McKinsey & Company

Airline distribution and retailing:

How payment innovation can help airlines improve customer experience and the bottom line

by Riccardo Boin, Reinhard Höll, Priyanka Ralhan, and Nina Wittkamp

September 2022

Contents

Disclaimer

McKinsey & Company has been working with the International Air Transport Association (IATA) on assessing the value in airline retailing and developing the Airline Retailing Maturity Index to provide airlines with different pathways and strategic considerations when moving to retailing. The insights on the payment opportunity have been developed using data sources from IATA, but solely represent the perspective of McKinsey & Company.

The airline industry defines retailing as placing the customer at the center of the shop/order/pay ecosystem regardless of shopping channel. This is enabled by the development, introduction and adoption of the New Distribution Capability and related standards that address the legacy distribution limitations impacting product differentiation and time-to-market, access to full and rich air content, and finally, transparent shopping experience.

Executive summary: Why payments matter

Airline retailing falls within sales and distribution, and allows airlines to sell new products in new ways—either directly to customers, or via intermediaries. The airline industry defines retailing as placing the customer at the center of the shop/order/pay ecosystem regardless of shopping channel. As the International Air Transport Association (IATA) notes, today's customers want personalization, efficiency, and seamless engagement—and retailing can enable richer customer engagement.[1]

The value of airline retailing is significant—it could be worth $40 billion by 2030.[2] And payments are a critical component of retailing. Simply put, payments matter. They are a critical link between airlines and their customers. Getting payments right could help airlines to fully realize the value of retail by improving the customer experience, thereby increasing sales and growing revenue.

Payments are at the intersection of five key trends affecting the industry: changes in customer expectations; shifts in payment methods; increased innovation; government interventions; and the evolution of the payment value chain.

Retail customers have become comfortable making high-value transactions digitally, while corporate travelers tend to value end-to-end solutions. Airlines can increase value for customers, and meet their expectations, by making the payment journey more convenient. While credit cards remain the most-preferred payment method, alternative payments such as digital wallets or bank transfers are on the increase, and airlines can test and onboard new payment methods to respond to this trend. Additionally, innovations such as mobile point-of-sale devices can provide seamless payment journeys and increase customer reach, while support from various government initiatives is driving the emergence of alternative payment methods such as e-wallets and local debit cards. Finally, the payment value chain is evolving toward a far more integrated and consolidated market, opening potential opportunities for airlines to forge strategic payment partnerships. Airlines may be well positioned to respond to these trends by making payments more of a strategic priority.

The cost of payments is significant, and as such present an area of potential savings. In 2019, airlines spent $20.3[3] billion in payment costs. To put this into perspective, this amount is equivalent to around 3 percent of airlines' total revenue, and approximately 78 percent of the industry's net profit. Payments also include substantial short-term financing costs—$2 billion's worth in 2019, representing 9 percent of airlines' total payment costs.

Much of this is expense is due to the high prevalence of credit cards as the preferred choice of payment. Around 70 percent of retail transactions are made by credit card. While credit cards offer many advantages for airlines and their customers—such as ubiquity, ease of use, and payment guarantee—they are costly for airlines as they represent 90 percent of total payment costs. Credit cards also offer advantages for airlines as up to 10 percent of ancillary sales are made using airline affiliated cards.

Furthermore, airlines collect revenues on behalf of other participants in the value chain—such as airports and tax authorities—and forward around 10 percent of the total value of their transactions, while still including payment costs for the total transaction value.

In general, airlines have yet to leverage the link between payments and customer experience; these are often viewed as separate concerns. But payments are an important element of the customer journey—each touch point presents an opportunity to capture additional revenue. The ease of making a payment is often a key decision criteria for customers when it comes to booking on an airline website as opposed to an online travel

[1] "Airline retailing," International Air Transport Association (IATA) website.
[2] Riccardo Boin, Alex Cosmas, and Nina Wittkamp, "Airline retailing: The value at stake," McKinsey, November 26, 2019.
[3] "Airline payment cost and revenue drivers study," Edgar, Dunn & Company (for baseline data only), September 2022; IATA industry data.

agency or booking platform and is a crucial factor in selling ancillary services along the payment journey. Improving ease of payments, and improving the sales conversion rate, has potential to boost sales.

Despite the significant upside, its associated cost, and its general importance in the customer journey, the area of payments as a strategic topic has often been unaddressed. There is frequently little transparency, ownership, or engagement with the topic of payments within the industry. For instance, many airlines do not strategically monitor payment and transaction data, and there is an absence of defined roles or KPIs in the area.

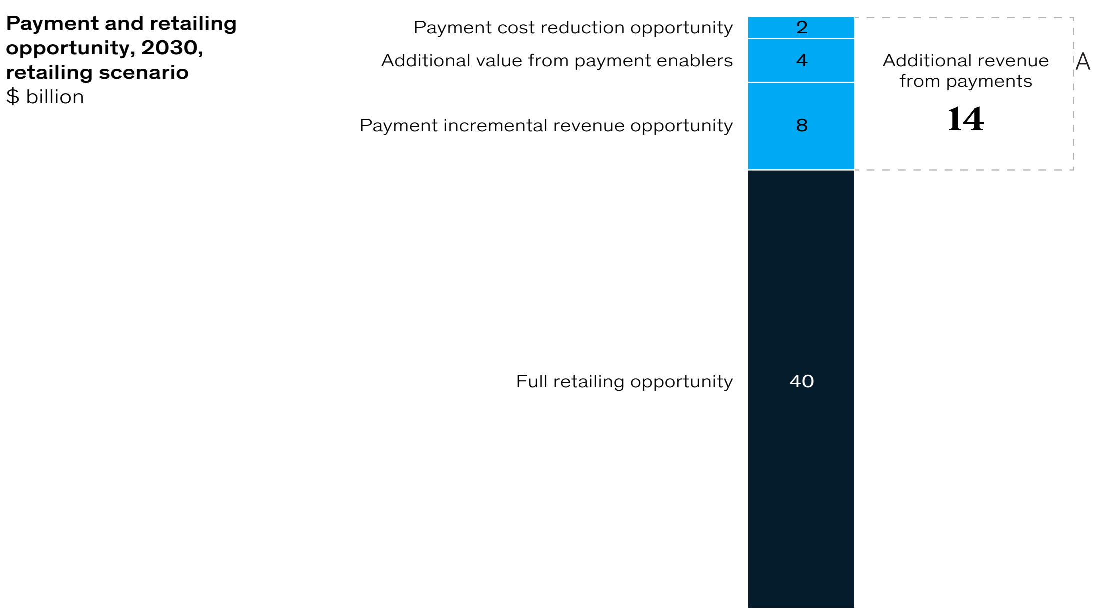
Getting payments right is challenging. The airline payment value chain is complex and the industry's greater share of cross-border payments, and higher fees compared to other retail industries, are significant challenges. But given the emergence of new payment methods, and a more integrated value chain, airlines have opportunities to reduce payment costs, improve customer experience—thereby boosting sales—and create additional revenue streams.

