

A MAGAZINE FOR AIRLINE EXECUTIVES

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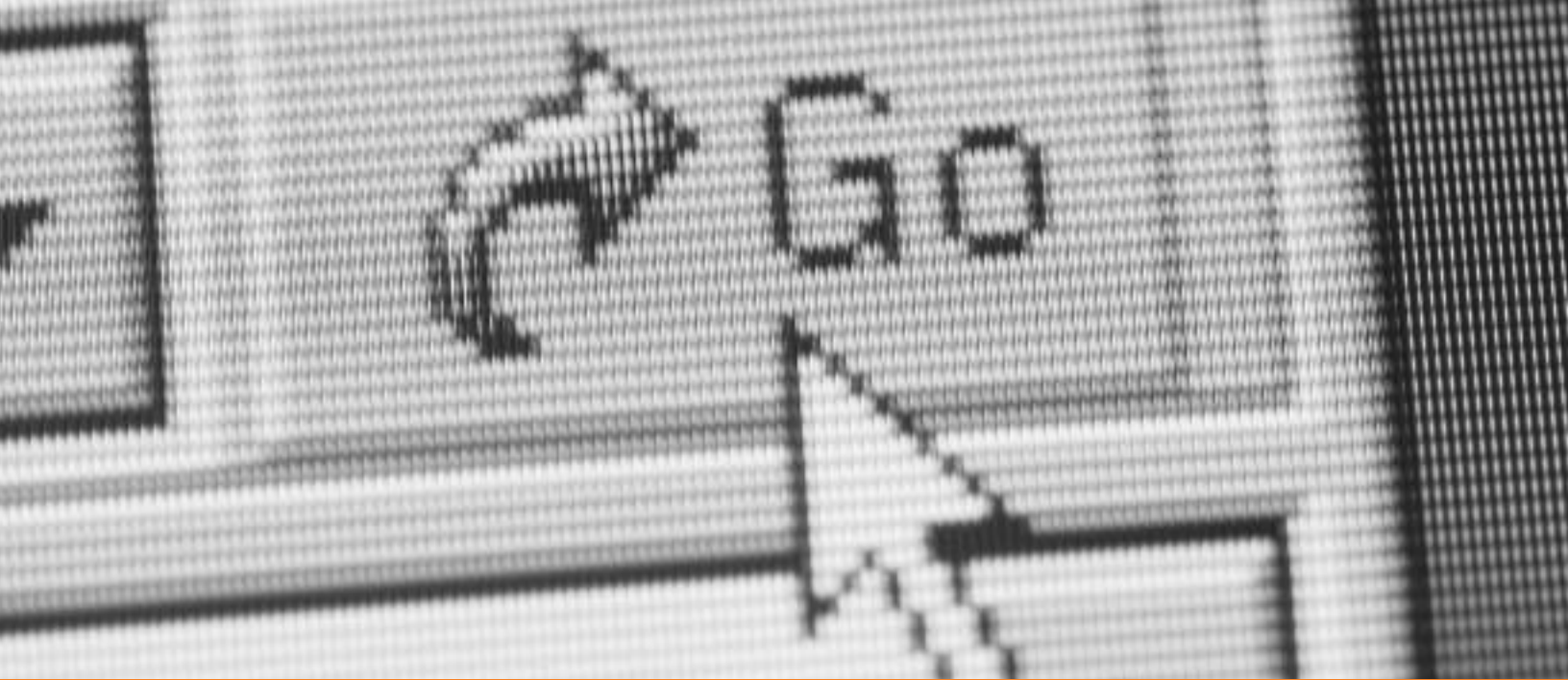
**David  
Siegel,  
CEO,  
US Airways**

INSIDE

Traditional carriers launch  
low-fare subsidiaries

How airlines weathered  
"the perfect storm"

Cathay Pacific Airways'  
crisis management process





*New Distribution Paradigms:*

# Controlling Costs in the Internet Age

*The growth of the Internet offers airlines more channels to distribute their product. As airlines increase use of these channels, they can take specific steps to control costs and maximize the benefits of online distribution.*

■ By Stan Boyer | *Ascend* Contributor

The advent of the Internet provides airlines with the opportunity to make substantial changes to the way they distribute their product. Not surprisingly, some airlines have recently placed more focus on direct distribution, interacting directly with travelers and bypassing intermediaries, such as global distribution systems and travel agents. Although airlines have always possessed this capability in their reservations centers, Internet-based distribution has taken the call center concept further by allowing more customers to interact with their schedules and fares than previously possible.

