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Chair of Tourism Management

WHICH FUTURE FOR THE AIRLINE DISTRIBUTION?

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Background

Airline distribution has a set of peculiarities that not only make it a very interesting case to study but also make quite inappropriate to apply extensively best practices and categories coming from other industries without understanding first actors, relationships and trends of this particular environment.

Specifically, airline distribution can be considered as the first “e-commerce” network ever realised. While it used to be one of the most innovative industries with regards of distribution technology and commercial practice, recently the airline and travel distribution seems to be in strong need for innovation. This is hampered by the fact that many consolidated practices and the fragmentation of many parts of the travel chain make really difficult to innovate.

Tnooz, a specialised source of information for the travel world, cites that nearly 60% of airline distribution is carried through indirect channels leaving a remarkable 40% to be sold through direct channels. If this from one side makes airlines one of the industries where the e-commerce is more widespread, on the other it means that fragmentation is a reality, as it can be observed in figure 1.

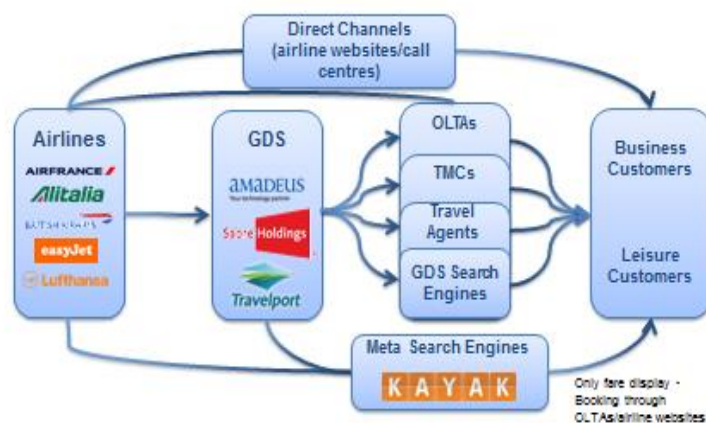


Figure 1. The airline distribution AS IS

Many actors operate between airlines and final customers: Global Distribution Systems (GDS) that are the technology distributors of the airline content in the indirect channels, online and off-line travel agents as well as travel management companies (TMC) that manage corporate business travel. Other than these ones, new technology players such as the meta-search engines have joined the marketplace by re-aggregating the fragmented content and make it easily available to the final customers.

Objectives and structure of the research

This work has the ambition to provide a comprehensive overview of the future scenarios that could shape the airline distribution in the coming years.

In order to accomplish this demanding objective, in the first place a historical analysis of the airline distribution, contained in chapter 1, has been carried out. By investigating the importance that distribution had in the airline development and by reconstructing the evolution of the distribution mix over time, some important trends and facts have been found and used to forecast the future of airline distribution. Several sources have been investigated and when possible data analysis on primary sources has been conducted.

After presenting the main events that shaped the airline distribution in the last 60 years, an in-depth analysis of the current travel distribution chain permitted to reveal the main actors, relationships and trends that characterise this environment. Furthermore, pro and cons of each channels from both the airline and the customers' perspective have been compared. The second chapter concludes that a change is needed as airlines, customers and intermediaries are simultaneously unsatisfied by the status quo and a change is needed.

Building on this assumption, the third chapter deeply investigated the future distribution possibilities. To construct the model, it was necessary to map the forces that shape and will shape the entire travel distribution environment (see Figure 2) This allowed to challenge the feasibility, benefits and cons of each proposed alternative model against the current distribution model.

To derive a final answer on the topic, each of the possible models of distribution have been regrouped in a flowchart (see Figure 3). In fact the future of the airline distribution depends by the degree of implementation of some key industry-wide projects. The feasibility of each of the scenarios outcomes as well as the relationships between the different events and projects have been analysed.

