, and business sense will be highly sought-after individuals."

What roles are essential so that disciplines are connected across an airline business? Some carriers are recruiting professionals with the know-how to manipulate the latest tools for crunching data at a large scale. They tell Skift they're looking for software engineers who can run database tools such as Apache Spark and Hadoop and who know how to take advantage of server-based platforms powered by third-parties.

Airlines are seeking professionals in marketing, revenue management, and pricing analysis who have worked to become adequately conversant in data analytics, too, so that they can hold informed conversations with in-house computer scientists about projects, strategy, and obtaining relevant and usable, i.e., "well-structured" data sets.

Some executives find themselves advertising for positions that are new to their operations. A case in point is the user-experience expert, or someone who knows best practices for optimizing how choices are displayed for consumers, testing them, and avoiding the traps described by behavioral economics, like choice overload. Presenting fewer, only relevant, or recommended choices and offering plain-language or memorably illustrated explanations can help avoid the overload.

Skift's research revealed that airline executives have mixed opinions of which talents and skills are most important and whether retraining is effective.

Skift investigation of the employee skills most valued by airline executives found that disciplines like e-commerce and customer centricity were most important. Both skills were ranked in the top two when executives were asked to consider what types of experience those in leadership positions for offer management needed to possess.

Most Important Skills for Airline Employees Who Oversee Merchandising, Ancillary, and Pricing Decisions (Ranked on a Scale from 1 to 7)



Source: Skift's 2017 Airline Survey on Leadership in Ancillaries, Revenue Management, and Marketing

Some executives said they are tempted to model their hiring of technical talent on a company like Amazon, the retailer that virtually invented online merchandising.

Admiration for Amazon and other tech giants is understandable. All companies stand to learn from how these tech goliaths hire, retain technical talent, build teams, and ensure accountability.

ADAPTING ORGANIZATIONAL STRUCTURES

Luring top talent is not enough. Many airlines need to deploy their employees' valuable skills and rare knowledge more effectively than their organizational structures presently allow.

Most airlines have structured themselves to sell and interact with customers based on models that now risk becoming outmoded. The organizational structure at any given airline is usually much the same as any other comparably-sized airline. It is typically built around core functions that have matured over many years and that, to an extent, operate independently.

The halls of airline trade conferences often echo with talk of "breaking down silos", or making sure that employees collaborate and that airline pricing analysts no longer work in isolation from, say, marketing departments. But that talk may not take companies far enough toward their stated goals.

Exhibit A is Amazon, which found it necessary to reduce the amount of coordination for the sake of coordination that many companies feel compelled to do. On this point, Brad Stone's book on Amazon, "The Everything Store: Jeff Bezos and the Age of Amazon," offers some insight courtesy of its CEO: "Bezos's counterintuitive point was that coordination among employees wasted time, and that the people closest to problems were usually in the best position to solve them."

"Getting people aligned properly in this new environment isn't easy," said Roger Harris, senior vice president of revenue management, distribution and alliances at AeroMexico. "That is not a criticism of the individuals; it's the organization and the incentives. Because I think successful people want to own a target, and they want to have control over it. And those lines are blurry."

Airlines are understandably unsure of the best structure to handle new interdepartmental and interdisciplinary challenges. One specific issue is which part of the organization will be held accountable for enhancing customized offer creation. Would a new team sit within the marketing-and-sales unit or revenue management, for instance?

Skift's survey found that more than half of airline leaders said that their current organizational model likely needs to be changed. Airline leaders also revealed in conversations with us that they have mixed opinions of where responsibility should lie for driving customize offer creation forward.

For some executives, a key question is how to align department-level goals with the interdisciplinary approach required for customized offer creation. A few airlines, such as Etihad Airways, have developed small cross-division teams — an initiative they said has yielded early dividends.

"We're setting up a trial where we create a small team out of various disciplines, which will include e-commerce people, revenue management, pricing people, and marketing people," said Dieter Westermann of Etihad Airways.

Other airlines, such as Air Canada, are experimenting with a so-called matrix approach. They realign teams so that the workers are more focused on interdisciplinary objectives, such as products or customer segments.

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It's not a technology problem. There's technology available to achieve our goals. It's a challenge of governance, organizational development, and maturity and structure, and a challenge of evolving how we as an airline deliver on data-driven customized offers for our customers.

— Mohammad Gaber, Air Canada

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"We've developed more of a matrix approach where products have owners for development and delivery within the marketing team," said Mohammad Gaber, who at the time of our interview was senior director, marketing and digital strategy at Air Canada. "Customer segments have their own champions, too."

If history is any guide, each airline organization will need to evolve and change through its own optimization process, as the carriers have done in response to other revolutions.

