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AVIATION TRANSPORTATION TOURISM

TURKISH AVIATION ACADEMY

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Airline Distribution

Istanbul Technical University

Air Transportation Management, M.Sc. Program

Aviation Economics and Financial Analysis

Module 12

14, November, 2014

Outline

A. Introduction to airline distribution

B. Passenger distribution

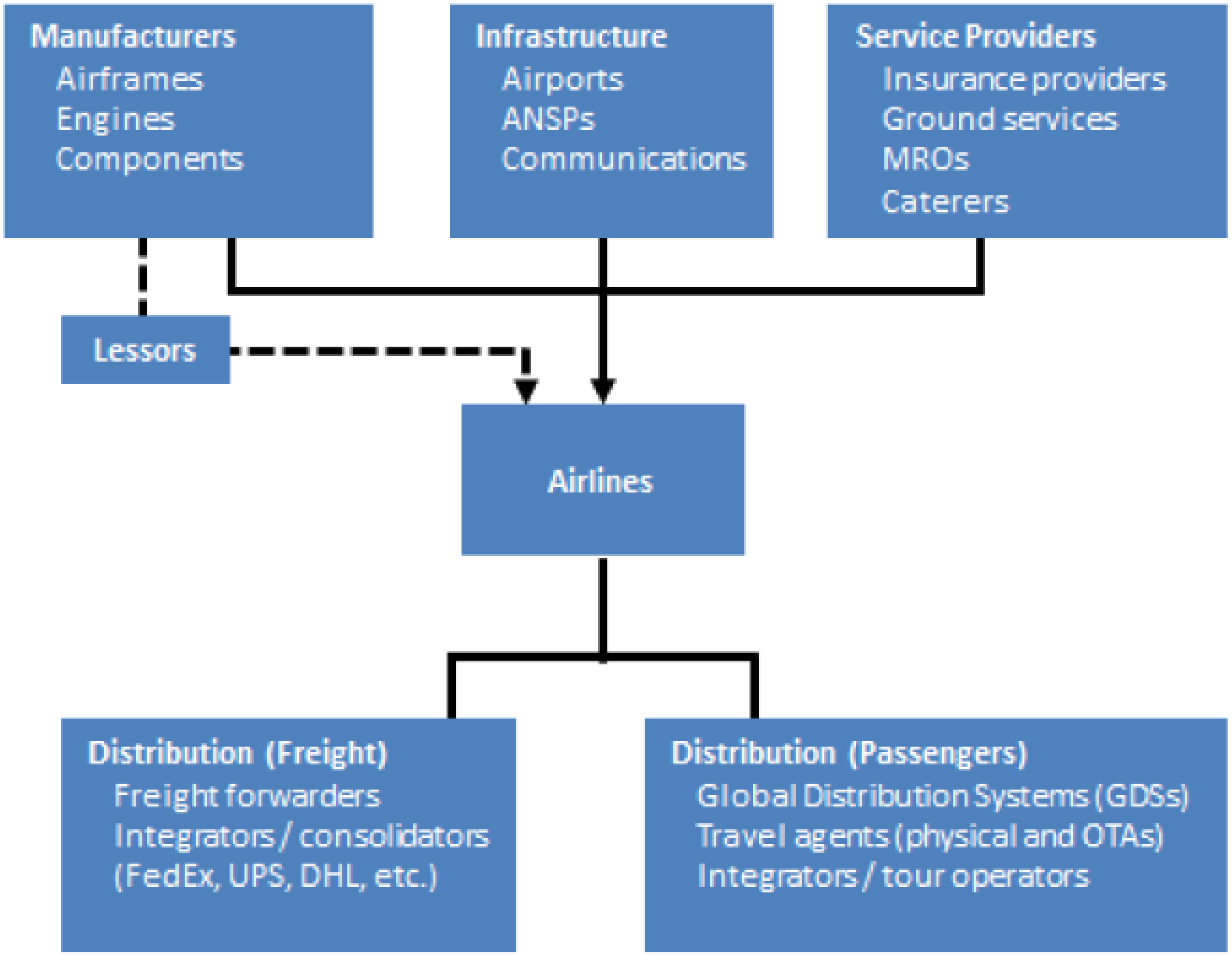
- B.1 Traditional distribution channels
- B.2 New distribution channels
- B.3 Issues in airline distribution

C. Cargo distribution

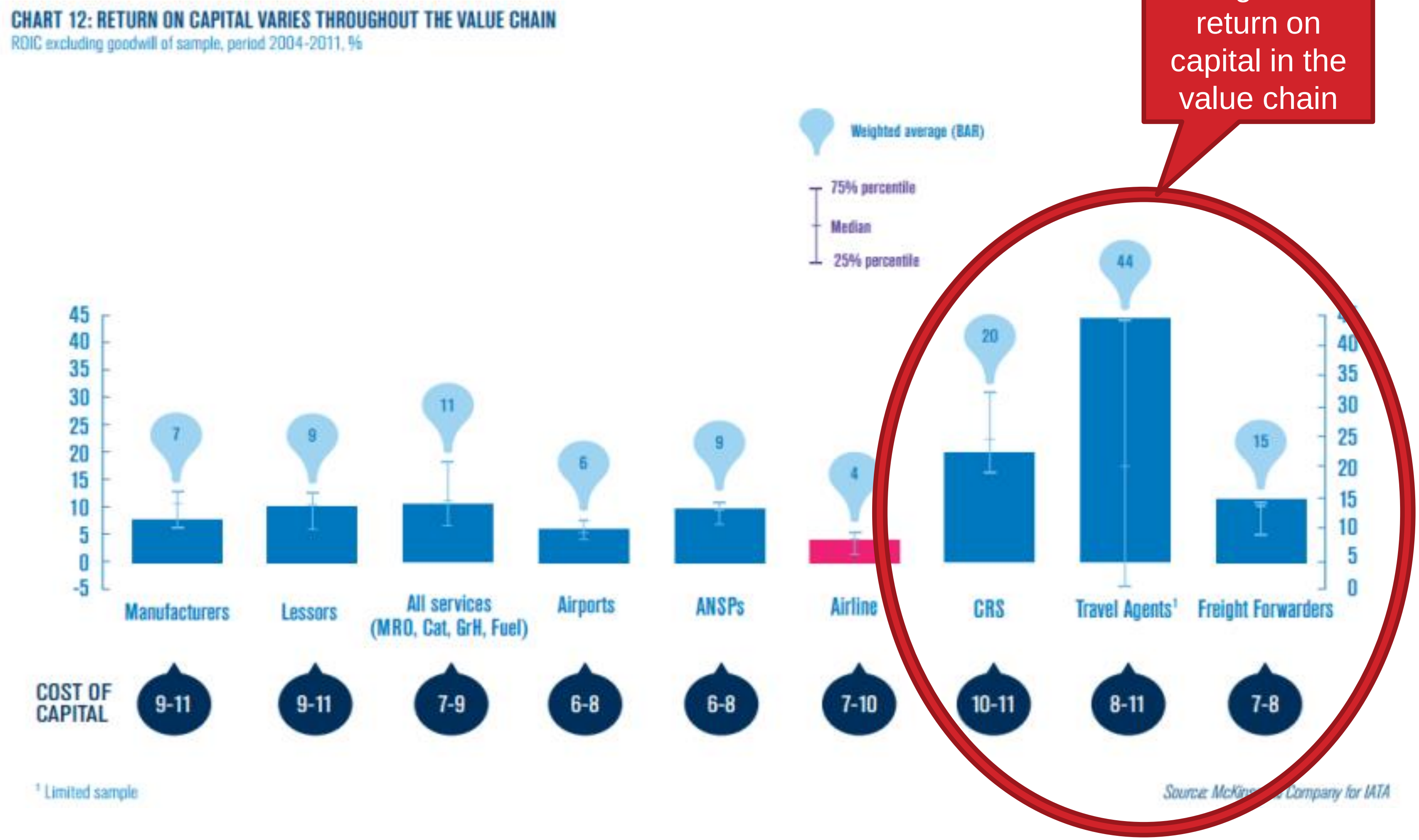
A. Introduction to airline distribution (sales)



