Distribution - Factors affecting distribution strategy

• Airlines drive to reduce costs
  • Distribution has been around 20% of operating costs
• Airlines wishing to have more direct contact with their clients
• Technology has provided the possibility of a direct channel between the airline and its customers
• Disintermediation - as airlines doubt the ability of agents to influence customers’ choice
• GDSs fees
• Large corporates are more professional in the way they purchase travel products
Star Alliance Carriers collective spend over USD $11bn on distribution

Total Mainline reservations, sales, advertising and promotional cost, by category 2004 est.

- Advertising & Promotions: 20%
- Other Reservations & Sales: 60%
- Pax Comm.: 19%
- Cargo Comm.: 1%

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost Q3 03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Media</td>
<td>8%</td>
</tr>
<tr>
<td>Personnel</td>
<td>2%</td>
</tr>
<tr>
<td>Loyalty Programs</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>7%</td>
</tr>
<tr>
<td>CRS / GDS Fees</td>
<td>18%</td>
</tr>
<tr>
<td>Credit Card Fees</td>
<td>18%</td>
</tr>
<tr>
<td>Salesforce /Reservations</td>
<td>5%</td>
</tr>
<tr>
<td>Benefits</td>
<td>6%</td>
</tr>
<tr>
<td>Management &amp; staff</td>
<td>3%</td>
</tr>
<tr>
<td>Other</td>
<td>8%</td>
</tr>
<tr>
<td>Passenger commissions</td>
<td>19%</td>
</tr>
<tr>
<td>Cargo commissions</td>
<td>1%</td>
</tr>
</tbody>
</table>

Sources: Form 414Q03, Star Alliance
The distribution value chain

- Airlines spend $5bn per annum on GDS fees

- Cost as % of ticket prices
  - GDS 8 - 11%
  - Travel Agency 1 - 2%
  - Mercantile fee 2 - 3%

Source: UATP (Universal Air Travel Plan), Airline Business July 2005 and July 2006
Airline Distribution Channels

- **Direct**
  - Sales offices
  - Call centres
  - Website
  - Corporate travel website

- **Indirect**
  - Traditional travel agents
  - On-line travel agents
    - Travelocity, Expedia, Priceline.com, last minute.com, ...
    - Orbitz in the US, Opodo in Europe, Zuji in Asia
  - Tour operators and consolidators
Airline Distribution Channels

Suppliers

GDSs

Supplier call centres & ticket office
Supplier web site
Corporate travel management
Traditional travel agencies & their web sites
Tour operators & consolidators
Internet travel agencies & airline portals

Customers
Travel Agents’ Traditional Services

• Marketing and sales
• Advisory service and itinerary planning
• Pricing and booking
• Subsequent amendments (back to advisory)
• Ticket issues
• Itinerary
• Invoice
• Delivery of documents (e-ticket or not)
• Accounting and credit
• Refund/Changes (back to advisory)

10% of total business is refunds and changes
Travel Agents’ other services

- Hotels booking
- Car hire
- Package holidays
- Foreign currency
- Travel Insurance
Travel Agent Remuneration models - Original Model

- **Commission**
  
  *a simple % of airline fare*

- **Override payment**

  *additional commission for achieving targeted business levels*

- **Net fares**

  *discounted fare offered to agent which could be sold to customers at whatever level the agent can achieve*
Airline Distribution Costs by Sales Channel: $300 Ticket (all channels)

Source: JP Morgan, 1999
Travel Agent Remuneration models

- **Commission**
  
  *a simple*% of airline fare

- **Override payment**
  
  *additional commission for achieving targeted business levels*

- **Net fares**
  
  *discounted fare offered to agent which could be sold to customers at whatever level the agent can achieve*

- **Flat fees**
  
  *a pre-determined amount for booking a ticket*

- **Service fee**
  
  *fee paid by customers for booking itineraries*

- **Management fee**
  
  *fee paid by corporate customers for managing their travel policy, all the commission from airlines passed on to the customers*

- **Transaction based fees**
  
  *similar to management fee but is based on each transaction undertaken*

---

**Original model**

- Customer pays agent
- Agent pays the airline (less commission)
- Airline pay agent override
- Agents returns the override to customer

**1st Phase**

**Airlines attack**

**2nd Phase**

**TMCs becomes traveller’s agent**
I WANT TO COMPLAIN ABOUT SERVICE FEES!

FINE - BUT IT WILL BE TWO QUID TO LISTEN TO YOU...

