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A Conversation With...

Giovanni Bisignani
director general and CEO
International Air Transport Association

page 38

INSIDE

6

g overnment regulations
affect globalization

42

I atin American carriers
grow regionally

50

AirAsia overcomes challenges
to its t hai-based subsidiary

From Distribution to Merchandising With ...

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The Full Costs of Airline Distribution

As airlines examine the full costs of online distribution, more are seeing the benefits of the high-yielding GDS channel.

Business models change and evolve. Take the business relationship between traditional airlines and their new entrant counterparts. Traditional airlines have historically had an interdependent relationship with global distribution systems. During the last few years, these airlines have also considered GDS distribution as a transactional expense to be avoided with vigor. Contrast these airlines with the value-focused or low-cost airlines that built their business models with very little GDS reliance. In somewhat of a reversal of thinking, these airlines are reconsidering the benefits of a multi-channel sales strategy that includes GDSs.

David Neelman, chief executive officer of jetBlue Airways, recently said his airline is “looking seriously” at participating in GDSs. At the Merrill Lynch Global Transportation Conference in June, Neeleman said jetBlue was missing out on business by not being in corporate travel departments’ booking systems. He acknowledged that when jetBlue participated in the Sabre® global distribution system, which it reentered in August, the average fares booked through the GDS were higher than those booked directly with the airline.

Why the Change in Thinking?

What these airlines and others have realized is that the GDSs have also evolved, fueled by:

- Changes in ownership structure,
- Significant investments in open-systems technology,
- Deregulation in previously regulated markets.

Airlines can now leverage the GDS to add value to their businesses beyond traditional distribution models. Factor in the value of real-time point-of-sale information and decision-support tools that GDSs have been developing, and it becomes clearer as to why many of the most innovative airlines are revisiting the value that the GDS can create for them.

To understand the change in thinking, we need to dig deeper than the high-level sound bites quoted in the media that talk about higher fares and convenience. But what does that really mean?

Higher Fares Through the GDS?

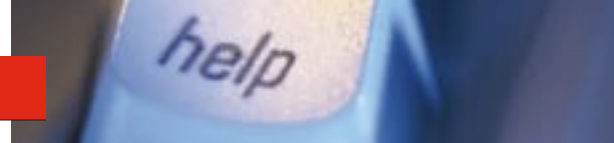
GDSs produce higher average fares, with yield premium of up to 20 percent, compared to airlines’ own direct channels. What is elusive about this statement is in the understanding of how. There are a multitude of contributing factors, but three key ones include:

- Because it is their core business, GDSs have invested in developing technology and support models required to make booking the airline product convenient and efficient for customers who exhibit a propensity to purchase higher average fares.



After pulling out of all global distribution systems, jetBlue in August reentered both the Sabre global distribution system and the Galileo GDS. David Neelman, jetBlue chief executive officer, said returning to GDSs would enable his airline to attract more corporate travel.

Photo by Stephane Beillard/AirTeamImages.com



“The airlines with the most advanced and arguably most successful direct Internet strategies are realizing that segments of online customer procurement can be expensive in many ways.”

- As a result of aggregating multi-channel global demand, GDSs have gained unique insight into understanding customer buying behavior, allowing them to ensure their investments meet optimal market needs.
- The high volume of aggregated demand is a meaningful factor in helping optimize an airline’s selling price. Low demand usually equals low price.

Today, most individual airlines cannot aggregate the same levels of demand or afford to invest in technology at the sustained levels required to meet the complete travel needs of the entire customer base.

It’s Also About Cost

Recent comments about the value of the GDS reveal a shifting perspective. The airlines with the most advanced and arguably most successful direct Internet strategies are realizing that segments of online customer procurement can be expensive in many ways. We have briefly discussed the lower average yields potentially arising from a primarily direct distribution strategy, but what other costs exist?

Consider almost all airlines are pursuing a direct-distribution strategy via their own Web sites. These airlines uniformly report that when they calculate all of the allocated costs

of development, support and infrastructure, their cost per booking is a fraction of the GDS booking fee. But one element of cost that is consistently absent from these discussions are the costs of search engine optimization. Any airline pursuing an Internet-direct strategy has to commit resources to this optimization to be successful.

An entire article could be written about this element of a direct Web site strategy, but for the purposes of this discussion, we will address one sub-component of search engine optimization: search engine advertising based on keyword search.