The aviation value chain



The distribution segment of the value chain



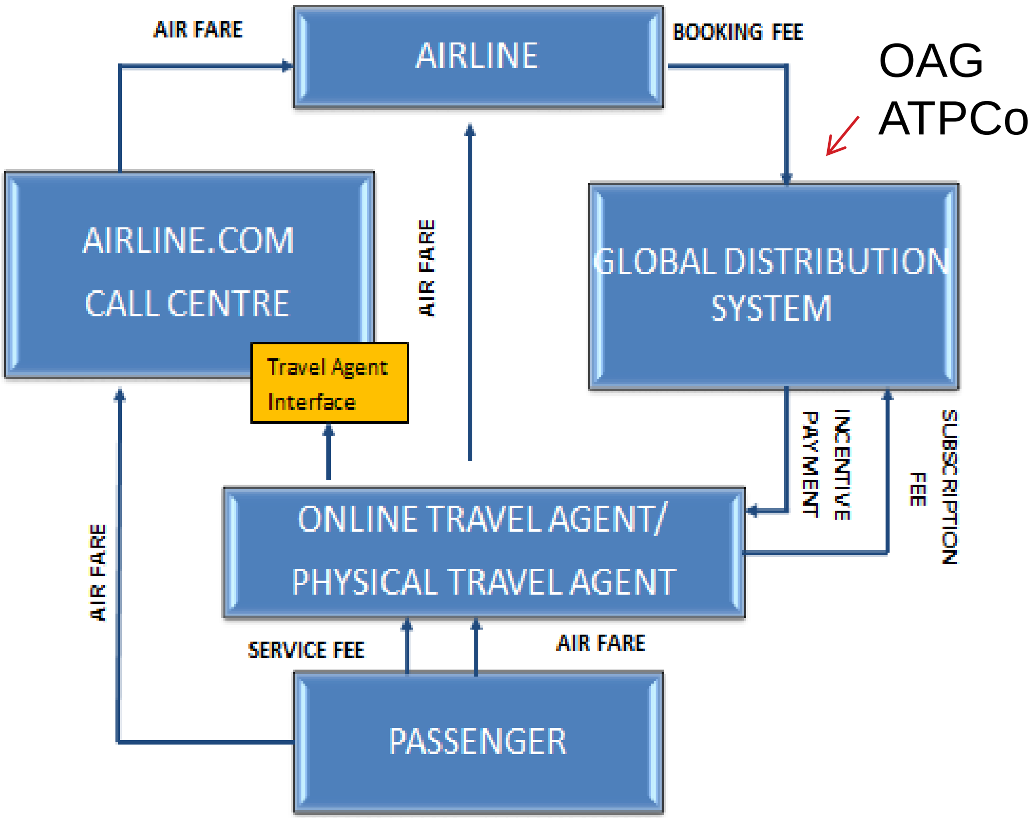
Highest return on capital in the value chain

Source: IATA

B. Passenger distribution

Main players in the distribution segment

- **Global Distribution Systems (GDSs)**
  - Successors of Computer Reservation Systems (CRSs)
  - Store and distribute information on airline schedules, fares and seat availability
  - Source information from airlines, OAG and ATPCO
  - Facilitate transaction
- **Travel Agents**
  - Physical travel agents (Brick & Mortar)
  - Online travel agents
- **Airlines**
  - Sell tickets directly to passenger via websites or partnerships with OTAs
  - Or via GDS-powered channels
    - Airlines pay a booking fee on a flight segment sold via a GDS-powered channel



The role of travel agents

- **IATA agents have access to all IATA airlines**
  - Airline access to 50,000 travel agents to sell product
  - Very efficient, financial protection, knowledgeable sales agents
- **Price comparison**
  - common and unbiased (??) sales agent for airline tickets
- **Ticket processing**
  - complex international itineraries
  - interline tickets
- **Information and expertise for consumers**
  - consumers who do not have access to the Internet
  - specific consumer groups
    (corporate business travel, government agencies, etc.)
  - Corporate travel departments
    must work through an accredited travel agent

Source: U.S. GAO (2003) Report 03-749

Trends in airline distribution

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- **In the mid-1990s two fundamental changes profoundly impacted airline distribution**
  - **Internet communication technologies enabled direct marketing by airlines to consumers**
    - Personalized airline websites
    - In the US, the share of online reservations increased from 7% to 30% between 1999 and 2002 alone *(now 36%)*
  - **Airlines reduced commissions paid to travel agents**
    - Pressure on airlines to reduce costs
    - E.g. Irish carrier Aer Lingus cut commissions sharply and made the lowest fares available through its website only (45% of tickets are sold online)

Source: U.S. GAO (2003) Report 03-749

Trends in airline distribution

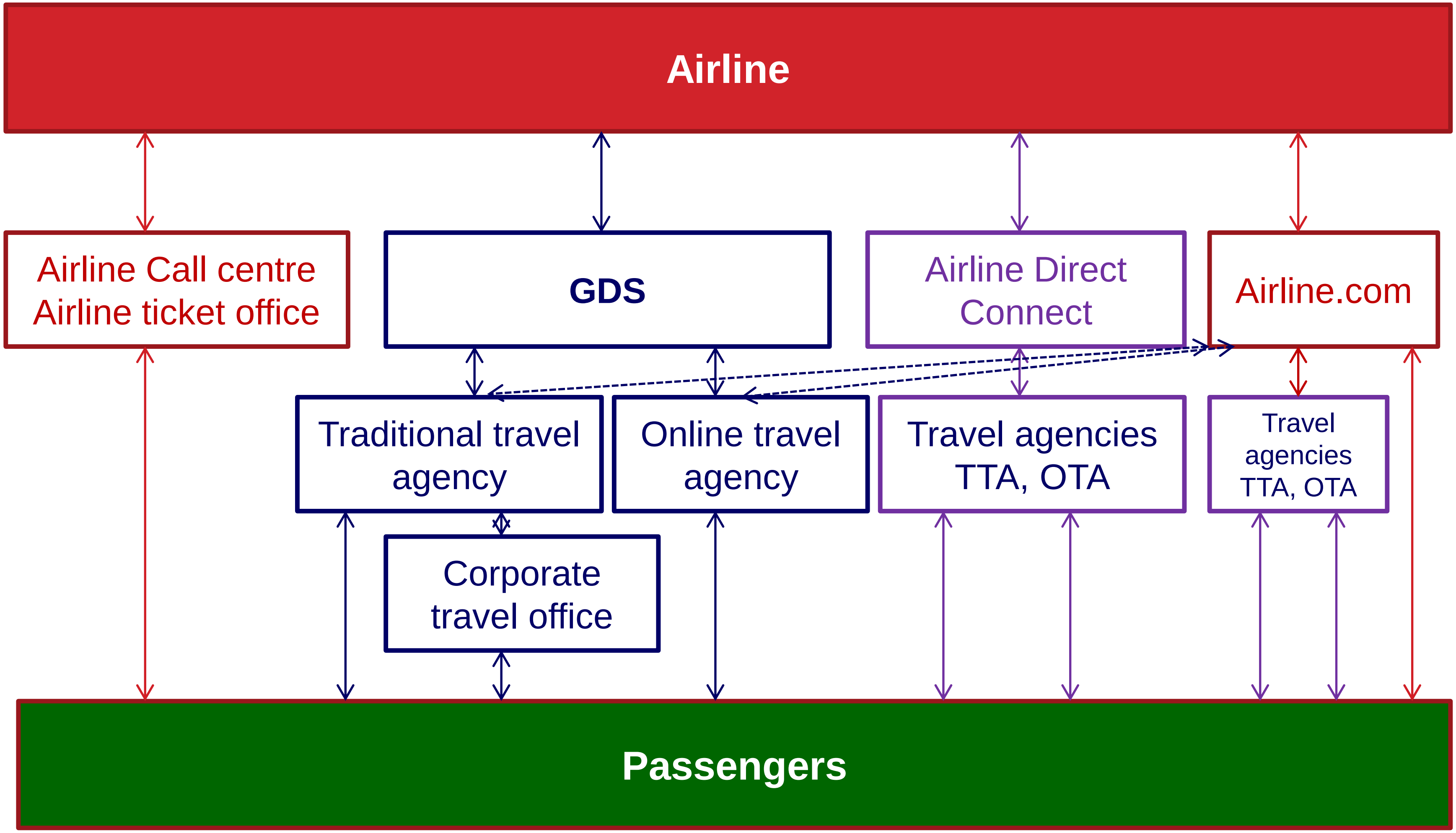
Lower cost → High cost (columns); Lower cost → High cost (rows)