## Airline Consumer Direct

Web-based distribution has taken several forms, and different models continue to emerge depending on where the airline operates. In North America and Europe, airlines tend to favor consumer-direct models for both published fares and distressed or “opaque” inventory. Some have attempted to engage travel agents with their Web sites as well. While this model has lowered distribution costs, it

has also had a severe impact on revenue.

The consequences of consumer-direct distribution include:

- Passengers use the increased price visibility of the direct distribution channel to find lower fares, reducing ticket yields,
- Travel agencies react to airline direct-sell competition, obtaining lower fares for their passengers in order to maintain viability, again reducing ticket yields,
- Airlines incur increased costs to maintain Web sites and other direct-distribution channel centers, often displacing any savings gained by decreased travel agency commissions.

The bottom line — Web-based, consumer-direct models often result in both product dilution and increased distribution unit costs.

## Online Agencies

Another distribution model that has emerged is the online travel agency. The online agencies have taken mainly two forms: published and net-fare retailers such as Travelocity and distressed

inventory agencies such as Hotwire.

The most recent statistics indicate that the top six online agencies in North America now account for about 25 percent of all travel agency bookings in the region.

What does this mean for airlines? If they plan to conduct business in the North American market, they should include these agencies. For carriers based outside of North America, these agencies provide an opportunity to distribute their product much more widely and with less effort than setting up sales teams in individual cities.

The advantages of online agencies include their widespread use for instant purchase, resulting in quick inventory turnover, and the breadth of products made available to the consumer, such as vacation packages and fly/drive deals.

However, the downside to using this distribution channel is that, like other consumer-direct sites, they draw a number of hits without resulting in actual bookings. Depending on an airline’s connectivity to the Web site or its sponsoring GDS, this could have a profound

impact on its host reservations system. Most of the larger online agencies are attempting to minimize the impact by reducing the number of hits to the airline's host system.

### Internet to Agency


For many areas of the world, Internet penetration remains moderately low, and thus consumer-direct models are not as effective. In these markets, some airlines are creating new models that use the Internet to connect travel agencies directly to an airline-sponsored Web site. Why would an airline choose this route?

The answer to this question lies in understanding what airlines perceive to be their largest costs of distribution. In Brazil, for example, the Real is nearly 3 to 1 against the Euro. If the fare between São Paulo and Rio de Janeiro is R\$600 or about €200 round trip, the agency commission is about 7 percent, or €14, and the GDS fee is €8, or 4 percent.

If the currency devalues to 4 to 1 against the Euro — as was the case in late 2002 — the impact is dramatic. Because much of the airline's costs are in the local currency, the airline leaves the round trip cost at R\$600 or €150. The travel agency commission remains the same at 7 percent, dropping to €10.25. The GDS fee remains constant in Euros, and now the €8 fee is equal to 5.3 percent of the fare.

The benefit is magnified with confirmed, passive, waitlisted or duplicate bookings for which a GDS often charges a fee. If a traveler has to waitlist for an earlier flight in the desired fare class, but is unable to get the fare, and the travel agency does not cancel the wait-listed segments in the GDS, then the GDS costs will now be about €16 or 10.6 percent of the new fare.

In this case, the electronic cost of distribution could be more costly than the travel agent commission. Therefore,



some airlines do not exclude travel agencies but encourage them to book directly on the airline's Web site, leaving the commission intact. In addition, credit card transactions, the mainstay of Web-

## THE HIGH • LEVEL view

### News Briefs from Around the Globe

#### Who

Cathay Pacific Airways

#### What

Renewed its "smartsourcing" contract with Sabre Airline Solutions. The three-year, multi-million dollar contract provides Cathay Pacific the full range of Sabre Airline Solutions' integrated portfolio, including consulting services.

#### Why

The smartsourcing contract provides Cathay Pacific access to new product releases and participation in Sabre Airline Solutions' extensive solutions user groups. Through the agreement, first signed in 1997, Cathay Pacific has accessed and implemented 19 Sabre Airline Solutions software applications.

"The strategic alliance developed with Sabre Airline Solutions will help us keep ahead of the competition," said Anthony Yeung, general manager information management for Cathay. "This partnership includes both soft-

ware and expertise in a range of areas including planning and flight scheduling, pricing and revenue management, flight operations and crew scheduling, and automated check-in.