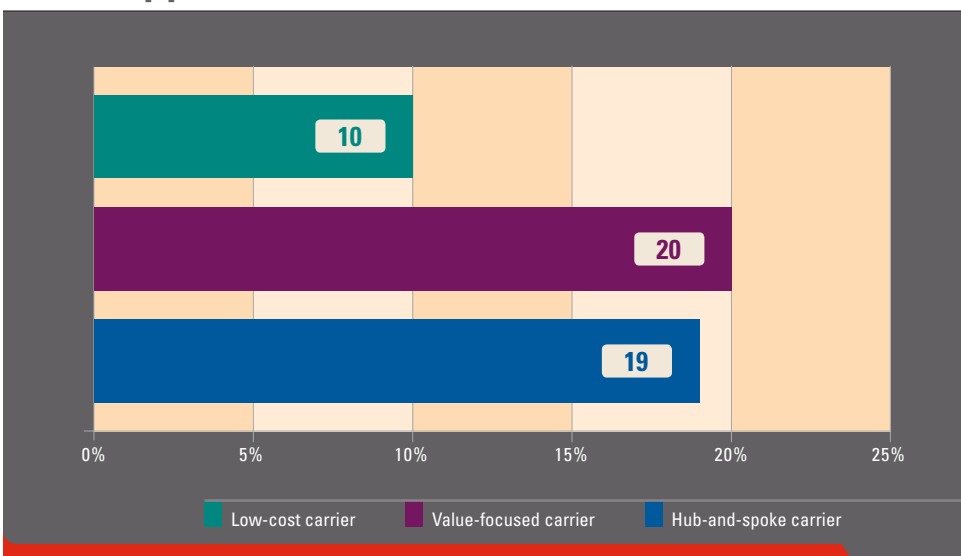
In this model, the Web site owner pays for the assurance of being included when an Internet shopper enters a specific keyword into the search engine. Since pricing is determined by a public, open bidding system, there is theoretically no limit to what a Web site owner would pay for the “right” keyword and top placement. The most successful models are employed by companies such as Yahoo! and Google.

Keyword search costs do not seem to get a lot of visibility in relationship to the overall cost of distribution. This is likely due to where the expense accountability resides within the airline organization. In some airlines, these expenses are bundled into their overall marketing and advertising spend, making it difficult to allocate to an expense per booking. In other airlines, it resides in their interactive marketing expenses and is often given a fixed budget amount. Today’s reality is that a small percentage of airline bookings are actually acquired as a result of keyword searches, so the cost-per-booking impact is relatively small when averaged across all direct bookings.

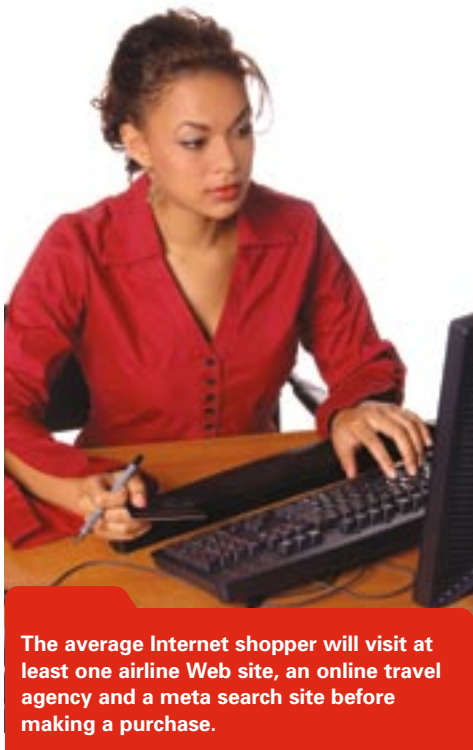
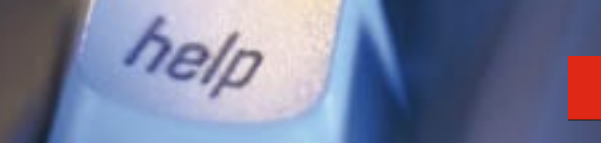
What’s the Point?

For most airlines, the expense is manageable today, but there are potential implications for the future.

Average Yield Premium of GDS Agencies vs. Supplier Direct



Global distribution systems have invested in developing technology and support models necessary to make booking the airline product convenient. It is the most efficient distribution channel, with yield premiums of up to 20 percent compared to an airline’s own direct channels.



The average Internet shopper will visit at least one airline Web site, an online travel agency and a meta search site before making a purchase.

Photo by Bobby Deal/Dreamstime.com



Photo by Dreamstime.com



Photo by Dreamstime.com



Photo by Ingvold Kaldhusaer/Dreamstime.com

Looking at recently observed samples of airline keyword search bid prices ranging from a low of US\$0.30 to a high of US\$2.01, some interesting analysis emerges. These bid prices mean that an airline would be charged rates somewhere in that range every time an Internet shopper clicked on one of the airline's keywords.

Our analysis of click-through rates shows an average conversion rate into actual bookings of 3.37 percent, meaning a booking acquired in this manner could cost an airline between US\$8.90 and US\$59.64 per booking — a lot steeper than the average booking fee from a GDS.

The airline response to this is usually — and on the surface rightly so — that the expense is justified since it helps them build direct relationships with potentially loyal repeat customers in the belief that this customer acquisition cost goes down over time.

For that to be true, Internet shoppers would have to be airline or site loyal and somewhat price insensitive, and airlines would have to invest in having the best site usability in the industry. Current industry research indicates that only a very small percentage of airlines and consumers validate these criteria.