By strategically addressing payments, airlines could realize approximately $14 billion in value by 2030. This figure includes revenue from payments, as well as value in cost savings (Exhibit). The $14 billion payment opportunity is in addition to the $40 billion in value at stake from airline retailing—combined, this is equivalent to around $10 per passenger.

Revenues from payments represent $8 billion in value and could be generated by increasing purchases of ancillary services, enhancing loyalty programs, and providing customers with more flexible exchange and refund processes. Many airlines are also looking to grow payments by extending reach to customers in emerging markets such as Asia, Latin America, and Africa.

Exhibit

Payments could create an additional $14 bn in value, while achieving the full potential of $40 billion from airline retailing.



[1]Includes opportunity from certain enablers like less customer drop-outs, improved payment conversion.
Source: McKinsey; IATA; Edgar, Dunn & Company (for baseline data only)

further $2 billion in value could be realized by reducing payment costs, particularly for B2B or corporate sales. For instance, airlines could revisit merchant fee agreements with card companies and acquirers to reduce costs, and increase automation to move B2B customers to lower-cost payment options.

Around $4 billion in value could be generated through putting payment enablers in place to increase direct channel usage, and improve payment conversion.

Addressing the payment opportunity could be a strategic move that may help airlines to prevent disintermediation or disruption. In fact, intermediaries such as booking platforms and online travel agencies have identified payments as one of their biggest opportunities for differentiation. Some of the larger players have begun to invest in fintech solutions to make the end-to-end payment journey seamless, which can drive customer loyalty and increase ancillary services sales.

Improving payments is an important lever to protect and realize the value of airline retailing. The opportunity cost, or the risk of doing nothing, will likely cost more than the expense and effort associated with taking action. If airlines don't consider payments as part of their retail strategy, they may only be able to capture around $14 billion of the $40 billion opportunity—they could capture $19 billion through retail sales, but this would be offset by an increase in payment costs of $5 billion, with no extra value being created through the payments opportunity.

Moving forward, six value-creation levers could help airlines to capture the $14 billion payments opportunity and realize the $40 billion value of airline retailing:

— *Increase customer reach and conversion,* by attracting customers in new markets and improving the payment experience to increase sales

— *Grow ancillary services,* and make them easier to purchase, thereby increasing incremental revenue

— *Enhance loyalty programs,* by drawing on insights from customer data, thereby increasing customer loyalty

— *Provide flexible exchange policies and easier refunds,* to improve customer experience, build loyalty, and boost sales

— *Become part of the corporate payment ecosystem*, for instance by offering digitized solutions and account payable automation, particularly for B2B or corporate travelers; and switching B2B sales to more cost-effective payment methods

— *Reduce working capital costs and payment costs,* for example, by optimizing fees and payment terms with payment providers, such as schemes and acquirers

Payments represent a $14 billion opportunity

Airline retailing—essentially placing the customer at the center of the shop/order/pay ecosystem, regardless of shopping channel—could be worth $40 billion by 2030.[4] And payments are a critical component of retailing. Getting payments right could help airlines to fully realize the value of retail and create additional value: The analysis undertaken for this report suggests that payments represent at least a $14 billion opportunity—in addition to the $40 billion retailing opportunity—that could be achieved through finding incremental revenue opportunities, reducing the cost of payments, and improving areas such as payment conversion.

Every year, there are approximately 2.9 billion airline booking payment transactions across the world—accounting for around $1 trillion in value. And while these payments represent valuable business transactions, they come with a price. In fact, the airline industry spends over $20 billion a year on payment costs.[5]

Furthermore, payments are a critical link between airlines and their customers and form an important part of the customer journey which can influence the overall customer experience. Given the significant cost size—equivalent to 3 percent of airlines' total revenue—and relevance to user experience, payments represent an opportunity for airlines to lower costs, boost revenue, grow business, and improve customer experience.