"The smartsourcing contract also assures we have significant input in further product portfolio development and enhancement from Sabre Airline Solutions, ensuring products that meet our objectives and technology that helps us remain at the forefront of the industry," he added. [a](#)



The development of the Internet has created more opportunities for airlines to distribute their product more widely and with less effort. However, new channels can result in product dilution and increased distribution costs. Despite the potential pitfalls, there are ways for airlines to control distribution costs and maximize the benefits of these new channels.

based distribution, require special care in order to avoid fraud. For this reason, it is often in the best interest of the airline to continue to have the travel agency handle the transaction, thus relieving the airline of the liability.

Whether this model will work depends on a host of factors such as Internet speeds and links throughout the country, and cost and availability of security features.

Airlines located where cash payment is the norm are experimenting with special bank accounts for individuals and corporate clients that will allow the airline to deduct funds from the account for the purchase of a Web-based ticket.

### **Controlling Distribution Costs Regardless of Channel**

Regardless of the channel, airlines must control distribution costs, which can range from 2 percent to in excess of 30 percent depending on several factors, including markets where they operate, how they manage currency exchange rates, whether they treat incentives as diminution of revenue or as a cost, which distribution channels

they use, their business relationships and overall marketing strategies.

Airlines can control costs in direct channels by focusing on:

- Corporate incentives,
- Call center and sales office efficiency,
- Waitlist control,
- Waivers and favors control,
- Group management.

For indirect channels, areas for cost containment include:

- Travel agency commissions and overrides,
- Waivers and favors control,
- Fraudulent booking and ticketing practices,
- GDS costs,
- Communication costs — SITA, Arinc,
- Online agency costs.

Many airlines focus on the costs of indirect distribution, most notably electronic distribution via GDSs. However, if an airline's reservations and inventory control are "hosted" by a service provider, then many of the same techniques used to control GDS costs can be applied in the hosted environment.

### **How to Control Distribution Costs Host Record Maintenance**

An airline should make use of data mining tools or robotics to eliminate unproductive records, such as unticketed bookings, duplicate bookings and waitlists that the airline knows will not be cleared. Many airlines only focus on critical flights, those at least 85 percent full, but any flight could contain a substantial number of these records. These records should be cancelled far enough in advance in order to ensure only accurate records on the day of departure, saving unnecessary GDS fees.

### **Inventory Control**

Airlines' desire for flexible product distribution led to the implementation of advanced, robust systems to control inventory. With this flexibility comes responsibility on the part of the airline to make the most of each system through which it distributes its product.

Within the GDS distribution framework, airlines can control distribution costs by conducting a monthly review of the GDS invoice detail, known as

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Online agencies continue to emerge as a more prominent distribution channel. In North America, the top six online agencies represent about 25 percent of all travel agency bookings in the region, and they are also gaining influence in Europe and Asia/Pacific.

billing information data tapes. Using tools that are available to analyze this data, airlines can focus on “unproductive bookings” such as:

- Bookings that have not been cancelled by a travel agency even after the airline has sent a message for the agency to do so,
- Bookings that are used for ticketing purposes only and do not affect airline inventory but still result in paying a fee to the GDS,
- Waitlist bookings that have not been cancelled by the airline or the travel agency.

These bookings must be cancelled by the travel agency at least 24 hours prior to the flight to avoid charges. Each GDS has procedures to work with participating airlines to remedy situations where agencies make fraudulent or improper use of the system. Two recent Sabre Airline Solutions clients actually turned off waitlist functionality, resulting in more than US\$1 million annual savings each. Such action is justified because booking curves are very short, and if the revenue management teams are performing their responsibilities, the need for waitlists is greatly diminished.

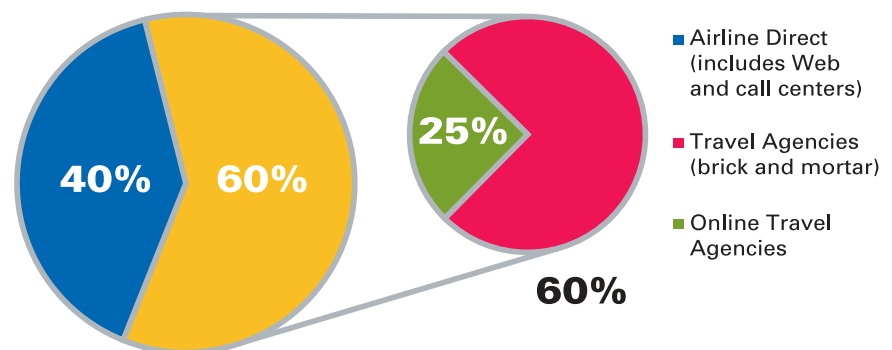
Many of these same principles apply in a hosted environment. An airline may be charged for either message traffic, reservations made or passengers boarded. In the case of reservations made, an airline should cancel as many unproductive bookings as possible prior to a flight. The 24-hour rule does not usually apply here, as is the case with GDS bookings.

