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Take a Trip into the Future

Technology-based Business Innovation in a Changing Global
Travel Distribution Market

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Fundamental Change in the Global Travel Market

Few established sectors of the global economy have felt the impact of the Internet more than travel and tourism. People have become accustomed to booking airline tickets online and are starting to self-book entire travel itineraries. The number of people who consult online customer reviews and check travel blogs before making their buying decision has increased significantly over the past years. At the same time, brand loyalty has fallen quickly—leading to an ever increasing fight for the end-consumer by all players in the global travel distribution market. Still, traditional retail travel agents and tour operators account for the majority of sales, but new online travel agencies (OLTA),

such as Priceline, Travelocity, Expedia, and Opodo, continue to grow fast and are gaining market share (see Exhibit 1).

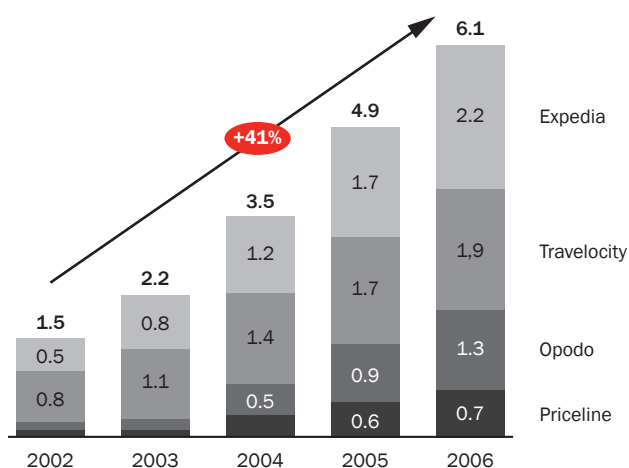
There are many examples of these fundamental changes in the travel industry as they affect all relevant players from travel suppliers (such as airlines, hotels, and railways) to travel intermediaries (such as consolidators, tour operators, and global distribution systems) up to the travel agents.

Particularly travel intermediaries need to adapt their business models to these changes in travel distribution. This viewpoint outlines the levers travel intermediaries have to pull to successfully compete in the changing world of travel distribution.

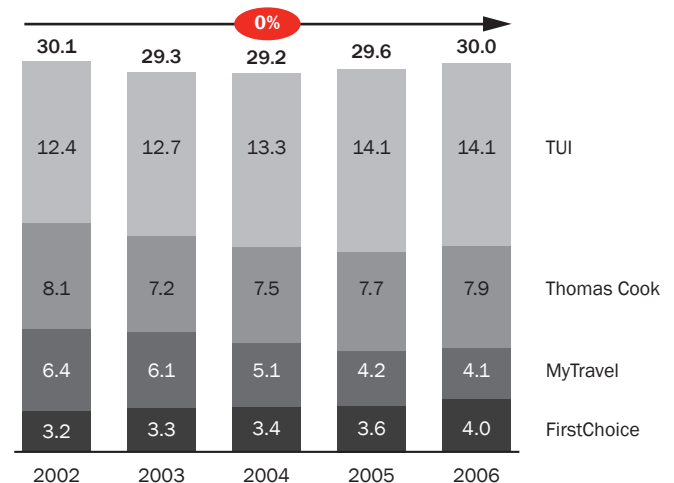
Exhibit 1

Growth Trends for Different Players in the Travel Industry
(TC and TUI Pre-merger)

Revenue of 4 Largest European OLTAs (€bn)