REDUCED DISTRIBUTION COSTS

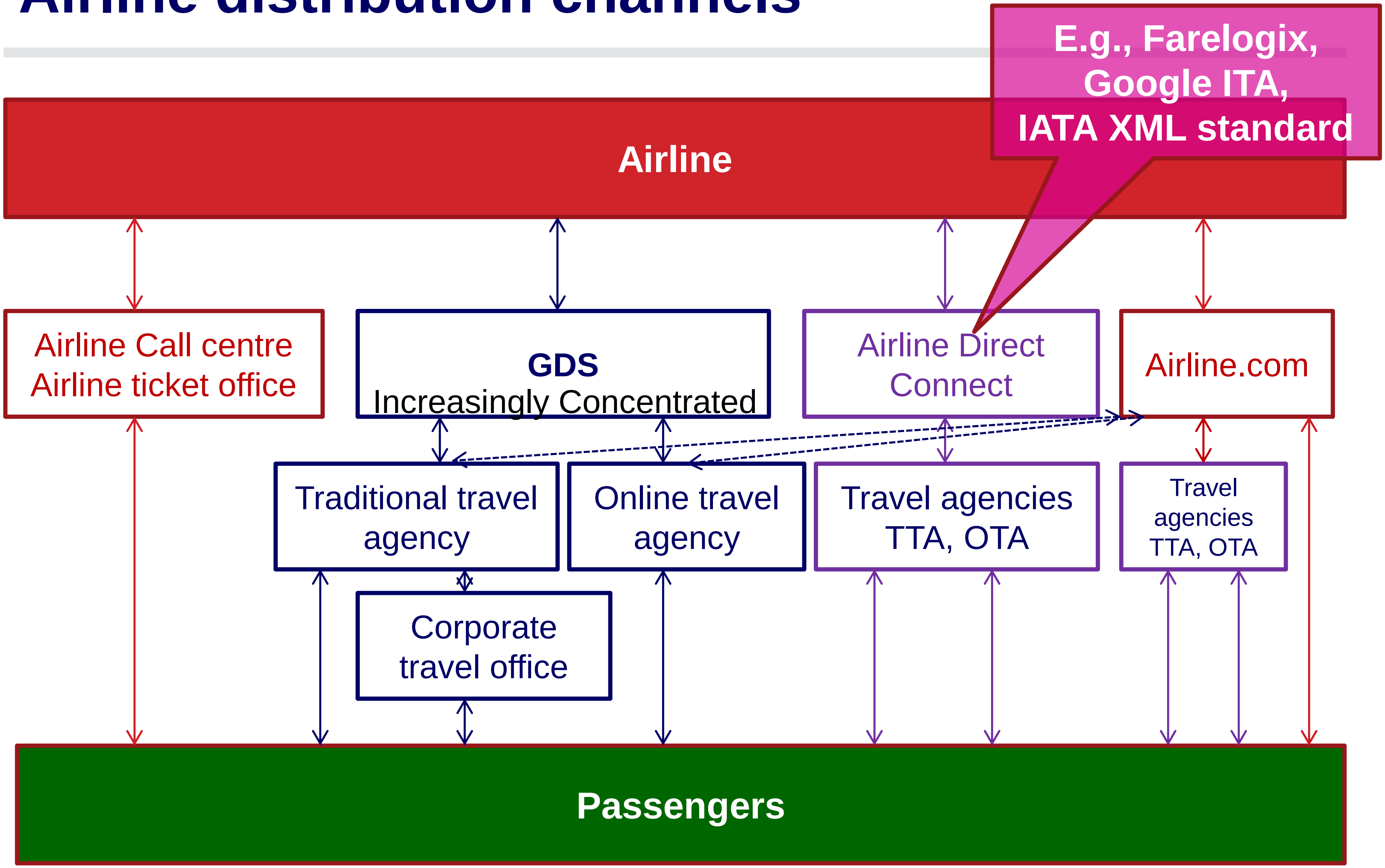
	Online	Offline
Direct	1. airline websites 2. airline websites for coporate bookings 3. airlines websites for travel agent bookings	1. call centres 2. airline ticketing office 3. city ticketing office
Indirect	1. online travel agents (Expedia, Travelocity) 2. online portals linked to GDSs (Opodo, Orbitz)	1. retail travel agents 2. wholesale travel agents 3. corporate travel agents