Travel Agent
BA’s Channel Shift

<table>
<thead>
<tr>
<th>Year</th>
<th>Ba.com</th>
<th>Call Centers</th>
<th>Online agents</th>
<th>Traditional agents</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/2004</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004/2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005/2006</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006/2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Channel shift

Share of revenue
Index = 100

2003 2004 2005 2006

Call Centre

Airline.com / Direct links

Travel agents

Online agents

0% 3% 14% 17% 11%

76%

Source: Harrop, IG Management, 2006
## Airline relationships with TMCs

<table>
<thead>
<tr>
<th>Change in relationships with TMCs in three years</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encourage direct booking for simple itineraries</td>
<td>4.22</td>
</tr>
<tr>
<td>Airlines &amp; TMCs develop global strategies for large accounts</td>
<td>4.00</td>
</tr>
<tr>
<td>TMCs will aggregate content for corporates</td>
<td>3.94</td>
</tr>
<tr>
<td>Develop new fee structures for complex itineraries</td>
<td>3.59</td>
</tr>
</tbody>
</table>

Source: Alamdari and Mason, 2004
Strategic distribution issues for airlines

Source: Alamdari and Mason, 2004
Changing Role of the TMC

PAST
- Low Commissions
- Transaction Fees
- On-line sales channel
- Procurement
- Multiple GDS
- Multi-market servicing
- Direct airlines sales
- Regulatory impact on decline

PRESENT
- High on-line adoption
- Procurement focus
- Solution provider
- Centralised multi-market servicing
- Value add proposition
- Regulatory impact changing

FUTURE
- High on-line adoption
- Procurement focus
- Solution provider
- Centralised multi-market servicing
- Value add proposition
- Regulatory impact changing

Source: Harrop, IG Management, 2006
The Future is Channel Fragmentation

3rd Party Channels

- Travel Agent / Consolidator: On-line or off-line

Consolidated MI

Company

Traveller

Channels

- GDS: 50%
- Private Fares: 0.5%
- Web search: 10%
- Supplier Direct: 10%
- Supplier Portal: 10%
- Supplier Website: 10%

Suppliers

Source: Harrop, IG Management, 2006
Distribution alternatives

• **Direct Connects**
  • Single inventory and single supplier
  • No shopping alternative other than via the GDS
  • No data integration other than via the GDS

• **Online Travel Agents and MetaSearch Engines**
  • Expedia, Priceline, Travelocity, and Orbitz all use a GDS for functionality, faring and pricing, and data integration
  • SideStep, Kayak, Mobissimo use ‘screen scrape’ technology for web fare comparisons

• **“Global New Entrants” - G2 Switchworks and ITA Software**
  • Utilises Worldspan for functionality, faring and pricing, and data integration
  • Limited airline content access and no hotel or car access
  • Conceptual platforms that claims equal functionality w/o a GDS
  • Developing solutions with limited testing and unknown scalability
  • Initial launch provides only access to air and only 8 carriers vs. 400+ in GDS
  • Claim inventory aggregation and Super PNR data integration

Source: Harrop, IG Management, 2006
Distribution strategies by segment

Youth/student | Seniors | Leisure pleasure | Business pleasure | Small and medium enterprises | Large corporate | Segment of one

Traditional offline travel agent
Online travel agent
Call Centre
Airline direct.com

Source: Harrop, IG Management, 2006
TMC strategic issues

1. Threat of merger or acquisition
2. IT investment
3. Global functionality
4. Global fulfilment
5. Communicating value proposition to consumers