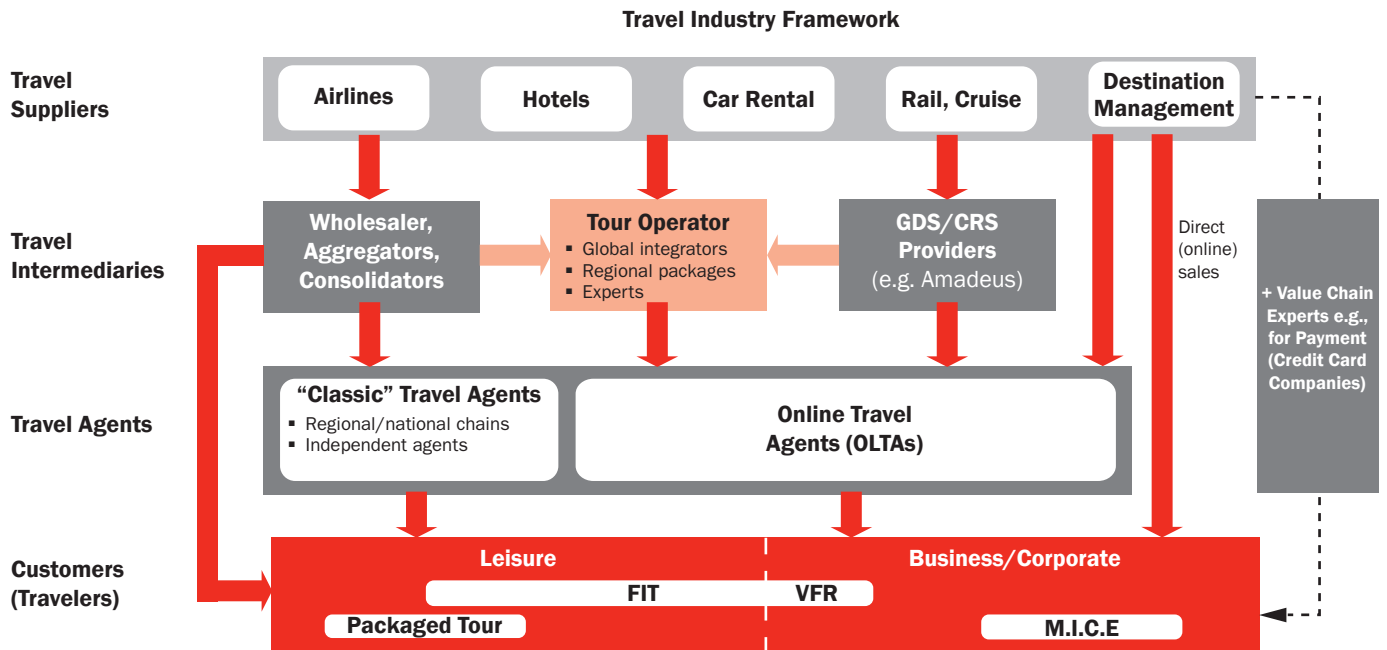


Revenue of 4 Largest European Tour Operators (€bn)



Source: Booz Allen Hamilton analysis at constant exchange rates

Exhibit 2
Travel Industry Value Chain



Source: Booz Allen Hamilton

Driving Forces Shaping the Travel Market in the Future

Changes in consumer behavior and new technology are the key forces driving fundamental changes in the structure and business model of travel distribution in the future.

Consumer demand is changing

There has been a significant change in how consumers shop for travel products and services. In the first place, there are changes in "macro" consumer behavior driven by new types of customer segments e.g., baby boomers, money-rich/time-poor travelers, families visiting relatives but no longer staying at the relatives' home. Leisure travelers are going more places, more frequently for short durations and require a much more flexible and customized travel product than the classic, pre-packaged 2-week holiday consisting of a charter flight and a hotel sold from a brochure in a travel shop.

It is also important to understand that many customers are not only looking for a different product but are using multiple sources of information for their travel planning. Customers want both expert advice and additional information like the increasingly customer-generated content on hotel rating websites, destina-

tion sites or price comparison engines. This creates a significant threat to travel intermediaries and suppliers since underperformance in price and service quality is fully transparent to all customers and can derail the slickest marketing campaign—the possibilities for disintermediation are enormous.