REDUCED DISTRIBUTION COSTS

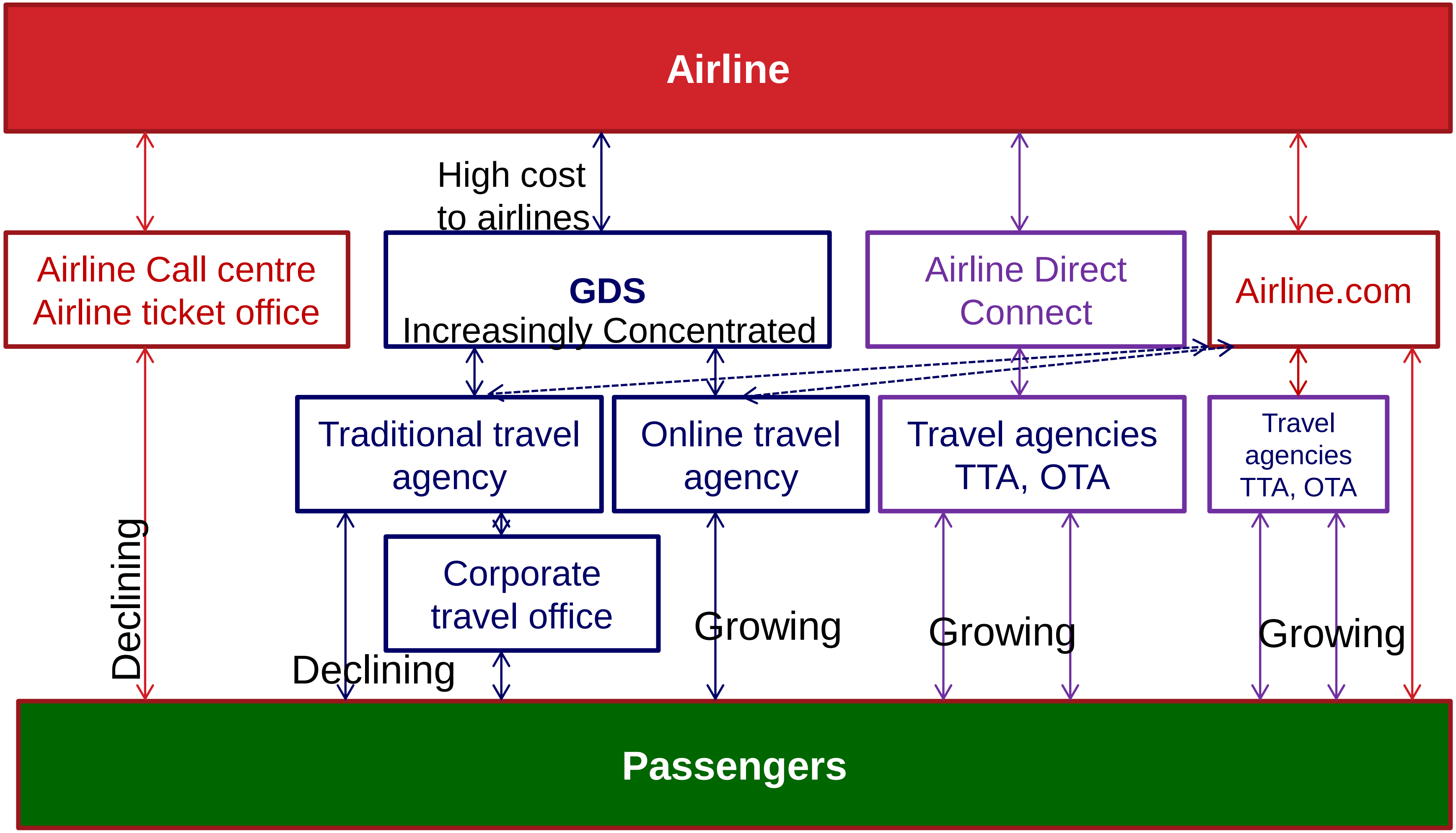
Airline distribution channels



Airline distribution channels



Airline distribution channels



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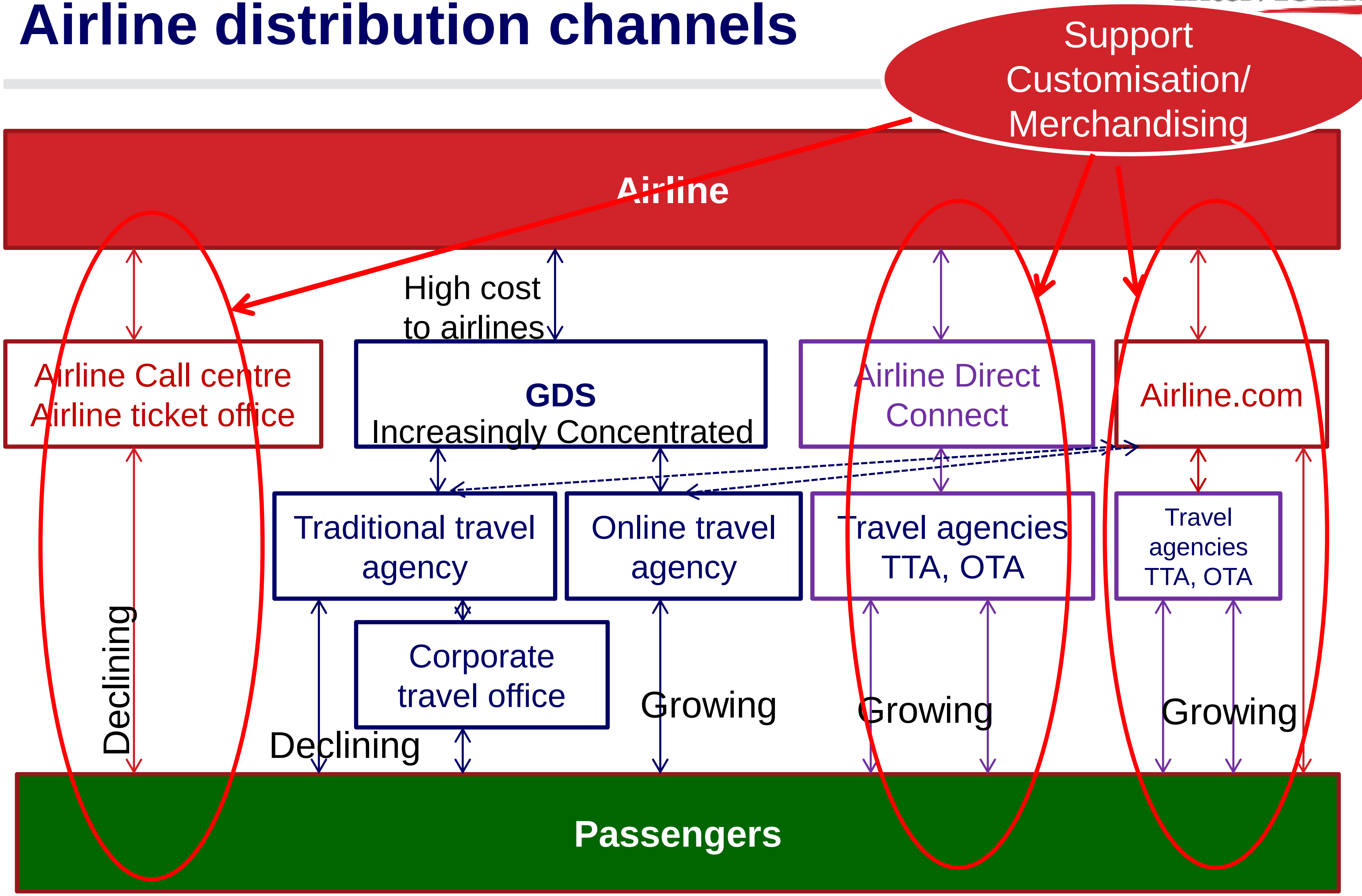
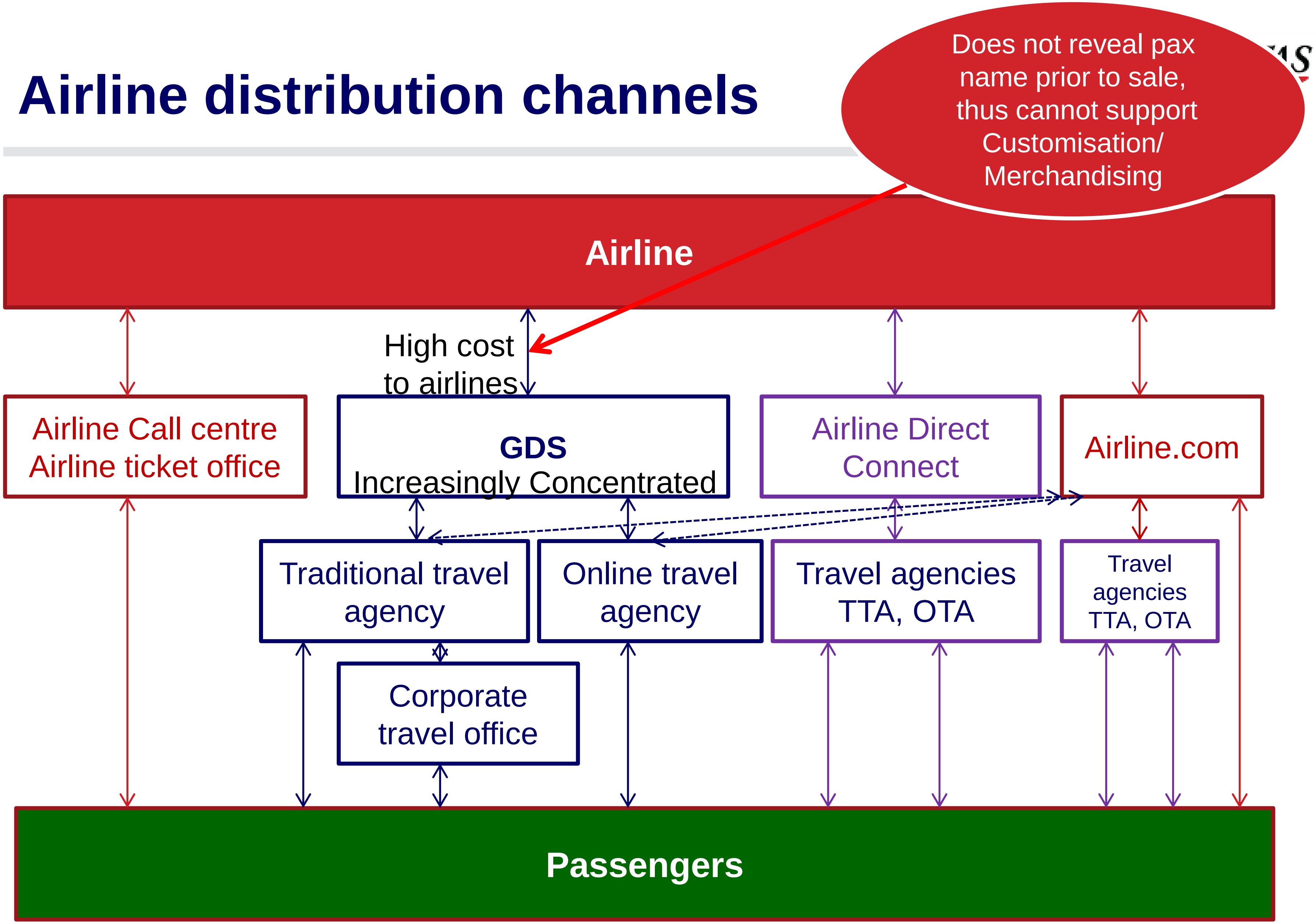
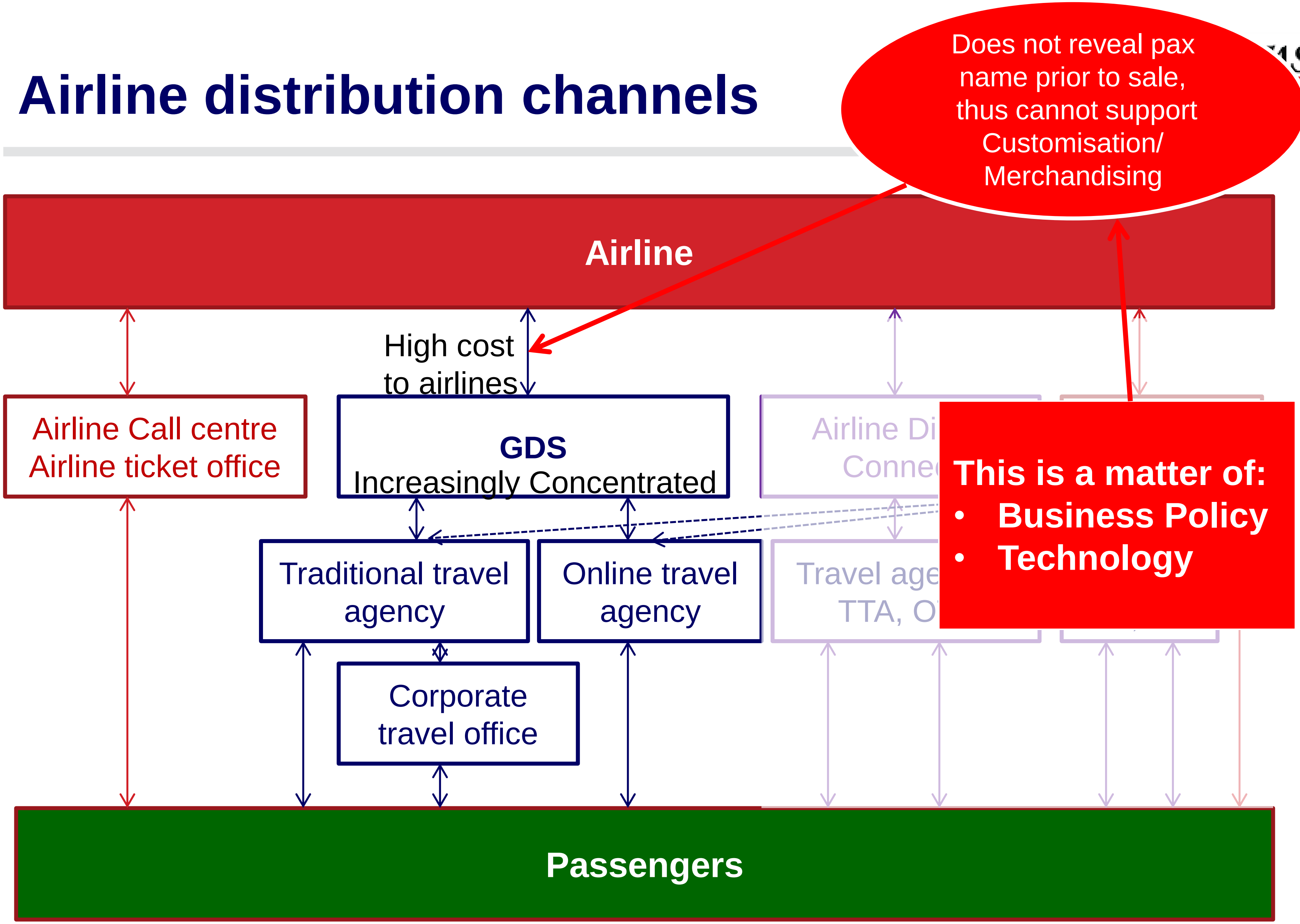


Airline distribution channels



Airline distribution channels



GDS versus online sales

64% of revenue 36%

- In the US, sales through GDSs generated 64% of airline passenger revenue in 2008. 50% of tickets
  GDS tickets higher fare
- In Canada, 75% of international, 40% of transborder and 25% of domestic travel is booked through GDSs.