When facing a leadership challenge like this one, impatience may be a virtue, so to speak. Airline leaders may need to relentlessly signal their priorities.

Some far-sighted executives are responding by adjusting their organizations in what could be called rolling processes. They keep fine-tuning until they find the right structure for their carrier's unique needs.

"We've got a lot of different teams and different groups, so it's been a challenge," said Allegiant's Lukas Johnson. "It's still a work in progress for us to figure out where groups best live.... Honestly, the company is probably going to go through a number of changes until we get to the correct structure."

Many airlines already know they need to hire top talent to capture the full potential of optimized offers. Yet some may not realize that the primary talent challenge they face is in neither recruitment nor compensation. Many carriers also need to innovate in how they structure their organizations. **New forms of collaboration will more fully maximize the deployment of their employees' valuable skills and rare knowledge – which often crosses disciplines, domains, and business units.**

INDUSTRY-WIDE IMPACTS OF CUSTOMIZED OFFERS



Source: [Unsplash](#)

The potential impact of customized offers is far-reaching, with both the airlines and their customers standing to benefit. What's in store for the industry as this new reality begins to take hold? In this final section, we examine the potential impacts.

For the carriers, customized offers will counter the perception that airline offers are commoditized and stem the intense downward pressure on prices and fare wars that have kept airline industry margins below a healthy level. And as airlines get smarter, more customer-centric, and more responsive to their customers, they will also be able to expand their business to offer new types of travel products.

Granted, reaching these outcomes will not be without challenges. The industry faces challenges with distribution which (while being resolved) may in the short term slow down the necessary changes.

THE END OF COMMODITIZATION

For the airline industry, the biggest impact of customized offers will be helping them reduce the impact of commoditization and the history of fare wars.

As mentioned in a previous chapter, the problem stems from behavioral economics. Presenting an all-in fare and focusing on promoting that price leads customers to think that the fare is the only important consideration. That makes airline flights appear to all be totally interchangeable; to be commodities like grain or frozen orange juice. Comparing one airline's fare to another is easier than attempting to contrast the airlines' service and comfort levels and how well each airline meets the customer's expectation. "It's just a function of, 'Is this number lower than that number?'" said Peters from BEworks. "Customers look for the path of least resistance which is to compare by price."

Airline flights are not commodities; they're not all the same. Customized offers aim to break the habit of presenting customers with choices that suggest airlines are all the same. Customized offers make it easier for customers to see what each airline offers and how well that airline meets their individual needs.

By making the full offer easier to understand by being clear about what is in and what is out, customized offers can benefit customers, who can make more informed decisions, and benefits airlines, who can better differentiate their offers.

Customized offers can also help by possibly reducing the frequency and severity of fare wars. When an airline offers only an all-inclusive fare, it's easy for a competitor to marginally undercut that fare: to offer a competing fare for only a few dollars less. Then the first airline responds by cutting their fare, and so on.

These fare wars might seem good for customers, as they result in lower ticket prices, but their impact in the long term is up for debate. One study found that airlines lost \$7.8 billion in fare wars over just one decade. The inevitable results include pressure on the wages of front-line staff, like gate agents and cabin crew, and overall cost-cutting that could reduce service levels to a point below what customers expect.

So fare wars brought about by offering only all-inclusive fares have in some cases pushed down service quality, while those same fare-only offers have made it difficult for customers to judge each airline's offer. As airlines continue to move toward customized offers, airlines can break that vicious cycle. Airlines can increase clarity of their offer, increase revenue, and perhaps use some of that money to improve some elements of the customer experience that have suffered over the last few decades.

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Today's customer demands a more transparent product and needs to know what is in, what is out, and especially what he can get for his money. Differentiating along the customer needs...is very important.

— Christian Popp, Lufthansa Group

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AIRLINES EXTENDING BEYOND FLIGHTS

Customized offers require airlines to become more customer-centric. When an airline embraces customer centricity, it prioritizes learning why customers are considering any given trip.

Armed with an understanding of why a customer is taking a trip, an airline can participate in related choices the customer makes. That participation will necessarily extend the airline's relationship with other travel providers.

As noted by Nawal Taneja, professor emeritus at the Center for Aviation Studies at The Ohio State University, "I'm not looking to buy a seat just to fly around and spend some time flying on an airplane."