Technology drives business model innovation

Low-cost carriers, such as Ireland's Ryanair and JetBlue in the USA, and selected flag carriers like Lufthansa are moving aggressively into the tourism market using dynamic packaging systems to add hotel room and car rental suggestions to their flight bookings. Likewise, hotels are trying to extend their direct sales and service offerings to combine their vacant beds with flights. The travel agents' global distribution system (GDS) is being bypassed as airlines, hotels etc., build their own databases of preferred partners and direct channels to the customer's wallet to pass the distribution costs back in lower prices.

Online travel agents like Expedia and Opodo as well as consolidators and bed banks are operating an asset-light business model (i.e. they are not working with their own hotel, airline, or agency capacity) and generate per-head EBIT margins that are almost up to eight times higher than those of the classic tour

operators. The better per-head profit of OLTAs is not surprising—the online travel agencies have replaced time-consuming catalog production processes by online product combinations (dynamic packaging), are accessing a wide variety of inventory sources via the Internet and distribute direct to the consumer via the Internet without maintaining a costly retail sales network. These attractive numbers have drawn search engine giants such as Yahoo! and Google to the travel market, and their recent entry is set to further shake up an already volatile sector.

Travel intermediaries are consolidating

As a reaction to these changes, the travel distribution market has seen significant consolidation activity. In early 2000 the focus had been on vertical integration, with the large mass-market tour companies purchasing a controlling interest in a chain of retail travel agencies, or charter airlines, to control the distribution of their product. Now the trend appears to be turning towards consolidation through transnational horizontal mergers and acquisitions. This trend is driven by the current overcapacities in the market and aims at achieving margin improvements through economies of scale. The UK's Thomson Holidays is now a subsidiary of TUI and other examples of recent transactions are the mergers of Thomas Cook and MyTravel, TUI and FirstChoice, and Travelscene American Express by the Stella group.

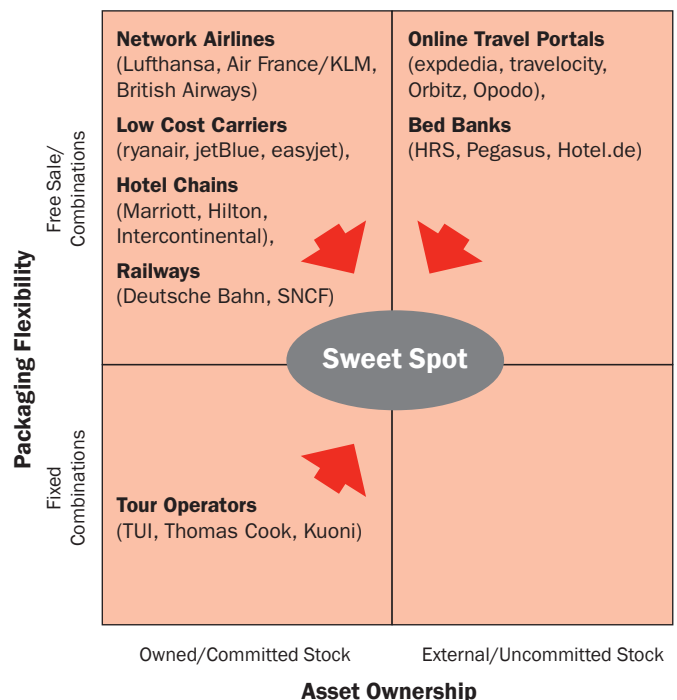
Cash-rich travel technology players are taking positions

Established, cash-rich players, such as the GDS providers like Amadeus and Sabre Holdings, are also active in the acquisition field as they foresee GDS fees slipping away. Amadeus, for example, has taken ownership of Opodo and Traveltainment to solidify its position in the growing European OLTA market; and Sabre has bought Travelocity to build a respective presence in the US and globally. In addition, Travelport—a \$2.7 bn company backed by the Blackstone Group—has built significant positions in travel distribution and technology by major acquisitions such as Galileo and Worldspan in the GDS space, Orbitz as a full-service online travel agency serving the direct-to-consumer and direct-to-business market, and GTA as an access provider of hotels, ground services, events and other destination services to travel agents and tour operators.