- Airlines increasingly use their websites for domestic sales (GDSs for international itineraries).
- Low cost airlines (e.g. Southwest and JetBlue) sell over 90% of tickets online.

Source: PhoCusWright (2009)
"The role and value of the global distribution systems in travel distribution"

Summary

- **There has been a clear shift from GDS-based to new and emerging distribution channels.**
- **Nevertheless, GDSs still play an important role in airline distribution:**
  - **Corporate travel**
  - **Government travel**
  - **International travel**
  - **Regions with limited or no internet access**

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B.1 Traditional distribution channels

How did we book tickets before?

- **In the past, passengers could book tickets with**
  - **an airline (call centre or ticketing office)**
  - **a travel agent (access to a CRS)**

- **Physical travel agents powered by CRSs accounted for a lion’s of all ticket sales**
  - **In 1999, 71% of all airline tickets in the US were sold via CRS-powered travel agents**

Source: U.S. GAO (2003) Report 03-749

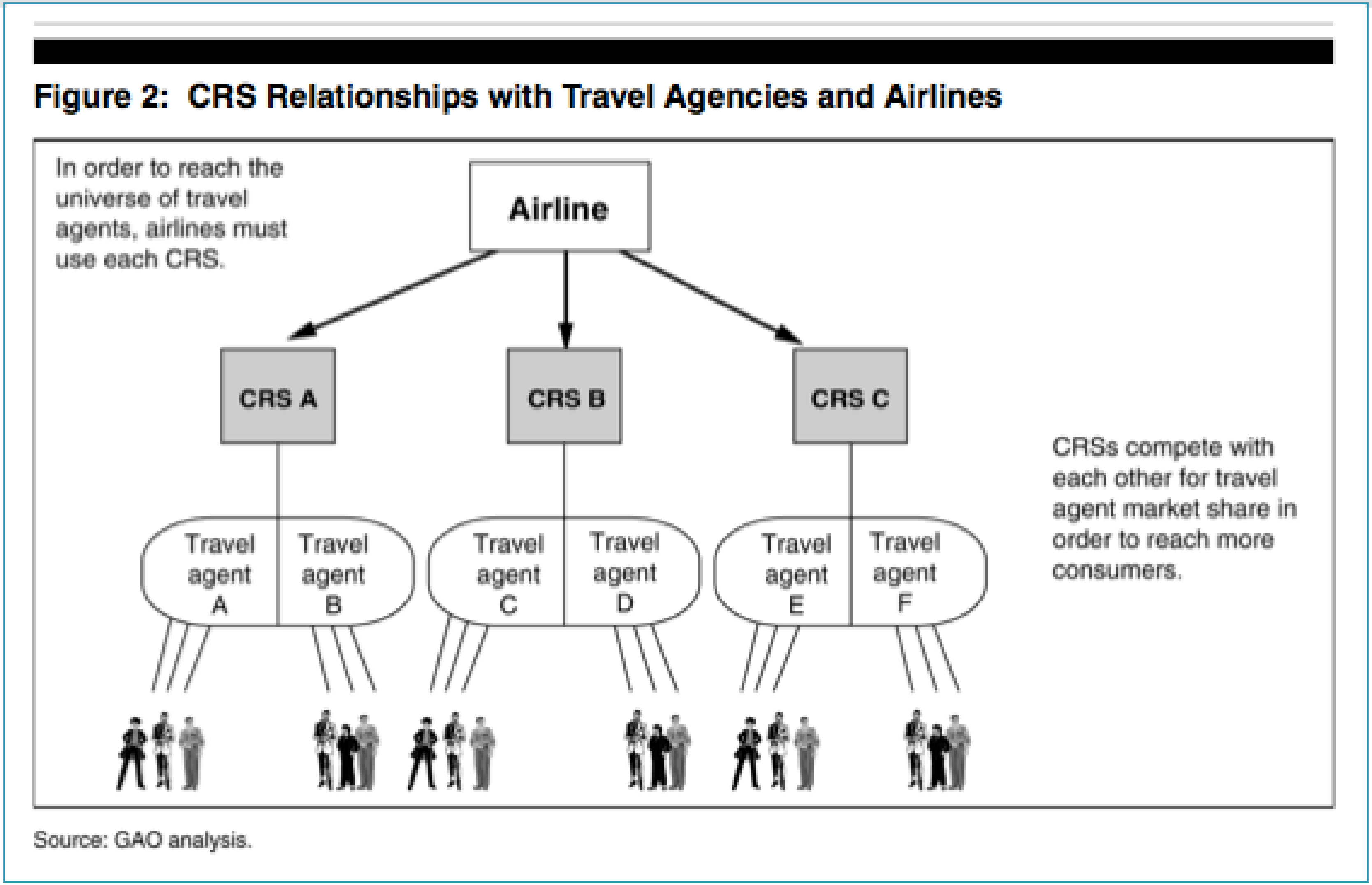
Computer reservation systems (CRSs)

- **Computer reservation systems (CRSs)**
  - **Developed by airlines in the 1960s...**
    - **Sabre was developed by American Airlines & IBM**
  - **Originally used to track flight and schedule information and sell airline seats**
  - **In the mid-1970s airlines provided access to CRSs for travel agents**
  - **Over time CRSs evolved and added new functionality**
  - **Most airlines sold off CRSs by the early 2000s**
  - **Today they are referred to as Global Distribution Systems**

ReserVec, Toronto, 1963

Source: Air Canada's website

Airline-CRS-Travel agent relationship

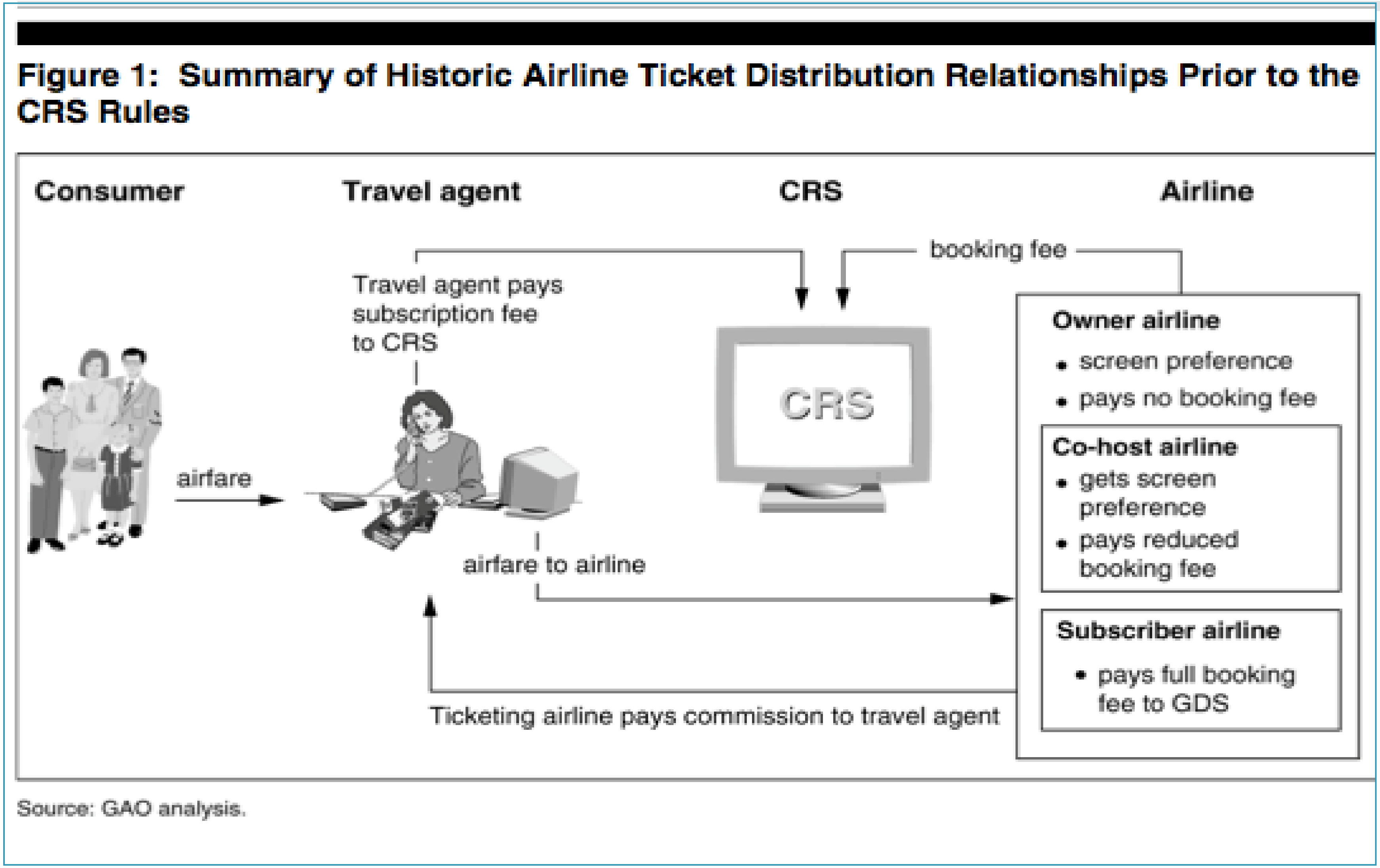


Source: GAO (2003)