Payments are at the intersection of five key trends affecting the industry, each of which provide opportunities for airlines to realize value: First, customer expectations are changing, for instance retail customers have become comfortable making high-value transactions digitally, while corporate travelers tend to value end-to-end solutions and self-service tools. Airlines can increase value for customers, and meet their expectations, by making the payment journey more convenient. Second, while credit cards remain the most-preferred payment method, there has been a shift toward alternative payments such as digital wallets or bank transfers. Airlines can test and onboard new payment methods to respond to this trend—while weighing up the costs and advantages of doing so. Third, innovations such as mobile point-of-sale devices can offer customers an improved payment experience while providing airlines with an opportunity to get to know their customers better through analyzing their data. Fourth, support from various government initiatives is driving the emergence of alternative payment methods such as e-wallets and local debit cards, and airlines could build operational models that are flexible and take local financial players and regulators into account. Finally, the payment value chain is evolving toward a far more integrated and consolidated market, opening opportunities for airlines to forge strategic payment partnerships and lower costs.[6]

Payments have not yet been fully addressed by the industry

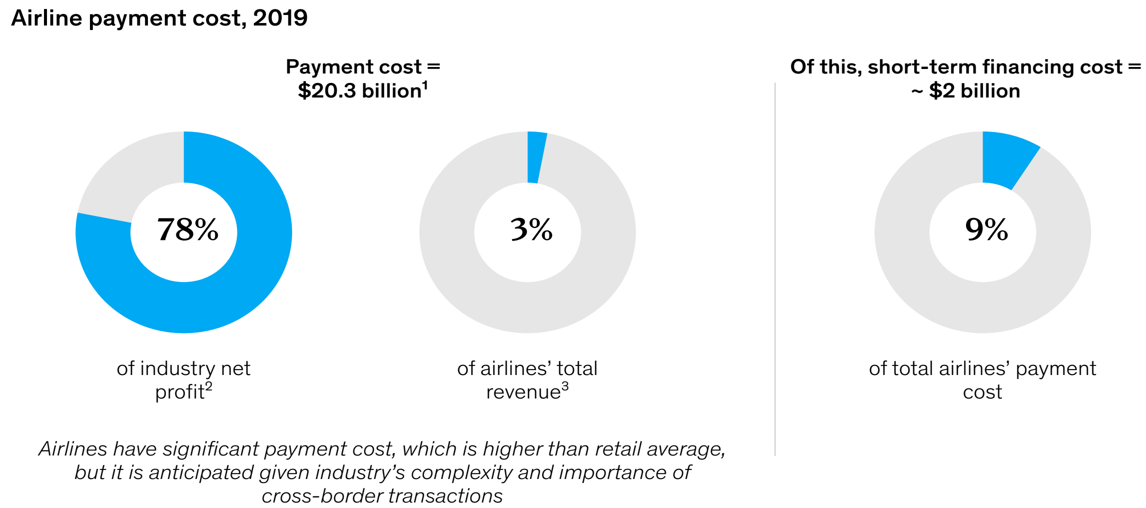
Payments offer a substantial area of value creation for airlines. They play a critical role in the airline value chain, connect airlines to their customers, and present a $14 billion opportunity to boost revenue and lower costs.

However, payments are an area of significant expense. Airlines spent $20.3[7] billion on payment costs in 2019. To put this into perspective, this amount is equivalent to around 3 percent of airlines' total revenue, and approximately 78 percent of the industry's net profit. Payments also incur substantial short-term financing costs—$2 billion's worth in 2019, representing 9 percent of airlines' total payment costs (Exhibit 1)[8]

[4] Riccardo Boin, Alex Cosmas, and Nina Wittkamp, "Airline retailing: The value at stake," McKinsey, November 26, 2019.
[5] McKinsey analysis based on data from the McKinsey Global Payments map, the International Air Transport Association (IATA), and "Airline payment cost and revenue drivers study," Edgar, Dunn & Company (for baseline data only), September 2022.
[6] Please see the 2021 McKinsey Global Payment Report for a more general discussion on payment trends.
[7] "Airline payment cost and revenue drivers study," Edgar, Dunn & Company (for baseline data only), September 2022; IATA industry data.
[8] "Airline payment cost and revenue drivers study," Edgar, Dunn & Company (for baseline data only), September 2022; IATA industry data.

Exhibit 1

Payment costs represent 3% of airline industry revenue and include high short-term financing costs.



[1] "Airline payment cost and revenue drivers study," Edgar, Dunn & Company (for baseline data only), September 2022; IATA industry data.
[2] USD 20.3 bn payment cost compared to USD 25.9 bn total industry net profit.
[3] USD 20.3 bn in payment cost compared with over USD 738 bn total airline industry revenue (excl. USD 100 bn for cargo and taxes).
Source: McKinsey; Edgar, Dunn & Company (for baseline data only); IATA annual review 2020

Around 70 percent of retail transactions are made by credit card, as they are customers' preferred choice of payment method. While credit cards offer many advantages for customers—such as ubiquity, ease of use, and payment guarantee—they are costly for airlines and represent 90 percent of total payment costs. But they also offer advantages for airlines as up to 10 percent of ancillary sales are made using airline affiliated cards.

But despite the significant upside that payments represent, the associated costs, and the importance in the customer journey, the area of payments as a strategic topic has often been unaddressed. Frequently, there is very little transparency, ownership, or engagement with the topic of payments within the industry today. For instance, many airlines do not strategically monitor payment and transaction data, and generally do not have defined roles or KPIs in the area. The absence of cross-functional payment teams in most airlines, leads to the fragmentation of responsibility across different functions, with limited overall accountability for payments. And even though multi-lateral relationships between airlines and schemes or issuers exist, and airlines recognize the value of co-branded cards and loyalty streams, the area of payments as a strategic topic has been unleveraged.

Furthermore, airlines often view payments as separate from user experience. Various intermediaries have invested in payments as a way to enhance the customer experience and build loyalty. This has led to disintermediation, for example booking platforms gaining greater numbers of customer transactions, instead of these sales being processed by airlines. By focusing on user experience, airlines could mitigate the risk of further disintermediation.

Considering that payments can take place across the end-to-end customer journey, this is an important element of customer experience—and each touch point presents an opportunity to capture additional revenue. The ease of making a payment is a crucial factor in selling ancillary services along the customer journey and is often a key decision criteria for customers when it comes to booking on an airline website as opposed to an online travel agency or booking platform.