### Availability Status Messages

Another area where airlines can

reduce distribution costs is availability status messages, or AVS messages. These messages are transmitted to the GDSs and other airline host systems to indicate whether a particular booking class of service is open or closed. An airline must establish an agreement with each system to which it wants to send AVS messages. Several types of agreements are available to avoid sending unnecessary messages. Unless the airline has direct connections to another system, the messages usually pass through a “clearing house” hosted

### Airline Distribution in North America



In North America today, 40 percent of all bookings are made directly with airlines. Of the remaining 60 percent of trips booked through travel agents, a fourth are made through online agencies.



by either SITA or Arinc, for which the airline is charged a per-message fee. In an attempt to achieve "last seat availability," airlines often set their inventory open/close thresholds too low and send large volumes of messages without realizing the potential costs involved.

Of course, for many airlines that participate at the highest levels of availability in the GDSs, AVS messaging is largely unnecessary and is only used as a back-up mechanism. Unfortunately, airlines often forget to change their agreements when they move to higher, more reliable levels of participation in the GDSs. One U.S.-based carrier recently modified all of its AVS agreements, yielding millions of dollars worth of savings.

### Web Transactions

Studies have demonstrated that Web site traffic creates substantially escalated numbers of transactions to the airline host system. Although Web-based travel agencies are working to rectify this issue, an airline should speak with the agency to adjust the volume of hits, based on technology available to the online agency.

For the airline's own Web site, which more than likely links directly to its host,

the airline should consider options such as caching availability for the most requested city pairs or limiting the number and types of transactions that can be performed from the site. These options must be implemented with care in order to avoid the perception that the airline is not providing the best options to its customers.


### Commissions and Incentives

Carriers with a presence in the United States have mostly eliminated travel agency commissions, resulting in lower overall distribution costs via this channel. However, in lieu of commissions, some carriers pay volume- or revenue-based incentives to agencies. The structure of the incentive program must be tightly controlled and integrated across all segments of the airline's indirect suppliers, such as consolidators, tour operators and corporate accounts.

### Sales Office and Call Center Efficiency

To serve customers better, airlines allow callers to book with its call center and receive their tickets via a travel

agency. Where ticketless or electronic ticketing is common, this practice can be eliminated. Where paper tickets are widely used, the practice can lead to higher distribution costs as the agency may have to make a "passive booking" in order to ticket the airline-originated booking. GDSs offer remedies for this with tools that allow the agency to "claim" the airline-originated booking from the carrier's host system. Using this technology, the airline avoids the cost of the passive booking.

As new channels of distribution emerge, it is paramount that an airline understands the costs and revenue ramifications associated with them. Only by understanding these issues can an airline successfully control its distribution costs. Through the *Sabre® Global Distribution System*, Travelocity and GetThere, a corporate online booking tool, Sabre Holdings provides an integrated offering for distributing through every channel and can assist airlines with managing the costs of distributing their product. 

*Stan Boyer is a director with Sabre Airline Solutions Consulting.*

## THE HIGH • LEVEL view

## News Briefs from Around the Globe

### Who

US Airways

### What

Selected Travelocity to be the exclusive distributor of hotels, car rentals and last-minute deals on its Web site, [www.usairways.com](http://www.usairways.com).

### Why

Hotel inventory provided by Travelocity to [usairways.com](http://usairways.com) will feature the entire complement of Travelocity's offerings, including guaranteed low-priced "Good Buy" rates. The same is true for car rentals and last-minute deals.

"Travelocity has forged a

reputation as being very supplier friendly, and we are looking forward to a mutually beneficial relationship with this industry veteran moving forward," said Steven Tracas, US Airways vice president of sales and marketing. "I'm confident our passengers will notice the added savings and convenience of booking their entire trip on [usairways.com](http://usairways.com) immediately." 