Business models are converging

These consolidation moves, however, are not addressing the fundamental questions around the future of travel distribution. The travel intermediaries need to redefine their roles vis a vis the customer and need to answer how they can establish a sustainable business model with attractive growth and margins in the future. Unfortunately, most players in the industry seem to be finding answers that appear to be highly similar, moving everyone into the same potential “sweet” spot (see Exhibit 3).

Exhibit 3
Converging Business Models in the Travel Industry



Source: Booz Allen Hamilton

- Classic tour operators coming from a history of selling pre-packaged, fixed-duration holidays based on pre-contracted inventories are aggressively building more flexible production models that allow dynamic packaging and pricing of travel products at the point of sale with improved online-front ends and are hence replicating elements of the successful OLTA model.
- Online travel agencies are refining their component-only or dynamic packaging model and are beginning to increase inventory risks by buying guaranteed hotel and airline capacity. At the same time, they cooperate with white-label tour operators

(e.g. Traveltainment) to bundle components into full-service travel packages. This allows them to meet demand and command premium prices in peak seasons, where travel demand has outgrown supply constantly over the past couple of years.

- Suppliers like airlines and hotel chains are increasingly selling directly to the customer, thus climbing the travel trade's value creation ladder. In this way, and by using tie-ups with the travel services of other providers, they are becoming travel intermediaries and even tour operators themselves.

New, Market-Driving Capabilities Are Required for Differentiation

With the convergence of business models, all players in the travel industry need to define how they will build and sustain a competitive advantage vis-à-vis their competitors in the future. Achievement of higher revenue growth and better margins will depend on the ability to build clearly differentiated capabilities and will center around building better consumer insight and sales capabilities while flexing the production model for travel services and deploying better capacity management to synchronize travel demand and travel supply.

Customers' needs when shopping for travel services

- Customers are looking for offers that are tailored to their specific travel requirements and interests (e.g., social needs, activity/relaxing, health) and that fit with their budget (luxury vs. low cost)—few Web sites are tailored to meet these different needs and interests.
- Customers want choice, price transparency and the flexibility to combine the features they're looking for. Ideally they want to find this in one place, reassured by the knowledge that they are not missing out on attractive options or bargains that might exist elsewhere. The current product offerings of travel intermediaries are not exhaustive and often do not provide the expected level of flexibility.

- Many travelers want to be consulted when making their travel decisions in a way that instills confidence that they are choosing the right travel product. Unlike business travel, holidays are important to families, for example, and buyers are thus careful not to spoil their quality time. Consumers punish over-promises in marketing and switch their travel agent—maybe forever!