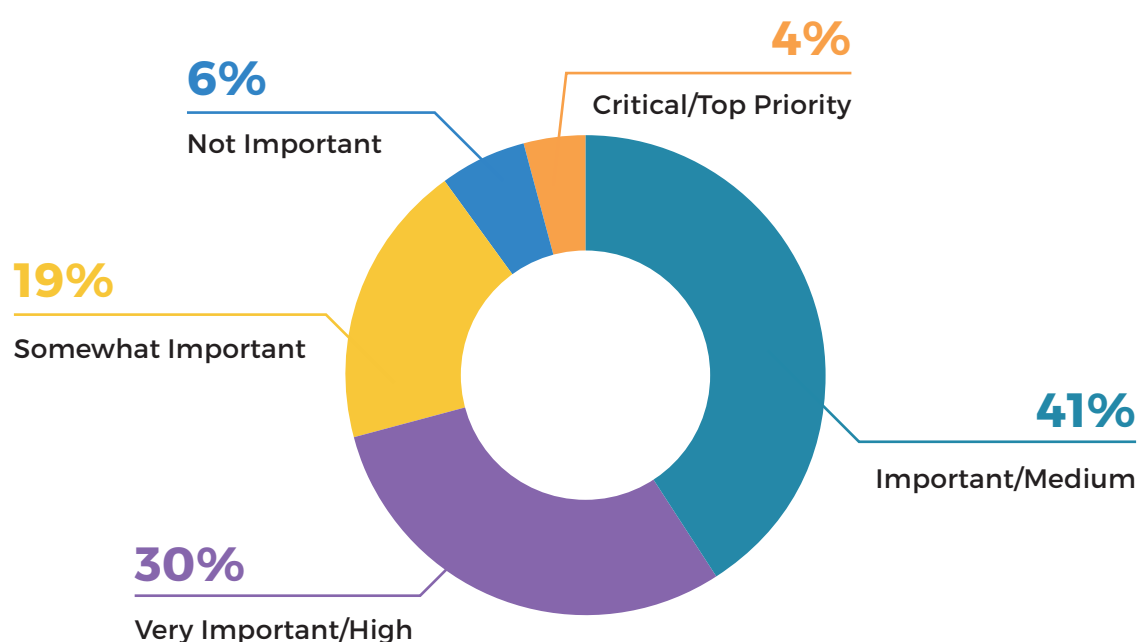
When the airline participates in the customer's broader travel needs, its effort could benefit the customer because the airline can provide insightful and useful recommendations and suggestions. It also benefits the airline as it participates in the revenue the customer was going to spend anyway on non-flight products, such as accommodation and ground transportation.

Customized offers will make these new opportunities possible, helping carriers to rethink how they align the products and services they offer to meet this demand. Best of all, third-party offers have fewer supply constraints compared to fare revenues, creating an opportunity without adding burdensome costs.

"We see more opportunity for ancillary revenue coming from outside the flight experience, but linked to the travel journey (e.g., optimizing hotels, cars, shuttles, tourist attractions, restaurants, nightclubs, etc.)," confirmed Juan Carlos Zuazua, general director of Viva Aerobus.

In fact, industry research confirms the growing support. Skift's airline executive survey found that 71 percent of respondents believed that offers of rental cars, hotels, and ground transfer options were either a "very important" or "important" priority.

How Important Are Third-Party Offers (for Hotels, Rental Cars, Transport) to Airline Executives' Customized Offer Strategy?



The idea has been around for almost as long as airlines. Pan Am founded InterContinental Hotels in the 1940s for airline customers to have a place to stay at their destinations. Air France founded Le Meridien in the 1970s. Allegis attempted to combine United Airlines, Hertz, Hilton, and Westin brands. “At the time,” Fader reflects, “it was seen as: if you tie three bricks together, they don’t float any better. But I think they were ahead of their time.”

“I think it’s important that airlines get out of the airline business,” Fader continued. “Or at least not make it their exclusive focus. [They should be] bundling in other products and services... not just cross-selling without being meaningful to customers.”

As customized offers mature, airlines have the opportunity to create more relevant offers for travel related needs, such as hotels and rental cars. The connection that Allegis couldn’t make on a corporate level could be established on a customer level and built upwards. The results could be a new round of enhanced cooperation between airlines and other travel providers.

REALITY CHECK

Creating customized offers will take work, and so will distributing those offers to everywhere airfares are sold. Airlines manage their own websites, apps, and call centers. But non-airline channels — travel agents, corporate travel management companies, and online travel agencies — represent a sizable amount of most airlines’ bookings today and will continue to do so in the future.

Every airline leader with whom we spoke mentioned the challenge of distributing customized offers to every channel. Many of the business and distribution systems were built for the old model, in which the fare included it all.

Yet it’s worth noting that some progress has already been made to change the situation, primarily through the industry’s steady refining and adoption of new technical standards. The best-known of these efforts is the New Distribution Capability (NDC) initiative led by the International Air Transport Association. Technology providers have also made cooperative, parallel advances.

Skift believes airline goals will be broadly achieved, despite some obstacles. The more airlines can enunciate and define the tactics that support their vision, the more efficient the multi-party technological evolution of the infrastructure will be.