A separate analysis has been then carried out in order to explore the innovative possibility of seeing airlines evolving to become the one stop-shop for travel. Starting from the views of some industry reports, the feasibility and the potential of such kind of initiatives have been discussed.

A second part of the analysis takes the airline carrier perspective and aims to find the optimal distribution mix for each type of airline. As it has been realised from this research that much

effort is still needed to align network strategies with the commercial and distribution ones, recommendations have been provided for both network carriers, regional and low-cost carriers.

Moreover in the remainder of the chapter, it is suggested a new commercial process for airlines that aims to maximise the profitability by allowing for greater integration between airlines departments.

Finally, the conclusions provide a final answer on how the airline distribution will plausibly evolve and how airlines can achieve greater profitability by harmonising their distribution policies with their strategies in a fast pacing market.

Methodology

To support the conclusions different analyses and literature reviews have been carried out. Several carefully selected industry resources and reports have been examined as well as the most recent press releases from specialised reviews and websites and some of the most authoritative books on this topic. Outside industry-related materials, some consulting documents and other industries resources have been scrutinised with the aim of providing recommendations supported by applicable other industries best-practices. When possible basic data and regression analyses have been executed, especially to determine the past trends of the distribution main variables and to find any relevant relationships between them.

This thesis has been conducted under the guidance of Professor Fabio Daniele Lazzerini, former Managing Director at Amadeus Italy and Enrico Bertoldo, Head of Operations at Amadeus Italy. In particular, interviews conducted with Mr. Enrico Bertoldo have been critical to give a practitioner's perspective to this work, by helping the author to enlighten airline distribution trends with the support of some useful information and opinions that would be otherwise impossible to find in any publicly available source of information.

Furthermore informal talks with two managers from two different leading European airlines, a low-cost carrier and a legacy airline, have been extremely useful to "taste the ground" over possible evolutions of the airline distribution environment and to confirm some assumptions made on the airlines' commercial process.

Finally, the author direct experience on the field, matured through the participation to an e-commerce research project jointly organised by Alitalia, the Dutch Embassy and the LUISS University and through working experience in the London office of one of the world's leading aviation consulting firms, has proven to be profitable to further calibrate the assumptions and the findings with the help of a more realistic vision of the airline business.

Findings

This thesis has first closely examined the historical role of distribution for the airlines and their markets, as well as the present situation's challenges. The research revealed that the airline distribution has come to a crucial point of its life, where change is needed as the current status quo hardly satisfies any customers, traditional and low-cost airlines, GDS, traditional and online travel agents.

Globally considered the airline (and the travel) distribution seems to not satisfy anyone of the actors involved. Leisure customers complain the difficulty in making travel arrangements that are aligned to their preferences and budgets and business customers pretend to have better transparency on the total cost of airline bookings and to seamlessly book ancillaries and other travel products through dedicated tools. Airlines are frustrated by the cost of distribution and by the fact to not being able to differentiate themselves in the indirect channels, while in the other side travel agents don't like the attempt of the airlines to go direct and to reduce the provision of commissions. In this rapidly evolving world, GDSs are threatened by the rise of direct channels and by the possibility that direct connect methods replace themselves.

It is then without surprise that the entire travel distribution chain is then characterised by the coexistence of "unhealthy" relationships among their actors that makes really hard to innovate harmoniously to ultimately meet the evolving customers' needs globally. The travel industry is probably one of the few industries where the relation suppliers-intermediaries-customers is "broken" and where it's very difficult to work together towards the common objective of increasing bookings volume and value by ultimately satisfying the customer.

It goes without saying that the airline distribution needs a change. Executives of both airlines, GDSs and travel agencies all envision a change. The question is whatever this change will be achievable and how much time will be needed. Nevertheless the simultaneous presence of aligned needs makes the change more achievable. In particular, it can be

observed that the need for personalisation of the travel experience coupled with comparability capability matches the needs of the airline carriers to offer their ancillaries services and to provide more information about their services in the indirect channels. This coexistence of these needs could be of fundamental importance to speed up the development of a “revised” distribution model that could “morph into commerce”.