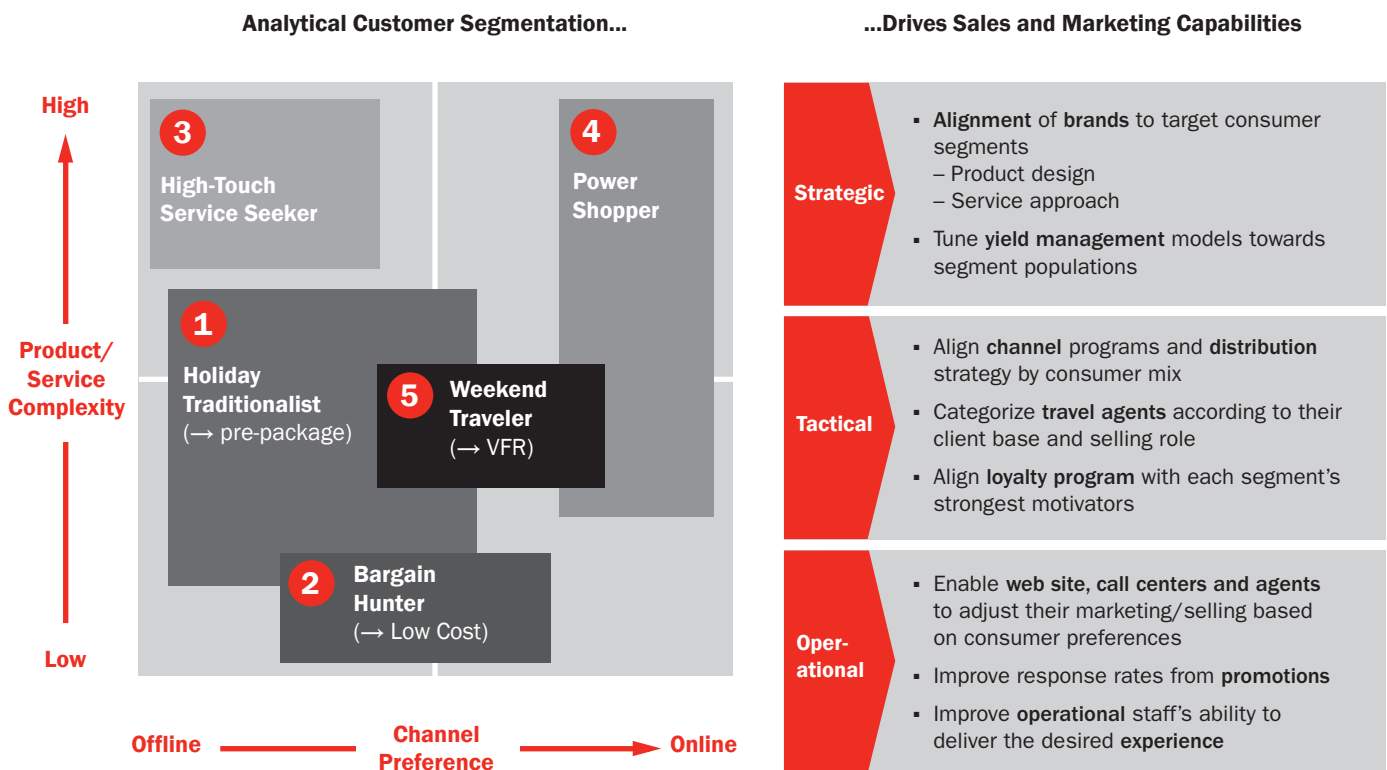
1. Build Better Consumer Insight and Sales Capabilities

Although the big players have invested millions of dollars in cutting edge websites, easy-to-use booking engines, and marketing data warehouses, today's online shopping experience for travelers is still not great. According to travel trade analysts IbisWorld, the Internet is still used primarily for simple bookings, such as point-to-point, short-haul flights or room-only accommodation.

In addition, many players in the travel industry know remarkably little about their customers and their specific buying preferences. Most industry players are still procurement and product centric, competing mostly on price with very little customization of their offering towards the different needs of individual consumer segments. The key to success in the travel industry lies, however, in building up much better consumer understanding and more sophisticated tailoring of product, service, and channel strategies against differentiated, well-defined consumer segments and their specific travel demands. Segmentation criteria need to be carefully chosen to address situational consumer needs, sales potential, operational complexity to serve, and profitability. This segmentation then drives the design and implementation of the required sales and marketing capabilities (see Exhibit 4).

Travel intermediaries and suppliers need to address these issues on the strategic, tactical, and operational levels. First of all, a clear alignment of brands to target customer segments is required in terms of product design, and a consistent service approach is needed from booking to fulfillment. Secondly, the channel and distribution strategy needs to be closely aligned to

Exhibit 4
Build Better Consumer Insights and Sales Capabilities



Source: Booz Allen Hamilton

the consumer mix to ensure that the available media and channel options are efficiently used to reach the target segment. And finally, on an operational level, websites, call centers, and agents need to adjust their marketing and selling techniques based on the defined consumer personalities.

