TRAVEL TECHNOLOGY RESEARCH
FIRST VIEW

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T2RL'S First View is our rapid analysis of breaking news. It helps provide perspective, putting the facts in the context of our wider and deeper knowledge of the market.

IT(A) hits the fan !

T2R Staff

The Facts

A number of industry players have decided to make a collective approach to try to block Google's purchase of ITA Software Inc. The organisation, Fair Search.org, is funded by Sabre and Sabre's Travelocity, Expedia and its brands and a number of other players including smaller software providers like Farelogix.

The Analysis

The supporters of Fair Search are clearly rather concerned about the effect of combining the dominance of Google in general Internet search and ITA in airline priced availability search. It is interesting that alone of the GDSs Sabre has put its name to the campaign. Neither Amadeus nor Travelport has decided at this stage to participate. The identity of the other major supporters – Expedia and Kayak with their subsidiary brands – gives a good indication of why this should be. Sabre is primarily concerned about the impact on its online travel agency brand, Travelocity. The mainstream GDS/Travel Agency distribution channel is unlikely to be Google's immediate target.

Leaving aside the obvious self-interest of the participants, Fair Search does have some very valid points as to why the Government should intervene in the acquisition of ITA by Google. The most significant relate to the ongoing provision of service to Google's competitors. Kayak falls into this category as do online agents like Orbtiz. There are contracts in place and Google would not breach those contracts but it has given no guarantees that they would be renewed at the end of their term.

It is our view that despite these valid concerns the Government will have to approve the deal. It will increase airline competition and it will provide downward pressure on airfares. The argument is customer choice and it is a difficult one for the regulators to oppose. However the reality is that Google, just like its GDS predecessors in travel search will need to be regulated. "Sponsored" search results are already a feature of Google and it is likely that airline search will be no different. The regulators will be keen to ensure that the processes behind such paid positioning are transparent and well understood by airlines and consumers alike. The early history of the GDS industry teaches us that there is ample scope for abuse in the presentation of airline search results.

Although Google has not yet made public its intended business model we believe that it will be to drive transactions directly to airlines' websites where bookings will be completed for most itineraries. In principle it could also drive bookings to the online travel agencies that compete in the same space, but the reality is that airlines control their inventory and online agents will struggle to compete. GDS full content agreements will protect them for a while, but if they are to remain relevant they must provide a distinctive and better customer experience that the airlines are able to do.

Shopping will be done on Google, booking and ticketing on the airline websites. This will increase airline competition and transparency, especially with respect to ancillary items such as bag charges, seat assignment and the like.

Google has become number one in search because it returns relevant content for its users. This is the fundamental customer proposition. In theory everything it does is about returning the most relevant content to the user. However sometimes it doesn't get this right. Google's secret algorithms stimulate the minds and keyboards of some the world's brightest mathematicians and it is permanently being gamed by those that seek to manipulate its weaknesses. This is a war of attrition in which the advantage passes back and forward, sometimes with bewildering speed.

Since the mid 1990s airlines, especially the low-cost carriers and their hybrid cousins, have used the Internet to achieve low distribution costs. Legacy airlines, especially in the USA have seized the opportunity to reduce their own distribution costs by using the same channel. LCCs and hybrids now represent around 23% of the World's total sales[1] with 72% of their bookings via the Web. In the USA the LCCs and hybrids account for 25% of the market and book 75% online. They effectively set the market price level in the online channel. Legacy airlines have been obliged to reduce fares in order to be relevant in the online world.

Without being able to reduce costs to the same level as the new entrants, the legacy airlines have found that acquiring customers with low fares is unsustainable in the long term. They have recently been working to increase effective pricing though unbundling services previously included in the ticket prices. In effect the airlines have worked very hard to reduce the transparency associated with the online market in order to increase their revenue.