The analysis of historical and the current trends has identified that:

- Legacy airlines, traditionally highly reliant on indirect channels, are keen to reduce the costs involved in distribution by switching to direct channels as much as they can and by negotiating lower fees with GDS.
- Low cost carriers either stick to a pure direct distribution model or, as a great part of them are adopting some peculiarities of the network carriers, they are commencing to distribute through indirect channels to intercept high-yield business customers. They are also starting to join global alliances, which means that at least for the short term they will need to use GDS.
- The rate at which these changes are happening depends also by the region. Western carriers are the leaders of the disintermediation processes while Asian and rest of the world carriers will be expected to remain bounded to indirect distribution for more time as the internet penetration doesn't allow to achieve a predominance of direct distribution in a short period of time.
- GDS have realised that they will not enjoy the monopoly they had in the former years and on one side are trying to retain their role as gateway to business customers and on the other side they are diversifying extensively their business by focusing on the provision of IT systems for airlines and travel actors that also comprehends modules used to manage airlines' direct channels.
- Recent studies, such as PhocusWright's reports, have shown that the switch to direct distribution has stalled. Now the airlines have realized they cannot grow their direct distribution further without increasing the cost of distribution, thus they need to find a new way to distribute their products.
- In the travel intermediaries' environment, there are two different situations: online travel agents are experiencing high growth while bricks and mortar travel agents are going to consolidate or to change their business model to niche or business travel agents.

- Customers are demanding more personalisation, comparability and transparency. New mobile channels are growing as they are increasingly preferred by customers. As the whole travel industry chain is now more than ever motivated to adopt a customer-centred approach, meaning that customer needs and wants will be one of the main determinants of airline distribution evolution.
- New entrants like Google, Amazon or Facebook have already entered or may consider to enter this market as they have the resources, competences and the fit to occupy a primary role in the travel distribution as this becomes more and more digital all over the world. These big players are not the only ones that are joining the market: many small online-based b2c or b2b firms are entering the market, providing valuable alternatives to the GDS and other traditional distribution actors.
- The legal and the general environment forces have always played an important role in the airline distribution, since the first deregulation in US was enforced. For this competition rules all over the world can play an important role while deciding which shape the new distribution will take in the next years.

All these forces have been mapped to constitute a base on which build the different scenarios. An overview of these can be appreciated in the figure below.

