

Why Unbundling is a Good Thing

By [CF](#) on Sep 19, 2013

You can probably look back and find plenty of posts that I've written about how unbundling in the airline industry is a good thing. So why am I bothering with yet another post on the subject? Well, Chris Elliott is at it again with a [misleading article condemning fees](#) this week. And now that USA Today has given him a bigger pedestal to shout from, I feel the need to shout back with a dose of reality. Fees, unbundling, a la carte, ancillaries... whatever you want to call them, they are a good thing. Let's see if I can make it easy to understand why.

I'll start with the often quoted "smoking gun" that all people against unbundling use. This is from Elliott's article:

Some companies, notably airlines, promised customers that unbundling offered the "flexibility" to pay for only what they use — and nothing more.

But there's no convincing evidence that they lowered their prices when they unbundled, which is what should have happened. Instead, they just added new fees to their rates, undermining their argument that they were helping you.

No, that's not what should have happened. This makes the assumption that the pricing structure that existed in 2008, when as Elliott puts it, "passengers were beginning to adjust to a new reality," was somehow sustainable. It wasn't. Oil spiked higher and higher and airlines were bleeding. Even today, oil is far higher than it has been historically and that's not something that's expected to change. With much higher costs, the airlines had two options. They could either raise fares or cut capacity. In the end, they did a little of both. (Though it should be noted that historically, airfare is still incredibly cheap. Domestically, the first quarter 2013 average fare was [19 percent below where it was in 1999](#), adjusted for inflation.)

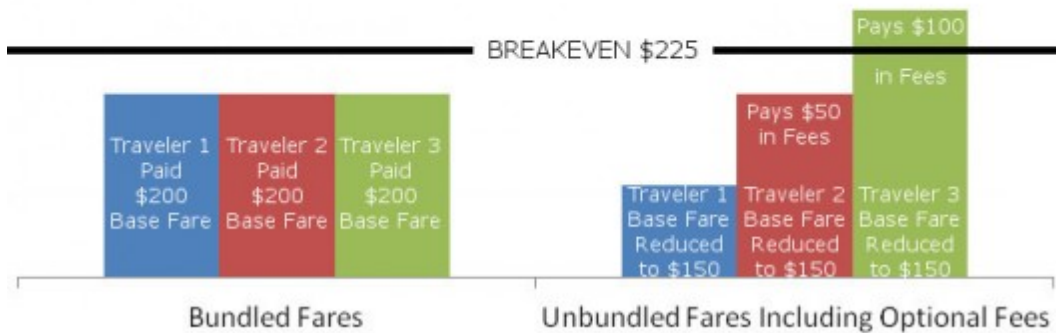
At the top end, they pulled a lot of flights and cut capacity. As basic supply and demand tells us, fares go up when supply tightens since there are fewer seats that need to be sold. But since people are particularly sensitive to fare increases, the airlines had to do more to continue to operate a robust network. So they created an alternate pricing structure which allowed people to pick and choose the amenities they wanted above and beyond a basic seat somewhere on the airplane. Below is how Elliott and others dreamed that would work out. (The numbers are just meant to illustrate the point and aren't actual numbers.)

How Travelers Wish Unbundling Would Work



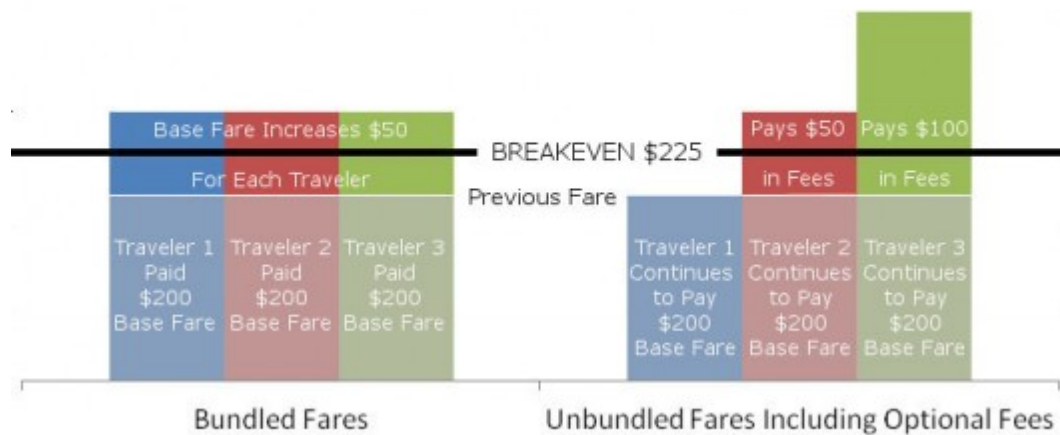
Elliott and others figured that fares should have dropped because that plus the new fees would have kept total revenue the same. Unfortunately, that dream is just a fantasy for one simple reason:

Why Unbundling Doesn't Work That Way



Airlines were losing a bunch of money at the previous levels, so just introducing unbundling didn't mean fares were going to go down for those who didn't want frills. Had that happened, the airlines would still be losing a ton of money. Instead, total revenue had to go up no matter what. With the new unbundled structure, prices went up less for those who didn't need more amenities than it would have otherwise. Or graphically:

How Unbundling Actually Worked



With the new unbundled structure, those who just wanted basic transportation may not have seen fares go down, but if they went up at all, it's a lot less than would have happened without unbundling. Yes, they got fewer frills with that fare, but for the first time, they had the choice on whether to pay for everything above and beyond basic transportation. Many people don't want that, and they pay less today because of it. For those who do want all the frills, however, unbundling has meant they pay more. In other words, without unbundling, the traveler wanting basic transportation would have paid more in order to subsidize the traveler wanting all the frills. That's why Southwest is often more expensive than other airlines for you today if you aren't checking bags or making changes. You're paying for those benefits even if you don't use them.

Now here's the kicker. People view fees differently than they do fares. They're much more price sensitive when it comes to paying base airfare than when it comes to paying fees. So if the old structure still existed, fewer people would have been willing to pay those high fares, and that means airlines would have had to cut capacity even more than they already have. There would be fewer choices for everyone and the fares would be higher.

The False Resort Fee Argument

Of course, just because unbundling is good doesn't mean that all fees are good or fair. Elliott tries to lump airline fees in with the one fee that I hate the most – resort fees. These are mandatory hotel fees that aren't included in the cost of the hotel rate, and that should be illegal. In fact, it would be illegal if hotels were regulated the way airlines are. When it comes to airfare, mandatory fees must be included in any fare shown. Period.

Elliott is trying to cast a shadow over all fees by comparing airline optional fees to resort fees, but that's just silly. They're very different beasts, and in the airline industry, unfair fees are specifically banned. If only that were the case in other industries as well.

If This is Good, Why Do People Hate It?

Now comes the big question. If unbundling is so good, why do people hate it so much? That is

absolutely where the airlines really screwed themselves. As mentioned earlier, when fuel prices skyrocketed in 2008 and airlines began to bleed profusely, they grasped at straws to find a way to right the ship. It was that introduction of first bag fees that really saw unbundling take center stage and ultimately enabled the airlines to get back on firmer ground.

The problem was that the airlines were so desperate to raise revenue, that they failed to really think about the customer experience at the time. It was one of those “shoot first, ask questions later” moments, simply because they were on the brink of financial ruin. Because of that, implementation was clunky and disclosure was poor. So it is indeed true that things didn’t start off very well, but that hardly means the practice of unbundling is a bad one. It’s just that the airlines set the precedent for hatred by doing it wrong in the first place.

Since that time, airlines have become better and better at displaying things properly. If you don’t know that a seat assignment will cost more or that you can pay for things like priority boarding or extra miles, then you just aren’t paying attention. Links to bag fees are made available during the booking process, though that’s an area where further work should be done by the legacy airlines. (The low cost carriers are much better at it.) If there’s any place where the fee structure is misleading, it’s not on airline websites but rather on third party online travel agent sites. But that’s a separate issue, and it’s not the airline’s responsibility to spoon feed them all the details. Online travel agents should be held responsible for providing an accurate display of what’s being offered, not airlines. But I digress.

In the end, the result of unbundling is clear. People pay less in base fare than they otherwise would, and they can pay more if they want more. Not everyone likes this, of course. Those who check a lot of bags, pay for meals, and pay for seats will undoubtedly be sad that others aren’t subsidizing them anymore. But just because they don’t like it doesn’t mean they can’t see that it’s the fair way to do things. If only the reporters writing for big newspapers could see that as well.