Source: Alamdari and Mason, 2004
<table>
<thead>
<tr>
<th></th>
<th>USA / Canada</th>
<th>Central / South America</th>
<th>Europe / Middle East</th>
<th>Asia / Pacific</th>
<th>Global Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amadeus</td>
<td>9 %</td>
<td>38 %</td>
<td>49 %</td>
<td>15 %</td>
<td>26 %</td>
</tr>
<tr>
<td>Galileo</td>
<td>21 %</td>
<td>6 %</td>
<td>31 %</td>
<td>15 %</td>
<td>22 %</td>
</tr>
<tr>
<td>Sabre</td>
<td>42 %</td>
<td>50 %</td>
<td>13 %</td>
<td>4 %</td>
<td>24 %</td>
</tr>
<tr>
<td>Worldspan</td>
<td>28 %</td>
<td>6 %</td>
<td>8 %</td>
<td>4 %</td>
<td>14 %</td>
</tr>
<tr>
<td>Abacus</td>
<td></td>
<td></td>
<td></td>
<td>19 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Topas</td>
<td></td>
<td></td>
<td></td>
<td>4 %</td>
<td>1 %</td>
</tr>
<tr>
<td>Infini</td>
<td></td>
<td></td>
<td></td>
<td>4 %</td>
<td>1 %</td>
</tr>
<tr>
<td>TravelSky</td>
<td></td>
<td></td>
<td></td>
<td>36 %</td>
<td>8 %</td>
</tr>
</tbody>
</table>

Source: Star Alliance, 2005

NB: Travelport which own Galileo purchased Worldspan in August 2007
GDSs’ Perspectives

• Types of transactions flowing through the systems are getting more and more complex

• The average number of transactions per booking has increased by 60% as there are more lookers than bookers

• Prepared to reduce fees in exchange for having access to airlines’ all content

• Are not prepared to remunerate travel agents the same as before and expect travel agents to bear some of the costs of a GDS booking
GDS strategic issues

1. Protect our company from takeover by other GDSs
2. Protect business from TMC moving towards our business area
3. Provide booking tools for corporates
4. Take advantage of opportunities provided by deregulation
5. Developing new pricing mechanisms for airlines
6. Realignment and change of the business model
7. Ensuring access to content

Source: Alamdari and Mason, 2004
GDS’ view of airline strategies

1. Put further pressure on GDSs to reduce fees: Very likely
2. Pass GDS fees onto corporates: Very likely
3. Pay GDS for favourable display: Very likely
4. Continue displaying information on all GDSs: Likely
5. Work only with preferred GDS: Unlikely

Source: Alamdari and Mason, 2004
## GDS fee structure development

<table>
<thead>
<tr>
<th>Feature</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable pricing will become the norm</td>
<td>4.88</td>
</tr>
<tr>
<td>Pricing based on airline market share in each market</td>
<td>4.13</td>
</tr>
<tr>
<td>Channel access based pricing</td>
<td>3.88</td>
</tr>
</tbody>
</table>

Source: Alamdari and Mason, 2004
GDS New Fee Structures

- In US GDSs were deregulated in 2003
- DCA3 (Direct connect access for 3yrs) agreements expired 2006
- Sabre, Travelport and Amadeus have new full content agreements with all of the US majors.
  - Agents can “opt in” to work with airline’s preferred GDS
    - Agents get access to content and avoids $3.50 per segment fees
    - But pay GDS $0.80 per segment (EAS - Efficient Access Solution)
      - For large TMCs this is taken from the incentive fee the GDS pays have traditionally paid the TMC.
  - Agents can “opt out” and not use airline’s preferred GDS
    - pay the airline a $3.50 per segment surcharge for any bookings
- TMCs still need access to full content so will pass on any additional costs to travellers in service charges
Strategic issues for corporates

1. Complete access to inventories
2. Ensuring accurate MIS
3. Improve data management
4. Better use of technology to reduce costs
5. Policy compliance
6. Internal communication with travellers
7. Improve business travel management processes
8. Develop use of self-service reservation systems
9. Globalisation of air deals
10. Integrating direct purchases within the travel programme

Source: Alamdari and Mason, 2004
Control of Spend by Travel Managers

- Travel manager needs to control/manage bookings to try to optimise the spend
- Travellers have more knowledge of prices as they scan the internet
- Travel managers discourage travellers booking online

Control of travel spend would be ceded to travellers
Travel managers believe that travellers booking online hinder their role of minimising travel spend for the company
- Also a waste of executive’s time
Online usage by business travellers

Channel used for last flight taken

- Company's Self Booking Tool
- Direct via an airline's website
- Telephone TMC
- Via Travel manager/travel arranger
- Emailing a request to TMC
- Via Secretary/PA
- Via an online travel agency