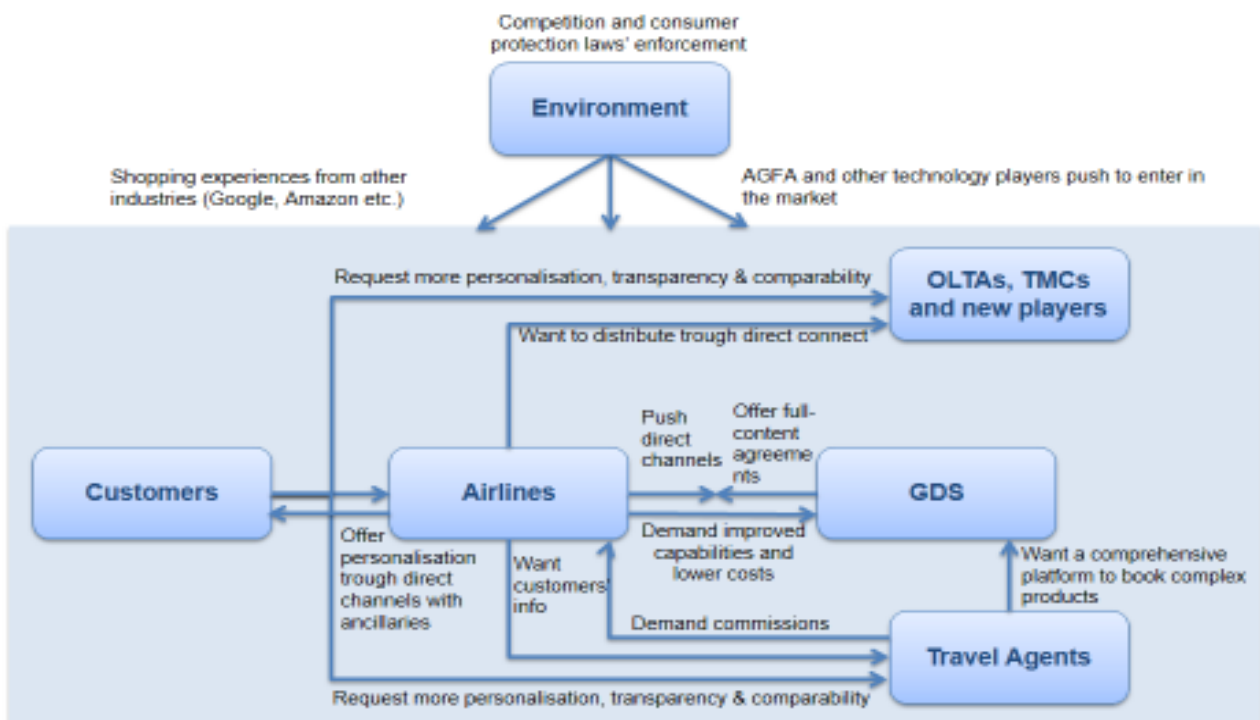


Figure 2. The forces that will shape the future airline distribution model

As it can be noted, trends are sufficiently clear. There are a number of forces, sometimes converging sometimes diverging, that are likely to shape the airline distribution in the future. This comprehends the disintermediation, fuelled by airlines pressure to reduce costs involved in distribution as well by airlines' need to better control distribution and to better respond to customers' arising need for personalisation. On the other side, the "hybridisation" of some low-cost carriers as well as the strong customers' need to compare different offerings act as a counterbalance. Also GDS full-content agreements seemed to be efficient ways to slow down the inevitable growth of direct channels.

What is less clear it's to determine how the airline distribution will appear in the medium and long-term and when exactly change will happen. Several alternative proposals from authoritative institutions documents have been scrutinised and from interviews with experts and from a careful consideration of the pro, cons and feasibility, the most extreme positions sustained by an IATA-commissioned report and from some airlines can be easily labelled as unrealistic, at least in the short term. In particular, the value-creation hubs proposal (VCH), which sees the airlines' alliance to take up, in a few years the GDS role almost completely, can be rejected purely on the basis of the high investment costs and coordination efforts that this project requires.

More in general, this research concluded that any model that completely or almost excludes GDS from the distribution environment in the next five years can be rejected. This is also because most of the world's large airlines have signed full-content agreements that basically oblige them to make available all their content through the GDS.

However, the IATA New Distribution Capability¹, innovations in the commissions' model, the entrants of new players in the market and even the VCH model can have chances to be realised and to change drastically the distribution environment.

In definitive, the answer about which distribution model will prevail in the future depends by a considerable number of variables which can be grouped in these three main categories:

- **The level of integration of the industry to successfully perform industry-wide changes, such as the IATA New Distribution Capability**
- **The ability of GDS to continue to be the only viable gateway to reach business customers, other high yield markets and overseas markets**

¹ A collaborative industry initiative to build an open Internet-based data exchange standard to allow more personalisation in the indirect distribution channels.

- **The reaction of the other actors to any subsequent industry-wide changes in the airline distribution** such as the implementation of any direct connect distribution service after the IATA NDC is implemented.

The different scenarios that can arise from the different combination of the three factors above have been explained extensively in the thesis and summarised in the figure below.