CRSs were used to disadvantage competitors

- **Different regions have different regulations**
- **There has been a strong incentive to bias CRS displays by moving the host airline's flights to top of screen.**
  - For example, funnel flights
    - (treat connecting flight as through flight
      and therefore would place service higher on screen)
- **Some countries adopted regulations to prohibit display bias**
  - Now considered anti-competitive
  - Fees to non-owner airlines increased dramatically

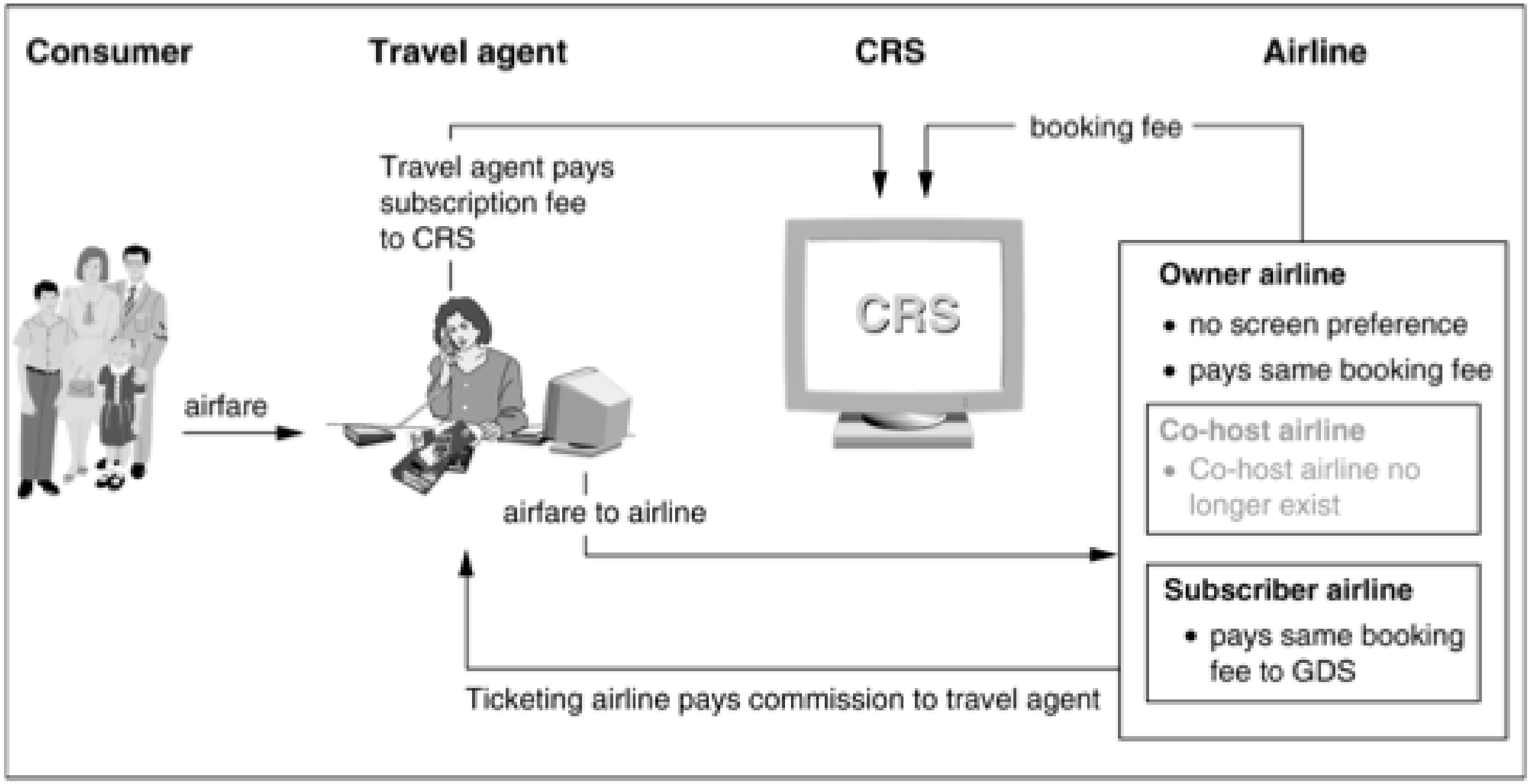
Display bias



Source: US General Accounting Office (2003)

Display bias

Figure 3: Summary of Historic Airline Ticket Distribution Relationships under the CRS Rules



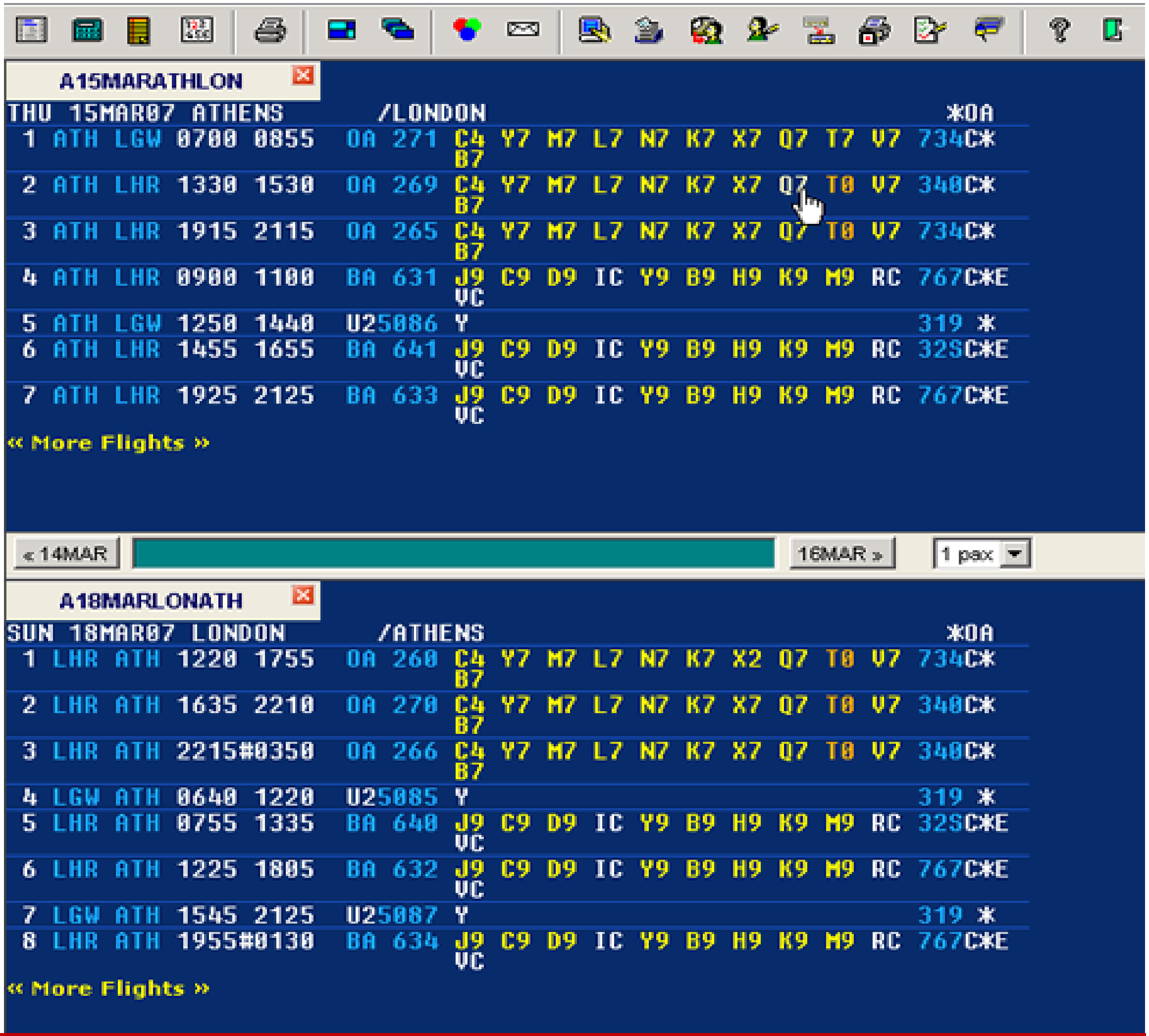
Source: GAO analysis.