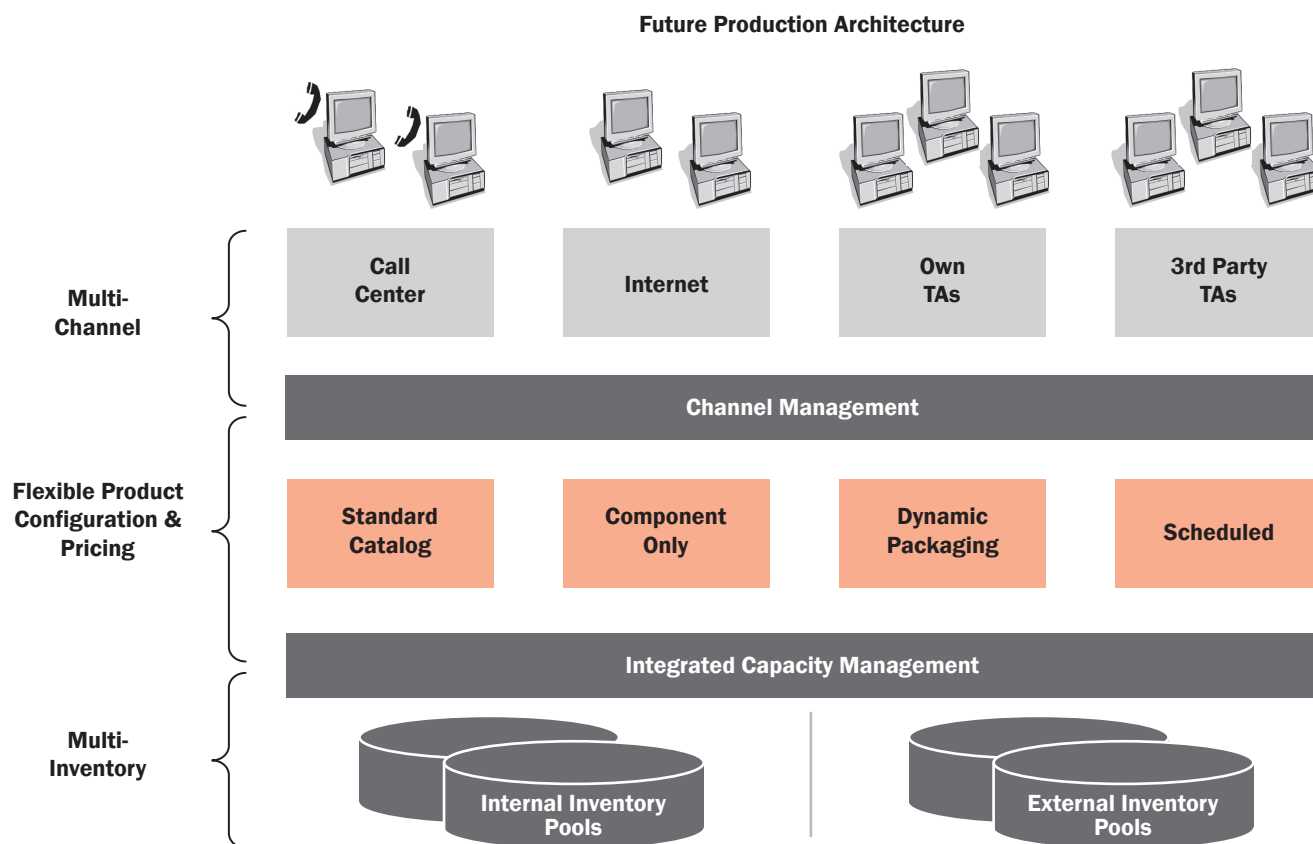
Information technology is the key enabler to build these new capabilities. The range of options spans database marketing to deployment of multi-channel IT architectures. In addition, the industry players have to improve the usability of their online presence by tailoring it to the different customer segments and making it available on mobile devices. Building interactive customer forums and content-rich websites with videos and 360-degree pictures is only the first step in this direction. Many travelers want to experience their vacation before they book it as part of their holiday experience and to avoid frustration in destination. Feedback from customers in the shape of forums should be harnessed to build interactive travel communities much like Web 2.0.