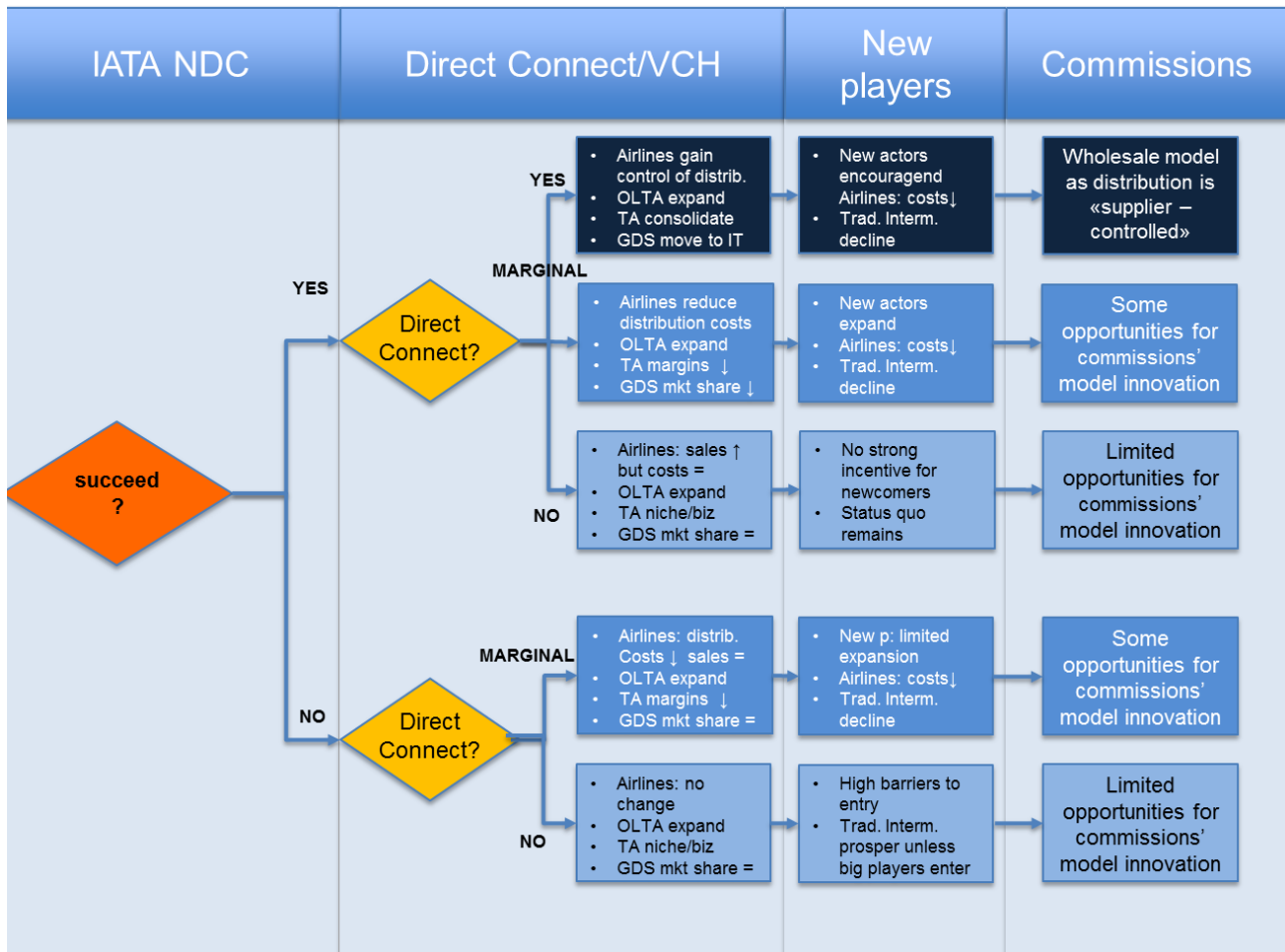


Figure 3. The possible future scenarios of the airline distribution

Basically for the first 5 years, a relative stable phase has been forecasted, where industry players can converge or not converge towards the realisation of the IATA NDC. If this happens, there could be three scenarios based on the level of implementation of any direct-connect initiatives, which the industry executives think IATA NDC can facilitate.