To illustrate, many airline experts see a payment approval rate of around 85 percent as positive, given the global and complex nature of the customer base. However, a small improvement of airline transactions through direct channels, would provide significant room to improve revenue. This approval rate can be explained by legacy practices, and the lack of new technology to ensure that transactions are secure.

Airlines could benefit from prioritizing payments as a key strategic area to unlock untapped potential and realize greater value. In fact, airlines may be well positioned to interact with payment providers, and deepen existing relationships, due to the global nature of the airline industry. The COVID-19 pandemic increased the overall risk in the industry, which has resulted in limited interest in partnering with airlines. By increasing their data transparency, airlines can become more attractive to partners, schemes, and acquirers.

The airline payment value chain is complex, and has its price

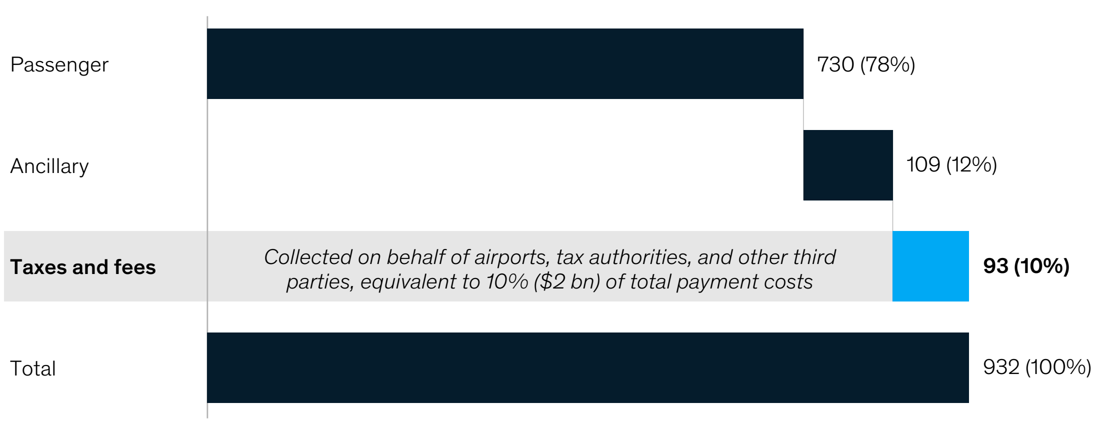
The payment value chain is complex, particularly given the global nature of the airline business, and transactions tend to cost more than in other industries. There are several reasons for this: The industry has a high share of cross-border payments, which adds complexity, and as a result issuers get relatively higher fees—up to 65 percent—compared to 20 to 40 percent for the overall market.

Airlines collect revenues on behalf of other participants in the value chain—such as airports and tax authorities—and forward around 10 percent of the total value of their transactions, while still incurring payment costs for the total transaction value (Exhibit 2). Several stakeholders are involved in the payments value chain, across both B2C and B2B payments (Exhibit 3).

Exhibit 2

Airlines collect and forward ~ 10% of their total transaction value to other participants, but still pay for the cost of those transactions.

Airline payments (excl. cargo), 2019, $ billion (share of total)



Source: McKinsey; IATA

Exhibit 3

Seven key stakeholders are involved in the airline payment value chain.

Illustration of airline payment via a consumer or corporate credit card in Europe

Participants	Retail travelers / Corporate travelers	OTAs[1] / TMCs[1]	Airlines	Payment issuers	Schemes	Gateway providers	Payment acquirers
Role in payment value chain	Make payment through preferred method	Booking platform chosen by customer	Accept payments from customer and pay related payment costs	Offer credit or debit card to customers	Provide network link to perform transaction	Connect electronic cart or virtual terminal/POS[2] to the payment acquirer	Provide payment processing, infrastructure, manage fraud, risk, and compliance

[1]OTA: Online travel agents; TMC: Travel management company.
[2]Point of sale.
Source: McKinsey; IATA; expert interviews

Each of these participants plays a different role and takes a different share of the payment fee value pool. Airlines are secondary beneficiaries in the value chain, along with online travel agents (in the case of B2C payments from retail travelers), and travel management companies (for B2B or corporate transactions). The primary beneficiaries of the payment costs, paid by airlines, include payment issuers, schemes, gateway providers, and payment acquirers.

For B2C payments, gateway providers and payment acquirers together receive roughly 70 percent of the merchant fees paid by airlines. Payment issuers receive 21 percent, and schemes receive 7 percent of these fees.

For B2B payments, the credit card issuers receive the bulk of the merchant fees, at 47 percent. This highlights why the high usage of credit cards is costly for airlines.Schemes receive 24 percent, and gateway providers and payment acquirers together receive 29 percent of costs paid by airlines.

These illustrative payment fees are based on sample transactions exclusively for Europe and do not include transactions made in other regions or through non-EU schemes such as American Express.

The underlying payment fees may be difficult to change. Established programs between airlines and other players in the value chain—such as schemes, and card issuers—are difficult to change structurally as airlines are a relatively small merchant group when compared to other industries. Payments received by airlines have less than a 1 percent share of total payment flows globally. Card usage is generally incentivized for all parties, but the costs are borne by the merchant.

Overall, the payment value chain has evolved from a fragmented landscape towards greater convergence, providing integrated capabilities. The onboarding of payment acquirers, however, often lasts three to six months, with vendor lock-in making switching difficult. Therefore, airlines could consider defining a payment partnership strategy with strong payment providers to develop industry-specific solutions, while also securing bargaining power in the increasingly consolidated market.

Payment methods can unlock revenue opportunities, mainly from retail travelers

Opportunities exist for airlines to improve the customer payment experience, particularly in direct channels, to reduce dropouts. Airlines could also re-evaluate all the payment interactions throughout the customer journey, make these easier, and perhaps grow engagement and ancillary sales at these points (see sidebar, "Payments are a significant element in the customer journey").