According to PhoCusWright, an independent travel, tourism and hospitality research firm, the average consumer shops between three and four Web sites before making a purchase decision.

What is conceivably happening is that airlines are spending up to five times the average GDS booking fee to attract a consumer

who will likely buy their cheapest fare. The next time this consumer purchases — if there is a next time — he or she will probably need to be reacquired at a similar expense. Today, that is on a small percentage of airline bookings, but in the future this expense exposure will surely grow.

Another perspective is that some airlines cap their keyword search expense through a fixed budget. What is the impact of that fixed cap? What happens to Web site generated demand and unique visitors? What is the value of lost sales because the airline wasn't included in the shoppers' search after the keyword search budget was spent?

An airline may consider a best-case scenario in which the consumer bypasses search engines to directly access multiple airline and agency sites to shop and possibly purchase the inventory.

This last point highlights another potentially hidden cost — the expense of the shopping request itself. Customer shopping activity on Web channels is much less productive than comparable shopping activity by professional travel agents through a GDS.

Low-fare search and city-pair availability transactions are two of the largest transactional expenses for computer reservations systems. By moving a larger percentage of a carrier's distribution into Web channels, its look-to-book ratio will increase, and increases in low-fare and availability transactional expenses should be expected.

Data from AGIFORS revenue and yield management study group in June 2003

predicted 60 percent increase in availability requests during a four-year period.

Four years ago, agencies had a 82.4 percent share of the market with a look-to-book ratio of 12. Combining the agency figures with an online share of 17.6 percent with its look-to-book ratio of 200 resulted in an overall look-to-book ratio of 45.1 for every booking.

This year, as the online share is estimated to reach 32 percent, the overall look-to-book ratio will increase to 72.2. And that rate will continue to climb as online market share grows.

What will the next four years bring in terms of growth when you consider the increased use of online robotics and meta-search engines such as Kayak and Mobissimo? Taking a cue from PhoCusWright, we can reasonably expect the average Internet shopper to shop at least one airline Web site, one online travel agency and possibly a meta search site with no qualification on the number of redundant requests made. Shopping volumes will continue to increase in absolute volume and in transaction complexity. GDSs are built to manage these types of volumes in a cost-effective, efficient manner. On the airline side, there is potentially a large cost burden looming, and we haven't even discussed the impact on availability errors of these increased airline direct shopping volumes.

The GDS as a Marketing Tool?

The GDS has moved beyond just distribution into providing advanced marketing tools. One area that airlines can now leverage

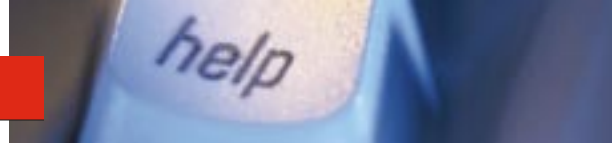


Photo by Renee Lee/Stockphoto.com



Photo by Mark Vull/Shutterstock.com

To retain online shoppers, airlines need to invest in having the best site usability, often leading to a higher cost of making a sale than that of a traditional global distribution system.

is the significant investment that GDSs have made in providing visibility into real-time shopping and purchasing behaviors. By muting the breadth of GDS distribution, some airlines are losing some of this visibility. Certainly these airlines get data on the purchasing propensities within their own inventory and flight schedule, but they lose visibility into how their product is shopped versus competitors. This can lead to “blind spots” in pricing and inventory management decision making.

Airline executives who are rethinking their distribution and sales strategies recognize some or all of the direct strategy considerations and are beginning to leverage the

expanded marketing and sales capabilities of GDS distribution in new ways.

Recently, a North American airline was struggling to penetrate the corporate market. By connecting to the efficient *Sabre* GDS, it immediately was able to expose its inventory to corporations on a global basis. The *Sabre* GDS is an integrated component of many of the world’s largest corporate travel departments and corporate travel management firms. Additionally, this airline utilized decision-support tools from the *Sabre Holdings*® business that enabled it to put targeted offerings — above and beyond its full content commitment — in front of specific cor-

porate sales outlets, resulting in more than a 9 percent improvement in load factor on targeted routes.

GDSs continue to offer the core value they always have; combining that foundation with changes in regulation, investment in open-systems technology and new market-driven tools, many airlines are seeing GDSs in a new light. These airlines are partnering with GDSs to create new sales and marketing opportunities in ways that were not possible in the past. **F**

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+count it up

26

Average percentage of tax paid on a US\$200 ticket in the United States, the same rate taxed for alcohol and tobacco, costing airlines US\$15.8 billion.

441 billion

The amount of expenses in U.S. dollars the world’s airlines incurred during the first half of 2006, a US\$32 billion increase from the previous year.

10

The amount in U.S. dollars it costs to process a paper ticket versus the US\$1 it costs to process an electronic ticket. Members of the International Air Transport Association issued 315 million paper tickets during the past year.