Source: Mason, Cranfield University, 2006
Direct channels dominates hotels

Hotel booking channels

Source: Mason, Cranfield University, 2006
Direct dominates Car Rentals

Source: Mason, Cranfield University, 2006
Direct booking may create difficulties

• When a traveller books direct…
  • Loses TMC support on that booking
    • Change tickets
  • Loses Management Information
  • Loses leverage against suppliers
  • May lose volume deals
  • Travel manager can’t trace traveller if transport crashes/terrorist attack/act of god
  • Harder to reconcile expenses
Companies using Self Booking Tools
Survey of 424 large corporates

Current Self Book Tool position

Using SBT: 65%
Implementing SBT: 15%
Planning to introduce SBT: 10%
Not planning to SBT: 10%

Source: Mason, Cranfield University, 2006
SBT booking penetration

Proportion of bookings made via company SBT

Source: Mason, Cranfield University, 2006
SBT saves TMC costs

How much does an online booking save in travel agency/TMC costs?

Source: Mason, Cranfield University, 2006
SBTs reduce ticket prices

How has use of SBT reduced average ticket prices?

Source: Mason, Cranfield University, 2006
SBT adoption by Industry

Adoption level by Industrial Classification

Source: Mason, Cranfield University, 2006
Three different groups of SBT users

<table>
<thead>
<tr>
<th></th>
<th>Cluster 1: Bureaucratically Hindered</th>
<th>Cluster 2: Wholehearted adopters</th>
<th>Cluster 3: Laggards in a Brave New World</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportion of sample</td>
<td>36.7%</td>
<td>39.0%</td>
<td>24.3%</td>
</tr>
<tr>
<td>SBT adoption level on Air Travel</td>
<td>44.9%</td>
<td>81.2%</td>
<td>12.3%</td>
</tr>
<tr>
<td>SBT adoption level on Hotel bookings</td>
<td>37.1%</td>
<td>57.7%</td>
<td>11.0%</td>
</tr>
<tr>
<td>SBT adoption level on Car Hire</td>
<td>31.0%</td>
<td>62.9%</td>
<td>10.8%</td>
</tr>
<tr>
<td>Length of SBT implementation (months)</td>
<td>38</td>
<td>42</td>
<td>30</td>
</tr>
<tr>
<td>% Increase in adoption per month</td>
<td></td>
<td>3.32%</td>
<td>0.82%</td>
</tr>
</tbody>
</table>

Satisfaction with SBT adoption level

<table>
<thead>
<tr>
<th></th>
<th>Cluster 1: Bureaucratically Hindered</th>
<th>Cluster 2: Wholehearted adopters</th>
<th>Cluster 3: Laggards in a Brave New World</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Satisfied</td>
<td>9.2%</td>
<td>50.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Reasonably Satisfied</td>
<td>56/9%</td>
<td>48.5%</td>
<td>18.6%</td>
</tr>
<tr>
<td>Rather Disappointed</td>
<td>24.6%</td>
<td>1.5%</td>
<td>48.8%</td>
</tr>
<tr>
<td>Very Unhappy</td>
<td>1.5%</td>
<td>0.0%</td>
<td>11.6%</td>
</tr>
</tbody>
</table>

Source: Mason, Cranfield University, 2006
Making SBT mandatory improves adoption

Source: Mason, Cranfield University, 2006
Future of Airline Distribution - 1

• The drive to reduce distribution costs through increasing on-line sales, e-ticketing, self servicing, reducing travel agents commission and battle against GDSs will be an ongoing strategy.

• As US and European airlines have benefited from the savings of distribution costs, carriers from other regions will speed up their move towards distribution revolution to have a similar cost base for competition

• Airline alliances may push for common reservation booking platform

• Internet will continue to revolutionise travel distribution
• Travel agents will see their shares of airline ticket sales gradually deteriorating as a result of the emergence of alternative channels

• Small agents could become under threat due to: less leverage to get good airline deals, the development of IT is too costly, they cannot influence corporate choice

• The market will experience a growing dominance by a handful of large agents (traditional and on-line)

• traditional agency skills with face-to-face contacts have to be complemented by offering specialist services and capabilities to consumers through the internet