One last reality check: Customers are accustomed to comparing airline product by price alone, and it will not be a quick or simple task to introduce them to a more beneficial way of thinking. But there are many examples in other sectors of customers learning new ways of comparison shopping.

CONCLUSION



Source: [Unsplash](#)

In our research, Skift found that customized offers for airline flights and flight-related services are the future of how airlines sell. But as the airline industry has moved toward creating these offers gradually and piecemeal, some important considerations have gotten a little buried.

We unearthed these considerations with the help of airline leaders and academics from outside the airline area, and by digging into research beyond the traditional airline domain.

Perhaps the most surprising discovery was the economic proof that **better pricing through the creation of customized offers can actually benefit customers, in addition to airlines. It's not a zero-sum game**, to borrow a term from the mathematical field of game theory. Both sides can come out ahead.

The economic proofs, revenue management practice, price theory, and behavioral economics added a whole new dimension to the story, which we feel can sometimes get bogged down in discussions of technology. While often amazing, technology is most useful in customized offer creation for enhancing how fundamentals can be implemented. And some technology, like that supporting distribution, still needs to catch up to meet the needs of the industry. Or perhaps we should say, "to meet the needs of the customers." Because **the underlying purpose of using the technology is to leverage how customers have different values and travel for different reasons.**

Those differences – best captured by understanding the idea of customer heterogeneity – provide the opportunity for airlines to use customized offers. Airlines have understood, on a certain level, customer heterogeneity. But they have never fully developed and applied that understanding.

To build upon customer heterogeneity, and actually progress with customized offers, airlines will have to change. Customized offers require interdisciplinary skills that haven't really been needed by airlines before. Many of these skills will leverage data science.

Some of the most important individuals will be those who can connect a business strategy with the application of data science. Those people will be like Freder in the 1927 classic movie Metropolis, the heart that connects the head and the hands.

But just recruiting data scientists isn't enough. There needs to be a business strategy informed by the possibilities of data science, plus changes in organizational structure.

Our research indicates that adopting customized offers will mean more work for airlines. But **the rewards come in the form of increased revenue and a decrease in the tendency toward commoditization.** Flights are not all the same. It's time to align the commercial model with the reality that airlines are different. Behavioral economics demonstrates that by breaking up all-in pricing, airlines and their customers can escape this commoditization trap.

Skift dug into the future of how airlines will sell flights and we found that customized offers provide remarkably fertile ground. Airlines can plant new ideas around that concept from a variety of sources. As those ideas sprout and come to fruition, **airlines can reap the benefits and so, too, can customers.**

Among airline leaders, we found the passion, dedication, and willingness to evolve and develop formulas for success. That gave us optimism about what's next for customized offers and the industry as a whole.

METHODOLOGY

For this report, Skift conducted interviews with representatives from a range of airline industry sources, including global full-service carriers, international low-fare carriers, and luxury carrier brands. Key conversations included executives from AeroMexico, Air Canada, Allegiant Air, Etihad Airways, Finnair, Lufthansa, Singapore Airlines, Southwest Airlines, Surf Air, Swiss International Airlines, Viva Aerobus, and Volaris, among others.

Skift also interviewed technology providers including representatives from Planitas, 15Below, and other industry participants. The report also includes highlights from discussions with business thought leaders from the Massachusetts Institute of Technology (MIT), The Wharton School, and global consultancies specializing in pricing and behavioral economics applications in marketing.

In total, Skift interviewed 22 business experts on the topics of airline pricing, marketing, revenue management, and merchandising. The report also collected responses from executives at nearly 30 carriers in the form of our 2017 Airline Survey on Leadership in Ancillary, Revenue Management, and Marketing. The survey asked in-depth questions about airline strategy, technology investments, and the impact that customized offers could have on company revenue.

INTERVIEW SUBJECTS

Peter Belobaba, Principal Research Scientist, MIT AeroAstro

Holger Blankenstein, Executive Vice President, Volaris

Sara Ellison, Senior Lecturer, MIT Economics

Peter Fader, Professor of Marketing, The Wharton School

Michael Farrugia, Chief Technology Officer, Planitas Airline Systems

Mohammad Gaber, formerly Senior Director, Marketing & Digital Strategy, Air Canada, and presently Global Practice Director, Digital Strategy - Travel, Adobe

Brian Gross, formerly Vice President of Digital Innovation/E-Commerce, AeroMexico, and presently Chief Marketing Officer of Yalochat

Roger Harris, Senior Vice President, Revenue Management, Distribution & Alliances, AeroMexico

Karl Isler, former Senior Director, SWISS International Air Lines, and presently owner of Karl Isler Consulting

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Campbell Wilson, Senior Vice President of Sales and Marketing, Singapore Airlines

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