Source: GAO (2003)

Global distribution systems (GDSs)

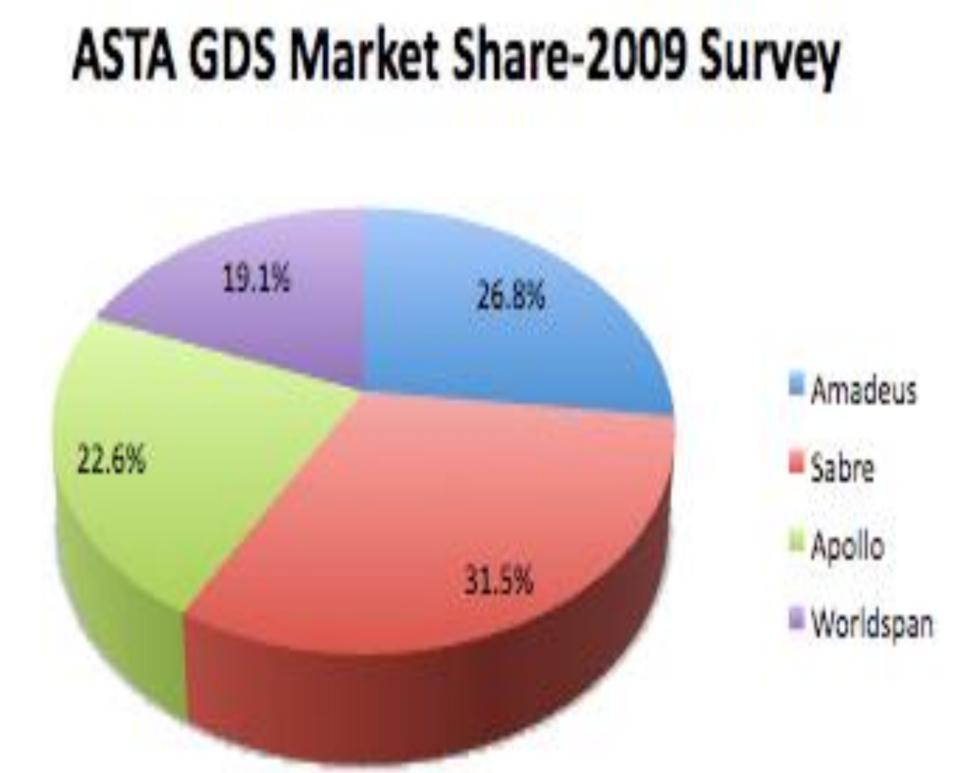
- **Global distribution aystems (GDSs)**
  - **Communication platforms that connect travel suppliers and buyers**
  - **In addition to information on airline tickets, GDSs distribute other travel services (car rentals, hotel accommodation, sightseeing tours, etc.)**
  - **Largest GDSs today are Travelport, Sabre and Amadeus**
  - **Sabre and Travelport account for 90% of tickets sold via GDSs in North America**
  - **Amadeus dominates GDS sales in Europe**

Travelport / Galileo User Interface, 2007



GDS market is highly concentrated

- **Sabre**
  - Owned by private equity firms
    - Silver Lake Partners
    - Texas Pacific Group
- **Travelport (Apollo, Galileo, Worldspan)**
  - Owned by a private investment firm
    - Blackstone Group
- **Amadeus**
  - Airlines are shareholders in the owning company
    - WAM Acquisitions (Air France, Iberia and Lufthansa are shareholders)



Source: tnooz (2010)

Global distribution systems

- **GDSs remain a major distribution tool**
  - **Over 60% of airline industry revenue comes from sales via GDS-enabled distribution channels**
  - **Used by scheduled carriers**
  - **Limited use by charter carriers and discount carriers such as Southwest**
  - **It is a global business**
    - Global consolidation; interline linkages partly driven by carrier alliances

PhoCusWright (2009)

What was the impact of CRSs/GDSs?

- **Situation in the United States**
  - **In 2008, 64% of airline revenue (50% of tickets) came from sales via GDS-powered channels**
  - **In 2002, 63% of airline tickets were sold through GDS-powered travel agents**
    - 54% of all sales come from the first line on screen
    - 92% of all sales come from the first screen
    - 20% increase in sales to vendor of a “biased” system

Source: U.S. GAO (2003) ; PhoCusWright (2009)

What was the impact of CRSs/GDSs?

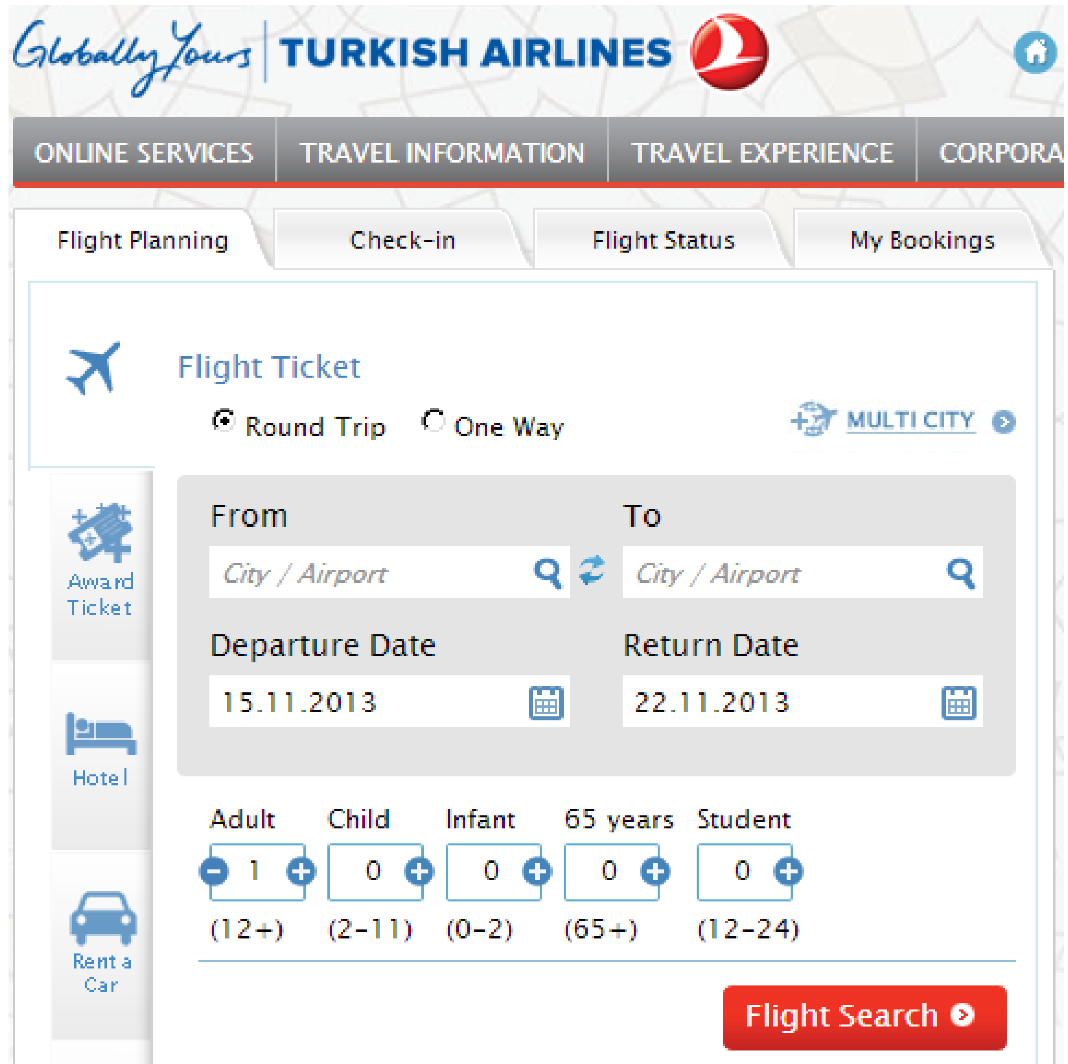
- **Situation in Canada**
  - **In 2000, 74% of tickets were sold by GDS-powered travel agencies**
  - **Agencies traditionally earned 10-12% commission**
    - In recent years “caps” have been placed
    - Larger chains greater opportunity for incentives & overrides
    - Travel agencies starting to place a service charge with its customers to partially offset the “cap” impact.