Customers have become used to convenient payment solutions, for instance those offered by large retailers. By contrast, many airlines have websites and payment procedures that can be difficult to navigate. Considering that credit cards are the payment option of choice for many retail travelers, airlines could increase revenue by ensuring that the payment journey is an easy one.

Credit cards are not costly for consumers, are ubiquitously accepted, and provide many benefits such as rewards and an extended credit period. Co-branded cards also provide incentives to customers such

Payments are a significant element in the customer journey

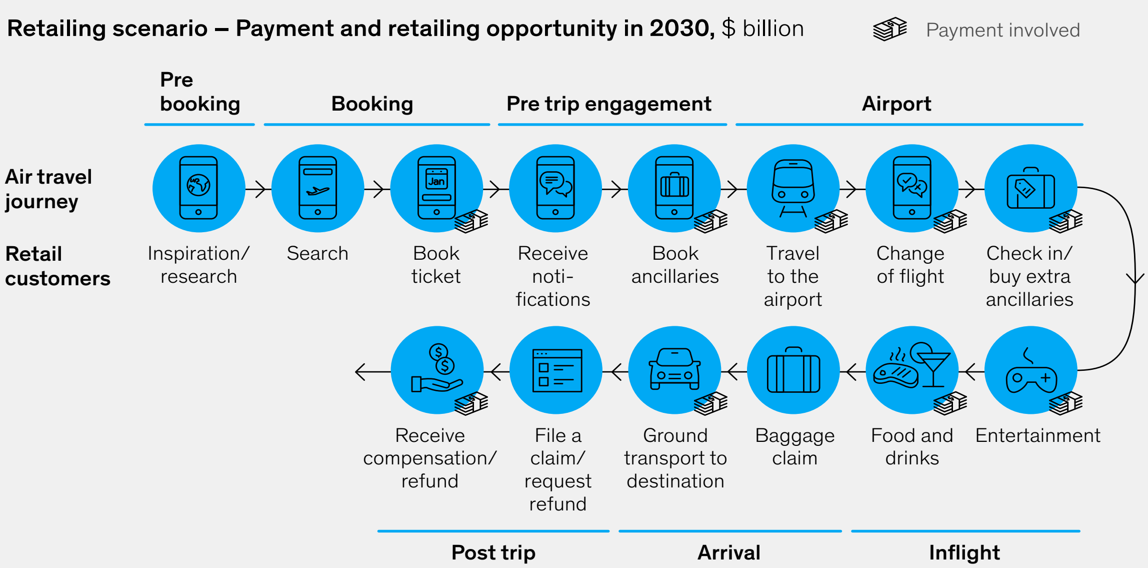
Payments are a critical link between airlines and their customers and form an important part of the overall customer experience. There are up to ten touchpoints where payments are involved, from booking to post-trip. Airlines could benefit from making the payment experience easier at these points, leading to increased bookings (or less dropouts during the process) and increased purchases of ancillary services (exhibit).

The increasing innovation in payment technology—such as e-wallets, new payment-acceptance devices like mobile points of sale, and seamless cross-border payments—provides opportunities for airlines to reach more customers, realize savings, and offer a better customer experience.

Exhibit

Payment is involved in ~10 touch points for leisure traveler journey.

Retailing scenario – Payment and retailing opportunity in 2030, $ billion



[1]Includes opportunity from certain enablers like less customer drop-outs, improved payment conversion.
Source: McKinsey; IATA
Disclaimer: Views and insights presented in this report have been developed using data sources from IATA, but solely represent the perspective of McKinsey & Company.

as loyalty points and rewards. Co-branded credit cards, issued jointly by airlines and banks, remain a significant driver as they are an important source of margin for airlines, particularly in the North American market—around a 90 percent share of 2018 revenue was from credit card points and commission from partner products.

Given the advantages for consumers, it is not surprising that between 21 and 52 percent, depending on the region, prefer to pay by card. However, more are becoming comfortable with using digital payment methods; in fact, 52 percent of consumers in Asia-Pacific say that digital or mobile wallets are their preferred ways of paying (Exhibit 4).[9]

Consumer preferences are shifting toward alternative payment methods, for example, 64 percent of Chinese citizens have a WeChat Pay account, and 58 percent of Americans have a PayPal account.[10] To respond to this trend, airlines can take steps to test and onboard new payment options, keeping in mind the benefits and costs associated with doing so. Some airlines are beginning to offer their own digital or mobile wallets, or at least support localized solutions, although they are still skewed towards online transactions, rather than mobile. At present, there is limited adoption of mobile wallet solutions by online travel agencies, providing opportunities for airlines to capture sales through these methods.

Exhibit 4

E-commerce usage patterns differ across regions.

Payment transaction split by payment method for retail consumers in e-commerce industry, 2018[2]

Lower Higher

	Asia-Pacific	EMEA	Latin America	North America
Digital/Mobile wallet	52%	21%	15%	20%
Credit cards	21%	30%	52%	47%
Debit cards	5%	20%	10%	19%
Bank transfers	12%	16%	9%	6%
E-invoicing	0%	3%	0%	0%
Other[1]	10%	10%	14%	8%

[1]Incl. prepay, postpay, prepaid card, direct debit, cash on delivery.
[2]Comparison of airline vs e-commerce payment usage for 2019 and 2018 data, respectively.
Source: McKinsey; Worldpay 2018 Global Payments Report; Worldpay 2022 Global Payments Report; McKinsey Panorama

[9] "Global Payments Report," Worldpay, November 2018; "Global Payments Report," Worldpay, 2022; "Global Passenger Survey," IATA, 2021.
[10] Mansoor Iqbal, "WeChat revenue and usage statistics (2022)," BusinessofApps, June 30, 2022; Jordan Tuwiner, "59+ PayPal revenue & users statistics (2022)," Buy Bitcoin Worldwide, July 22, 2022.