2. Deploy Flexible Production Models

Due to their different backgrounds, tour operators and online travel agents have a history of different business models operating along distinct production and fulfillment processes. As production models converge, online travel agents have to build tour operations capabilities further—either on their own or supported by contracting semi-anonymous “white-label” tour operators (like “VTours” in Germany). Meanwhile, tour operators and their associated wholesalers have to increase the flexibility of their current production and fulfillment processes.

The key criterion to making either of these production and fulfillment processes work is the flexible handling and packaging of multiple components from hundreds of inventory sources. These components have to be packaged and priced in real-time, and the customer must be steered towards finding his tailor-made solution. A key success factor is to have full flexibility in moving pre-contracted capacity across brands, channel, and destination and to source dynamically short

Exhibit 5
Multi-Channel, Multi-inventory Production architecture



Source: Booz Allen Hamilton

term to ensure the inventory can be sold to the highest paying customer at any time.

Based on this thinking, we believe the travel intermediaries (be they on- or offline) that excel will have dynamic procurement and production processes in place where the system will bundle all the elements of a holiday at the time of booking. Behind this booking engine, the company needs highly dynamic product configuration, pricing, procurement and inventory management processes in place to be able to react to customer requests and to hourly changing prices.

This should be backed up by robust management information available in real-time in order to steer this process. Of course, investing in modern IT infrastructures is a key prerequisite to realize these streamlined and more dynamic processes (see Exhibit 5).

3. Synchronize Demand and Supply Through Better Capacity Management

The business model of an OLTA, which is not sharing inventory risk with its suppliers, has clear limitations: The financial risk of ensuring that the perishable seat/bed is sold remains fully with the supplier. Therefore, suppliers have little loyalty and offer fewer price discounts to the online consolidator vis-à-vis traditional agents who block-book. Because suppliers further down the value chain will trade certainty for margin, airlines, hotels, and ground transportation companies will be less willing to supply OLTAs until they are willing and able to take inventory risk or guarantee sales to suppliers of perishable stock, particularly at low season. Wherever there is a bottleneck, such as attractive 4- and 5-star hotels in key holiday destinations, OLTAs will lose out.

Those intermediaries that are not willing to enter into inventory risk sharing agreements will be able to

offer availability and attractive prices in markets with overcapacities only. As flight capacities are likely to increase (driven by low-cost carriers) and as LCCs sell directly to customers, attractive bed stock, particularly at peak travel times, will become ever more scarce—which also shifts the current focus of yield and inventory management in Europe from managing flight risk to bed risk.

Entering inventory commitments is therefore a key business and margin driver, which requires the capabilities of managing the delicate balance between securing enough capacity at the lowest price on the one hand and risking price deterioration of aging inventories on the other. This requires intermediaries to have sophisticated capacity and yield management processes in place like airlines and large hotel chains.

Attempts to solve this profitability problem as a tour operator with more math have so far been unsuccessful because of the immense product and organizational complexity of travel intermediaries. Therefore, effective capacity and yield management requires travel intermediaries to build capabilities that allow them to make more educated and sound decisions when entering capacity commitments. This basically encompasses three main processes:

- Demand forecasting—Entering the right inventory commitments in the right destinations at the right point in time is still the 100 million dollar question for travel intermediaries. However, many players are still making such decisions more on gut-feel and experience basis rather than on a factual analysis of differentiated consumer needs, competitor strategies, and changing destination attractiveness. Deploying a well-structured, long-range demand forecasting process by destination will be a key necessity for travel intermediaries in the future.
- Pricing and yield management—In general, pricing and yield management processes currently deployed at travel intermediaries have significant shortcomings. Pricing schemes are to a large degree production driven and set months in advance of the actual sales period. Going forward, pricing changes will happen more frequently and will be based on a true understanding of consumer behavior and competitor moves. In that context,

travel intermediaries need to significantly ramp up their pricing and yield management capabilities with regard to processes, skills and tool support.