B.2 New and emerging distribution channels



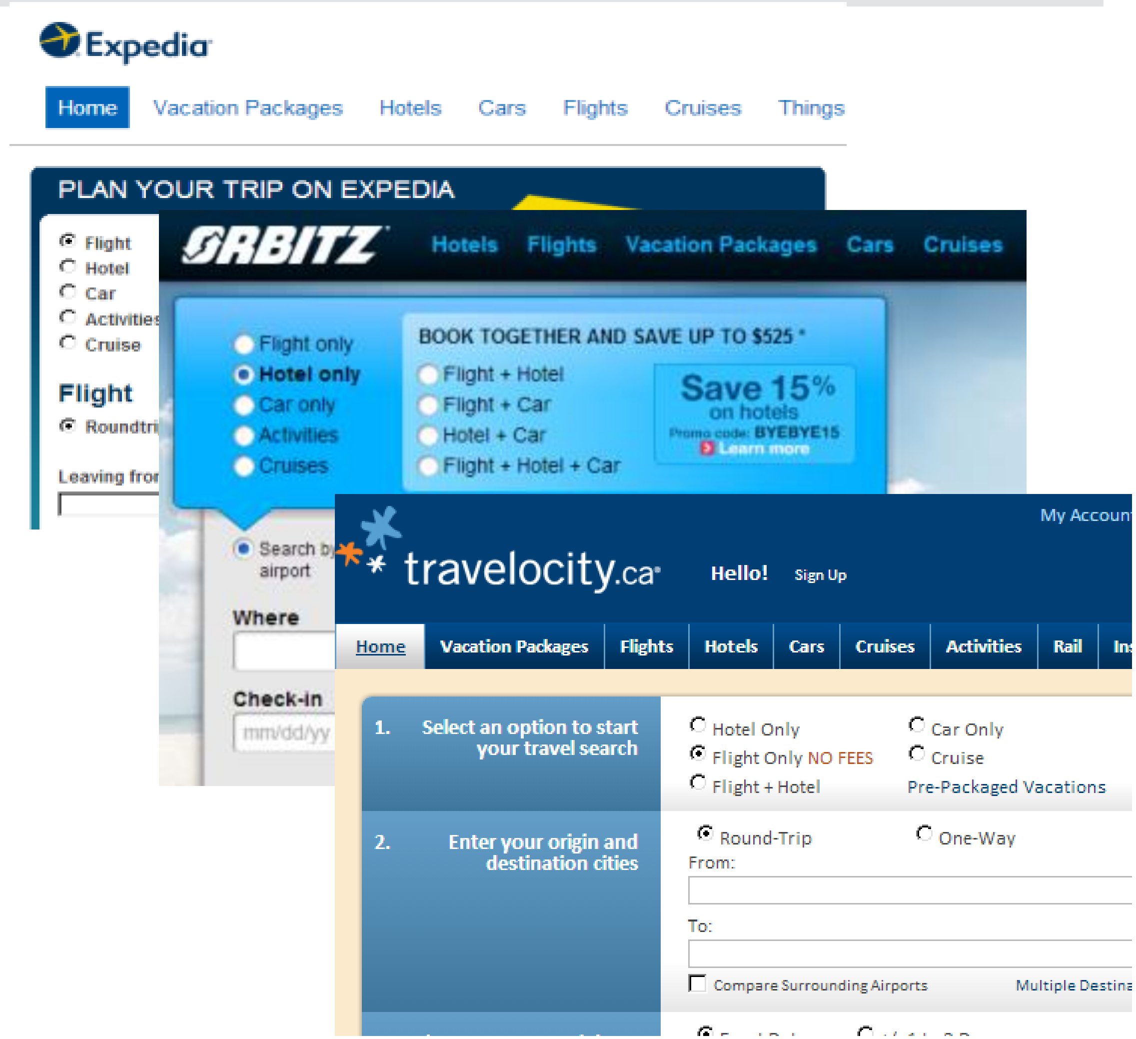
Airlines' websites

- Airlines made substantial investments to develop personalized websites
- Travellers can buy personalized product offerings
  - Ticket at the base price
  - Ancillary services for an additional price
- Airlines save costs when bypassing expensive intermediaries (GDSs and travel agents)
- LCCs use direct sales as a way to keep costs under control
  - over 90% of tickets by Southwest and JetBlue are sold via their websites



Integrated websites

- Websites which act as an online travel agency
- Travellers can compare fares, schedules and other flight information
- May be independent or owned by travel suppliers
  - Orbitz is part-owned by Travelport
  - Expedia is independent
- Bookings via integrated websites may be channeled via GDSs or directly access airlines' inventories
- Opaque websites
  - Blind auction principle
  - Priceline.com



Direct airline-travel agent partnerships

- **Online travel agencies increasingly develop direct links with airlines**
  - **E.g. American Airlines and priceline.com**
  - **E.g. Air Canada and Kayak**
  - **Objective is to bypass costly GDS systems**

IATA's New Distribution Capability

- **Airlines use different technological standards when selling through their websites and through GDSs**
- **XML used for website sales and supports customized product offerings**
- **EDIFACT/TELETYPE used for GDS/travel agent sales and does not support customized product offerings**
- **NDC is designed to bridge the gap between the different standards**
- **NDC is currently in the pilot stage**

Source: IATA's New Distribution Capability (NDC) Program

What is the impact of new and emerging distribution channels?

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- **Airlines seek to enhance competition between distribution channels**
  - Goal is to reduce cost of distribution
  - Greatly increased quality of service to consumers
  - Support airline industry goal of a merchandising approach to defining and selling the airline product
  - Move away from mass standardisation of the airline product
  - To a customised service and price for consumers
- **Gains to consumer from lower fares**
  - As a result of enhanced competition between new and traditional distribution channels

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B.3 Issues in airline distribution

Issues with airline distribution

- ***"We are not keeping up with the rest of retail and consumer marketing when you look at [airline] distribution"***

- Jim Davidson, President of Farelogix

Issues with GDSs

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- **GDSs use outdated technologies that were developed in the 1960s**
- **GDSs do not have interoperability and are fragmented**
  - an airline has to participate in multiple GDSs which do not communicate with each other
- **GDSs do not display information on ancillary services**
  - price of luggage check in, onboard meals, assigned seating, etc.

Issues with GDSs

- **Exercise of market power results in high fees to users (airlines)**
- **GDSs have high return on investment, especially compared to the airline industry**
  - **This suggests a certain degree of market power vis-à-vis airlines**

C. Cargo distribution

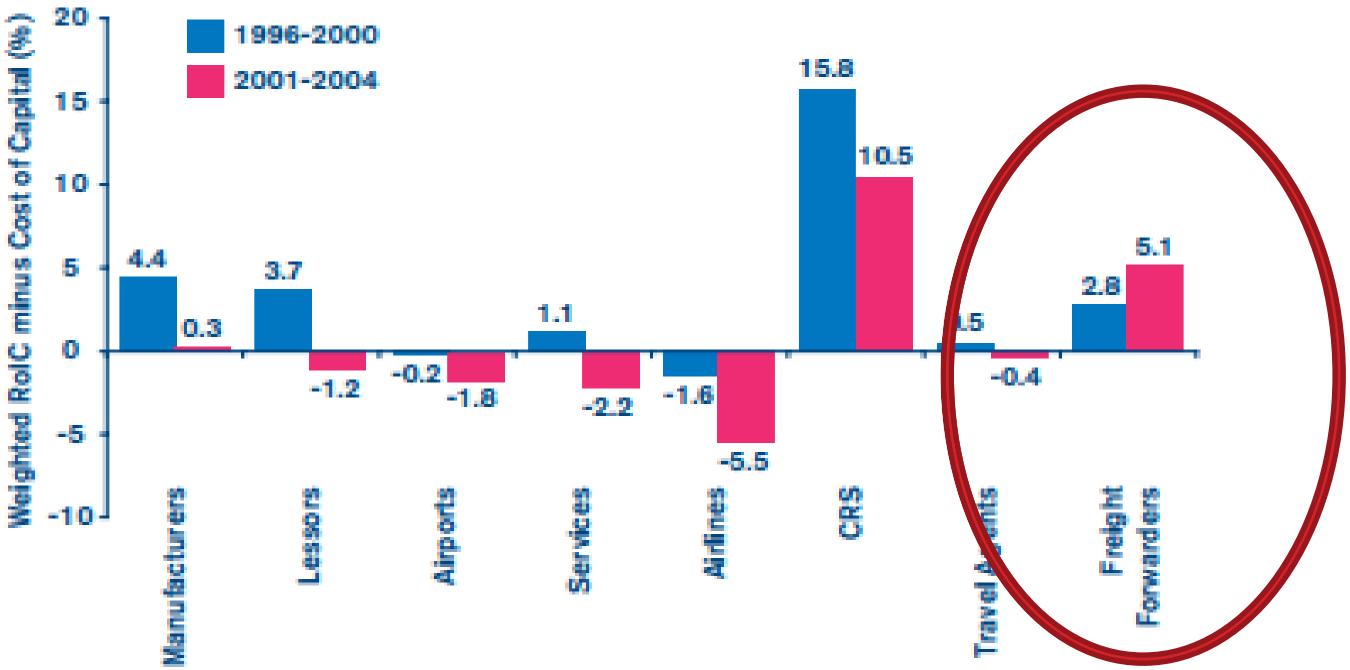
Freight forwarders

- **Freight forwarders play a critical role in air cargo distribution**
  - Handle over 70% of world's freight
- **Some freight forwarders have evolved into global providers with worldwide networks**
  - Expeditors, Panalpina, etc.
- **A trend of increased consolidation in the freight forwarding sector can be observed**
  - Leads to economies of scale and increased investor returns in the freight forwarding sector

Freight forwarders

- **Freight forwarders returns are counter-cyclical**
  - Higher average returns during downturns

Figure 5.2: The Weighted Return on Invested Capital minus the Cost of Capital by Sector



Source: IATA

Freight forwarders

- **The consolidation trend means that there are fewer and larger global players**
  - High entry barriers due to economies of scale
  - Direct air cargo distribution channels (airlines and shipping companies) exert limited competition due to lack of skills or smaller networks, but
  - Emerging Chinese and Asian competitors provide some competition in this sector

Partnerships

- **Emergence of partnerships between airlines and freight forwarders**
  - **e-freight** is a project designed to reduce the amount of paper documentation in air cargo and replace it with electronic documentation and data exchange
  - **e-AWB** is an initiative designed to remove paper air waybill
    - these partnerships involve airlines, freight forwarders, shippers, ground handling companies and customs authorities

FedEx/UPS/DHL/Purolator

- **FedEx was established in the early 1970s**
  - **Originally express parcels, documents**
  - **Expanded to larger items and trucking**
- **FedEx and UPS leading companies in the U.S.**
- **DHL in Europe and other markets**

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