There are opportunities to improve corporate travel payments

Corporate credit cards are widely used for corporate travel, although they are relatively more expensive for the customer—and expensive for airlines too. But more cost-efficient corporate payment methods are available. For instance, between 25 and 35 percent of corporates with external revenues greater than $300 million have implemented fully digital financial automation and B2B payments software, and this is expected to increase over the next few years.[11] As corporate travel tends to bring in significant revenue, providing process efficiency can benefit all parties and lower airlines' costs.

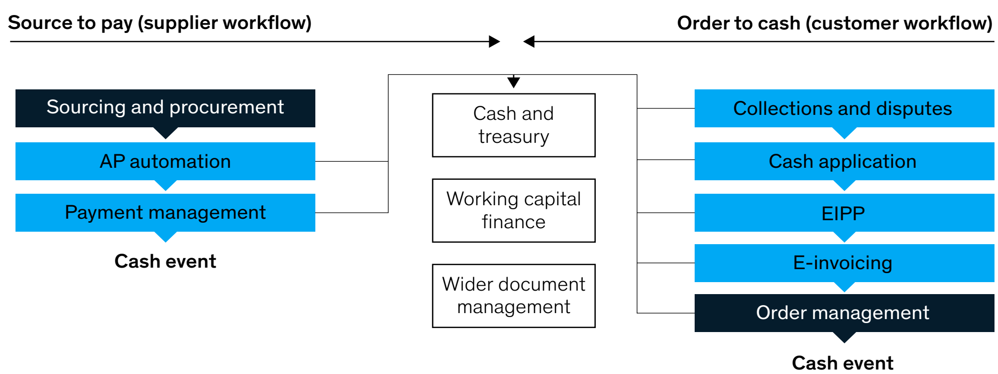
The financial automation race may be on as airlines look to shift corporate travelers to lower-cost solutions. Account payable automation is one area of opportunity to do so. Such automation leverages existing robust enterprise resource planning (ERP) systems and provides an automated invoicing and reconciliation system. It also gives the customer the option to choose the cheapest payment method, such as an account-to-account transfer. Automation solutions can help corporates meet their objectives of greater digitization and lowering costs (Exhibit 5).

Airline bookings and transactions are largely digital, so adopting account payable automation should be actionable for most companies. In addition, there are already relevant providers operating in the market, offering airlines the opportunity to adopt financial automation and B2B software.

Exhibit 5

Introducing account payable automation could benefit airlines and corporate customers.

Financial automation allows corporates to automate workflows, incl. B2B payments



Overview of account payable automation

- Account payable management to connect corporate and consumer workflows, leveraging existing robust ERP systems
- Automated invoicing system
- Option to select cheapest payment method like A2A transfer

McKinsey

[11] Alessio Botta, Reet Chaudhuri, Nunzio Digiacomo, Matteo Mantoan, and Nikki Shah, "How transaction banks are reinventing treasury services," McKinsey, October 2021.

Airlines have potential to drive change

Capturing value from payments requires technological solutions. Travel companies are focused on offering airlines financial solutions, but few fintechs are currently doing so. As there is limited fintech activity in the airline industry, payment innovation may need to come from within the industry.

There are more than 12,000 fintech companies globally. Yet, their involvement in the airline industry is limited as less 100 are focusing on airline payments at present.

This relatively low level of fintech activity could be attributed to sector-specific characteristics, for example, the frequency of transactions tends to be more sporadic than in other industries. And airline payment solutions often need to work worldwide, given the global customer base and the relevance of cross-border transactions. In addition, the industry has lower margins than other sectors, at around 3 percent, and accounts for only 1 percent of global GDP—making it less attractive to fintechs looking for fast adoption and scaling. Volatile market forces may also be at play, as fintechs have generally become more risk averse, and fewer companies may be willing to enter the airline industry which is perceived to be riskier than other industries.

Evolving value-added services improve customer centricity

Increasing market competition among payment issuers and acquirers has brought about additional value-added services (VAS) being offered to customers, such as automated on-boarding and digital customer credit. These services can improve customer centricity, and generate additional revenue opportunities, for instance from enhanced data analytics.

Exhibit 6

Airlines are likely to spend more on payments in the future as use of value-added services (VAS) increase.

Additional VAS, potential increase in use by airlines

High		Medium	Low
Payment gateway across VAS	Digital consumer credit	Interoperable QR code solution	Employee management and payroll
Enhanced marketing-related advanced analytic services	Automated customer onboarding	Subscription management tools	Instant deposit/returns
Data and reporting	Certified enabled fraud services	FX and liquidity management	Online merchant lending (marketplaces)
New customer/seller identification	Churn reduction analytics		KYC for sellers (marketplaces)
Improved authorization rates			POS financing

[1]Incl. prepay, postpay, prepaid card, direct debit, cash on delivery.
[2]Comparison of airline vs e-commerce payment usage for 2019 and 2018 data, respectively.
Source: McKinsey; Worldpay 2018 Global Payments Report; Worldpay 2022 Global Payments Report; McKinsey Panorama

Even though VAS can benefit airlines and customers, the costs associated with increased VAS are borne by the merchant. Looking forward, payments costs are likely to increase over time, as airlines are likely to spend more on payments as the use VAS increases (Exhibit 6).

With increasing scope and usage of VAS, airlines may need to undertake a cost/benefit analysis for each new payment method to assess how it may be relevant and useful for them.

For instance, the billing and settlement plan (BSP), designed to simplify selling, reporting, and remitting procedures, is a cost-effective payment method—and more airlines could take the opportunity to implement it to reduce payment costs. The cost of not implementing BSP, or replacing it with a more expensive payment method, could lead to an additional $5 billion in payment costs by 2030.