- Dynamic Sourcing—Travel intermediaries need to move from a static to a dynamic sourcing process. Product management and procurement need to be active in the destination markets on a permanent basis and contract new, promising inventory positions and divest inventories that are not selling as expected. This dynamic sourcing process can best be compared to a broker model which permanently buys and sells inventory based on clearly defined rules.

Summary

The travel distribution industry is undergoing unprecedented change. As different production models converge, the players in this industry face manifold challenges. Those companies between the travel supplier and the end customer—the intermediary—need to stay focused on customers' needs by serving the different customer segments with the right product and service offerings while investing in the customer interface, improving their pricing and yield management, and deploying streamlined and dynamic processes. But depending on their history and current situation, the challenges are also different for online travel agents, tour operators, and suppliers:

- Tour operators (e.g., TUI, Thomas Cook, Kuoni, First Choice, Liberty Travel) will have to flex their business models and build dynamic packaging and pricing capabilities. The inherent changes that come with this approach are significant and will require tour operators to build new processes and systems, and most important, re-skill their organizations in all areas from dynamic sourcing over packaging and pricing to distribution. To use a supply chain analogy, this is in essence a shift from a production-centric push model towards a consumer-centric pull model.
- To further grow in revenues and margin, online travel agents (e.g., Expedia, Priceline, Orbitz, Opodo and Travelocity) will have to broaden their revenue bases, take more inventory risk, and build capabilities to manage and package those inventories. This will probably require the OLTAs to enter into alli-

ances with key travel suppliers to secure the most attractive inventories for them. OLTAs need to move fast as the classic tour operators are catching up in building OLTA-like distribution and packaging capabilities. For example, Expedia and lastminute.com are already starting procurement of allotments with hoteliers in some travel destinations.

- Suppliers (e.g., airlines, hotel chains, railways, and car rental agencies) have to aggressively extend their direct sales channels to the consumer and use their strong brands to strengthen their core product and move into adjacent product categories. LCCs like EasyJet, JetBlue and Ryan Air; flag carriers; and also rail companies are driving the bundling of their flights/trains with hotel beds—but so far primarily in a retail model only. Suppliers have to make strategic decisions how to focus—whether to become full-fledged travel intermediaries or even tour operators themselves.

Making the right choices and investment decisions now is key. Players who will actively drive innovation

along their travel distribution value chain by leveraging the capabilities of new technologies will belong to the winners in this highly competitive market.

Realizing the Opportunity

From project work for major tour operators, online travel agents, airlines, cruise operators, and railway companies throughout the world, Booz Allen Hamilton has gained intensive insight and experience in the travel and tourism industry by supporting clients in all phases of their business model transformation from strategy to execution.

Booz Allen can help players in the travel industry develop strategies to win in this changing marketplace. We support our clients, shaping their future business models and processes, implementing new and differentiating capabilities in travel procurement, production, pricing, yield management and distribution. We are designing the required transformation program—on the business and IT sides—and support our clients during implementation and value capture.

What Booz Allen Hamilton Brings

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for more than 90 years. Providing consulting services in strategy, operations, organization and change, and information technology, Booz Allen is the one firm that helps clients solve their toughest problems, working by their side to help them achieve their missions. Booz Allen is committed to delivering results that endure.

With 19,000 employees on six continents, the firm generates annual sales of \$4 billion. Booz Allen has been

recognized as a consultant and an employer of choice. In 2007, for the third consecutive year, *Fortune* magazine named Booz Allen one of “The 100 Best Companies to Work For,” and for the past eight years, *Working Mother* has ranked the firm among its “100 Best Companies for Working Mothers.”

To learn more about the firm, visit the Booz Allen Web site at www.boozallen.com. To learn more about the best ideas in business, visit www.strategy-business.com, the Web site for *strategy+business*, a quarterly journal sponsored by Booz Allen.

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