If the direct connect or the VCH model is fully realised, airlines will be fully in control of the distribution, GDS will be really marginal actors, new players are strongly incentives to enter the market and commissions can be revolutionised. While airlines could be strongly

incentivized to make it happen, this scenario seems to be unlikely to materialise, at least in the short term.

Much more likely is the scenario where NDC is realised and direct connect is in place but it doesn't comprehend all airlines. In this case, airlines reduce distribution costs, achieve better yields and revenues and GDS still exist and still represent an important cornerstone. This scenario is still of interest for new players and could represent a serious treat for the incumbents. Also the different balance of powers could allow for the emergence of a different commissions' model.

If the IATA NDC materialises but the direct connect model fails to emerge, airlines can still benefit from a better quality level of their sales channels but it is likely that there will not be dramatic changes in their distribution costs. Instead it could be reasonably expected that airlines will use the NDC argument to negotiate further discounts to the GDS but the value of these will not probably be more pronounced than the discounts applied today when a new participating carriers' agreement is negotiated.

There is also a not remote possibility that IATA NDC project stalls and the distribution infrastructure remains unvaried. In this case the innovation towards the new standards will be carried independently by the different GDS and by the new technological players like Farelogix that will create alternative ways of distributing airline content.

What will effectively change in this case, will again depend by the level of implementation of any direct connect initiative. In any case the maximum attainable level of GDS bypass will be for sure lower.

Looking at the micro-level, most airlines have still chances to generate greater value from the existing distribution channels without committing themselves in dramatic industry-wide changes. Some respected consultants and industry commentators that can benefit from a wider perspective of the aviation industry than a certain number of airlines executives, remarked that many airlines are not generating the whole potential that could be achieved from their assets because of organisational problems.

Interviews with industry experts and some industry reports have enlightened that in some cases:

- Network, revenue management, pricing and sales & distribution decision are taken unilaterally by their respective department leading to sub-optimisation of the results.

- Airlines tend to focus too much on the cost of distribution rather than considering the net sales and the relative yields coming from the different channels.
- Airline distribution decisions are not aligned with the airline strategy and business model.

In order to let airlines to fully benefit from their existing channels and in order to guide them towards the best-practices of distribution management, different distribution mix have been suggested for each type of airline and a revised commercial process has been recommended.

Concerning the alignment of the distribution model with the airline business strategy, based on historical performance it has been concluded that only low cost carriers and network carriers that have global networks and global brands (such as Emirates) can reasonably expect to achieve a greater part of their sales through direct channels. Other network carriers have instead to ponder carefully their distribution mix by carefully analyse the situation before embarking themselves in radical direct-based distribution projects. In particular, literature reviews and interviews with experts have evidenced that network carriers should:

- Attract the greatest number of home market passenger to their direct channels, in order to reduce their distribution costs.
- Open international and intercontinental routes only if they have in place or they can easily build in a short time a distribution strategy that ensures satisfactory yields for both inbound and outbound traffic.
- Collaborate with GDS and other travel intermediaries to achieve a better control of the content, higher yields and ancillary revenues streams.

Even if it varies on a case by case basis, regional airlines will continue (for at least the next few years) to be heavily reliant on indirect channels especially for connecting passengers, while hybrid low costs will need to be rethink some part of their processes and organisation in general to profitably enter in the indirect channels circuits.

As to what concerns the airline commercial process, the keyword is integration. Many aviation consultants and airline executives claim that only by allowing better cross-departmental communication, data integration and continuous adjustments of the plans with all the main departments of the commercial function, better results can be achieved .