As airlines look to increase customer centricity, by offering VAS or improving the payment journey, they can build their offerings around customer personas that give insight into what matters to customers and what types of payment methods they prefer.

There is increased risk of disintermediation

If airlines do not take this opportunity to utilize payments effectively, they are at risk of greater disintermediation in the market. In fact, intermediaries such as booking platforms and online travel agencies have identified payments as one of their biggest opportunities for differentiation and have begun to invest in solutions to make the end-to-end payment journey seamless, which can drive customer loyalty.

For example, Booking.com, one of the largest online lodging booking platforms, created an internal fintech business Finextra. This payments platform processed more than a third of Booking.com's bookings in Q1 2022.

And Hopper, an app that helps consumers find the best deals on flights and hotels, launched various customer-centric initiatives and products to boost sales. The company's "price freeze", "cancel for any reason", and "flight disruption guarantee" products contributed to around a 10 percent increase in the average value of each order. As Hopper's CEO, Fred Lalonde, says, "the product-market fit for these products is clear—almost 60 percent of our app customers purchase at least one fintech product when making a booking … if all travel brands distributed travel fintech, it could generate around $200 billion in customer spend".

Given these trends, and the $40 billion in airline retailing value at stake, airlines may have to redefine their payment strategies to remain competitive and avoid further disintermediation.

The value-creation opportunity, and how airlines could achieve it

Improving payments is an important lever to protect and realize the value of airline retailing. The opportunity cost, or the risk of doing nothing, will likely cost more than the expense and effort associated with taking action—or even result in airlines not being able to capture the retailing opportunity, leaving $40 billion on the table at an industry level. Addressing the payment opportunity could be a strategic move that may help airlines to prevent disintermediation or disruption. The following two scenarios could emerge, the first where airlines capture greater value from payments, and the second where there is greater disintermediation in the market:

Large airlines emerge as travel platforms. In this scenario, leading airlines would bundle offers across different aspects of the travel journey and attract customers through direct access, without intermediaries. Airlines would integrate their retailing and payments strategies, potentially capturing $40 billion in retail sales and an additional $14 billion from payments by 2030.

Online intermediaries reach scale and airlines experience greater disintermediation. In this scenario, online intermediaries could reach scale through consolidation, and continue to develop and monetize fintech solutions, payments, and value-added services. Additionally, greenfield platforms could emerge for travel, such as an Amazon-style platform that owns the customer relationship—thereby rendering airlines as "fulfillment service providers". Such platforms could create richer customer profiles, and provide better order fulfillment and payment services. In the absence of an airline payment strategy, this scenario could result in airlines capturing around $14 billion of the $40 billion retail opportunity by 2030. Although airlines could capture $19 billion through retail sales, this would be offset by an increase in payment costs of $5 billion, with no extra value being created through the payments opportunity (Exhibit 7).

By strategically addressing payments, airlines could avoid the disintermediation scenario and put conditions in place to capture the full $40 billion value of airline retailing, and the additional $14 billion from payments, made up of revenue and cost savings (Exhibit 8).

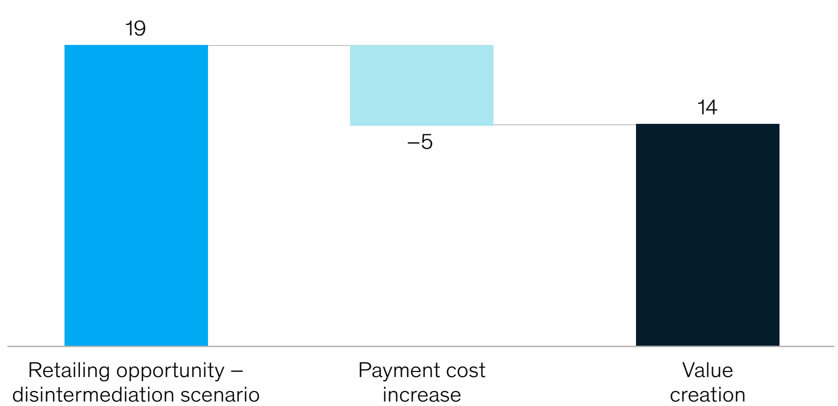
Airlines could generate $8 billion in additional revenue from payments through increasing purchases of ancillary services, enhancing loyalty programs, and providing customers with more flexible exchange and

Exhibit 7

If airlines don't consider payments as part of their retail strategy, they will potentially create only ~ $ 14 bn in value.

Disintermediation scenario – Payment and retailing opportunity in 2030, $ billion

Equivalent to ~ $2.5 per pax

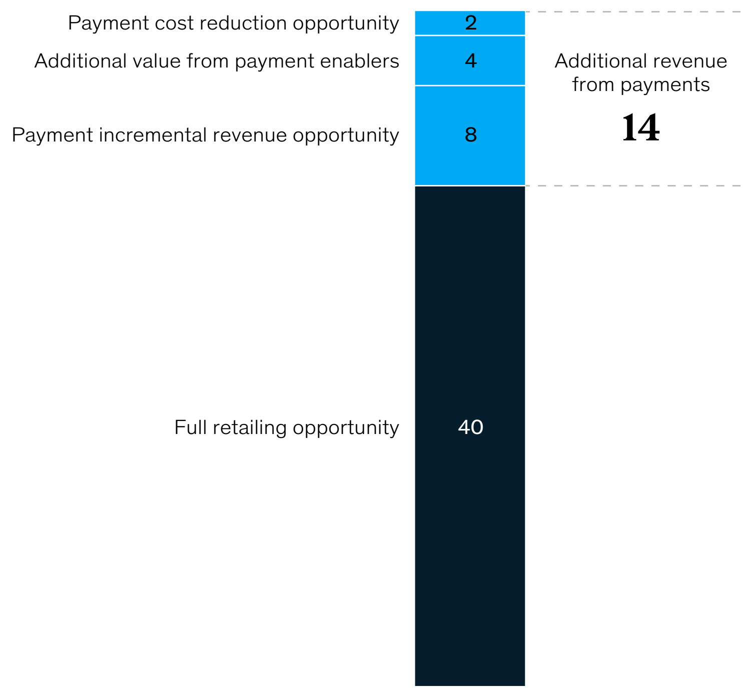


Source: McKinsey; IATA; Edgar, Dunn & Company (for baseline data only)

Exhibit 8

Payments could create an additional $14 bn in value, while achieving the full potential of $40 billion from airline retailing.

Payment and retailing opportunity, 2030, retailing scenario
$ billion



[1]Includes opportunity from certain enablers like less customer drop-outs, improved payment conversion.
Source: McKinsey; IATA; Edgar, Dunn & Company (for baseline data only)

refund processes. Airlines could also grow payments by reaching customers in emerging markets such as Asia, Latin America, and Africa.

A further $2 billion in value could be realized by reducing payment costs, particularly for B2B or corporate sales. For instance, airlines could revisit merchant fee agreements with card companies and acquirers to reduce costs, and increase automation to move B2B customers to lower-cost payment options.

Around $4 billion in value could be generated through putting payment enablers in place to increase direct channel usage, ensure that customers are less likely to drop out of the sales process, and to improve payment conversion.

Realizing value through six key levers

Moving forward, airlines could seize the opportunity to create value through payments and achieve the full potential of airline retailing. To do so, they may need to focus on growing passenger and ancillary revenue, enhancing the customer experience, preventing disintermediation, and lowering payment costs across the value chain.

The following six value-creation levers could help airlines to meet these goals. The first four of these levers relate to B2C opportunities and focus on revenue growth, the fifth presents ways to reduce costs, particularly for corporate travelers, and the final lever presents opportunities to reduce overall costs.

1. Increase customer reach and conversion
Airlines could look to attract new customers, especially in the growing customer segments of emerging markets. They could also improve the user experience when it comes to booking through direct channels, to increase usage and prevent customers from dropping out of the sale during the process. Airlines will also need to improve payments conversion, for instance by improving customer experience and minimizing technical issues.

2. Grow ancillary services
Improving the overall customer experience could help to grow ancillary services and increase revenue. Micro-redemptions could be introduced, for example, to increase the number of customers using ancillary services, such as miles or cash for flights, lounge entry, or on-board Wi-Fi. Airlines could also nudge customers towards purchasing ancillary services throughout touchpoints on the customer journey.

To do so, airlines would need to enable all relevant payment methods along the customer journey, allowing travelers to use their preferred payment methods and making it easier for them to purchase ancillary services.

3. Enhance loyalty programs
Payment methods and co-branded cards are an important driver for creating attractive loyalty programs. Card usage, and engagement around payment touchpoints, provide an opportunity to get to know customers better. Few airlines are fully utilizing this source of insight today. By analyzing customer data, airlines could offer enhanced loyalty program options—thereby not only improving the customer experience, but also achieving more value from retailing.

4. Provide flexible exchange policies and easier refunds
By proving more flexibility on fares and refund options, airlines could offer passengers a wider choice, improve the experience, build loyalty, and boost sales. They could also incentivize customers to use refund methods that airlines prefer, such as travel coupons. Airlines could also provide automated refunding, the need for which has surged since the start of the COVID-19 pandemic.

5. Become part of the corporate payment ecosystem
As corporates tend to use relatively more expensive payment methods, airlines could explore ways to reduce costs in this area by switching to more cost-effective payment methods and at the same time making the payment process more efficient for their customers. Importantly, airlines could become part of the financial automation ecosystem, and provide better and more integrated solutions, such as introducing account payable automation, and increasing digitization for corporate transactions. They could also expand their acquirer base to improve foreign exchange terms, as well as relook at terms with their partners for co-branded cards.

6. Reduce working capital costs and payment costs
To reduce overall costs, airlines could encourage customers to use payment methods that have shorter settlement times, which would help reduce payment costs across the value chain. They could also try to negotiate lower fees and better payment terms with payment providers, such as schemes and acquirers. Additionally, airlines could take steps to shift travelers to more cost-efficient payment methods, for instance through direct channels.

These levers may differ depending on the type of carrier, as well as the regional and global scale of the business—there are likely to be bigger opportunities for individual airlines than for the overall industry.

Imperatives for airlines going forward

By improving the customer experience, airlines could find a way to grasp the full potential that payments offer. Keeping the six value-creation levers in mind, they could create seamless, innovative payment experiences for both retail and corporate passengers across the booking, in-flight, and arrivals journey.

Airlines looking to realize the payment opportunity could consider taking the following actions:

1. Integrate the payment strategy, including point-of-sales and appropriate channels, into the design of the overall customer journey, thereby improving the customer payment experience

2. Establish transparency on payments costs—and monitor and compare costs against competitors in each market—and develop an integrated distribution and payment strategy to address costs

3. Integrate and link payment strategies across all commercial departments including customer experience and distribution

4. Define differentiated strategies for retail travelers and corporates, and ensure specific customer needs are satisfied, for instance by leveraging different payments methods for each customer category, or collaborating with local payment providers to define an operating model that best suits local customers

5. Diversify channels and acquirers, and revisit the relationship with card issuers to optimize costs and payment terms

6. Collaborate or partner with local payment providers to allow retail travelers to use preferred local payment methods

Riccardo Boin is a partner in McKinsey's Milan office and **Nina Wittkamp** is a partner in the Munich office and are leaders in our airline practice. **Reinhard Höll** is a partner in the Düsseldorf office and **Priyanka Ralhan** is a knowledge expert in the Delhi office and are leaders in our payment practice.

The authors would like to thank Vik Krishnan, Peimin Suo, and Jasperina de Vries for their contributions to this report.