Google will have the ability to break this model with ITA. We expect that Google will offer a priced availability search that allows users to compare the products that they actually wish to buy. Baggage charges, early boarding, advance seat selection and other unbundled products would be included or not according to the preferences of the customer. This could either be explicitly stated at the time of initiating the search or held in the profile for users of iGoogle.

In order for this to work airlines must elect to participate in the Google searches. ITA can calculate any price for any itinerary when the fares are "filed" with ATPCo or SITA and in future it may offer airlines the ability to file fares directly. However it cannot obtain availability information unless the airlines provide it, either directly or via their own websites. Google could possibly use ITA's Needlebase software to gather and organise availability data.

Recent court decisions obtained by Ryanair in Europe establish a precedent that airlines are able to prevent third party web sites scraping availability data without consent so the Google process would be useless if the airlines don't want to play. However if any significant carrier elects to participate then effectively they will all have to. Staying outside Google, especially in the USA, would likely require significant marketing spend, or the lowest fares or more likely, both. Assuming that Google is able to achieve a similar level of penetration in travel search to that which it enjoys already in general search it will quickly become the dominant provider of neutral air travel information. Prospects for other online providers will be distinctly poor.

It's no surprise then that the travel aggregators are the ones that face the biggest risk to their business. This explains the Fair Search coalition.

[1] T2R's own proprietary research available.

The Speculation

We have argued that the deal will be allowed to go through but with strings attached.

The DoJ is likely to pull out the old rules it had from the early days of the GDSs and should probably consult the historians on GDS abuse in the past. It will realise that it cannot allow market forces to take care of the issue. There are too many opportunities for market distortion, and ultimately for disadvantage to the consumer.

The European Union will probably consider the Google process close enough to existing GDS practice to deem Google a GDS, and may to want to mandate Google adherence to the GDS code of conduct.

Either or both of these regulatory bodies will have multiple interests in Google:

- Google will probably have to expose its planned algorithm for presentation to the regulators. It will have to be described in terms that are comprehensible and relevant to the regulatory process.

- Google / ITA is likely to be forced to allow any airline to participate. Airlines may choose not to participate, but Google will not be able to prevent them. The costs of getting availability to Google / ITA will be the airlines', but that's probably the extent of direct fixed costs.

- Airlines are also likely to see an increase in some system transaction costs, although there is an argument that their system look-to-book ratio will decline due to the offload of pricing to ITA's infrastructure. Only availability management will remain. The consumer performs the search; they set the attributes that are relevant and Google returns those products that are available now and/or those products that would be available at some other time.

- Differentiated pricing on the click-through or the deep link to booking could distort competition. It will have to be one price for everybody. Anything else might be seen to influence the economics and therefore pricing to the consumer. Referral costs would have to be standardised, terms like non-discriminatory pricing are likely to be back in fashion.

A preliminary calculation of the financial opportunity for Google might take the following form:

- 2.7 billion passengers were flown world-wide in 2009. 30% were sold via the Internet. With 30% of the market Google would process around 240M passengers.

- Assuming Google's market share would double over time to 60% (still less than its current share of general search), and this would also drive Internet sales to the point where 50% of seats were sold online, we get to some 810 million bookings.

- At $1 per booking, 10 years of revenue would be $8.1 billion. Assuming it costs about $100-200M a year to run the service then Google will generate about $6 billion from its investment of $700 million. Even taking risk into account, this looks decidedly worthwhile.

So regulation will prevent Google from excluding any airline, probably limit charges to something reasonable and put a squeeze on the GDSs, particularly those that do not have an airline IT business.

Profits on airline IT will increase as airline inventory systems need to be upgraded to generate and send the appropriate availability to Google. Add the airline IT systems providers' ability to charge for EMDs and this picture becomes even more complicated.

For a while the airlines will be happy. Their e-commerce sites will boom. They will develop attractive UIs and APIs to ensure that their ancillaries are available and Google will aggregate all of the attributes that are relevant to the customer. The unbundled will become bundled again. Google will stimulate the minds and revenue management systems further than they have ever been stimulated before.

Google will be forced to continue its contracts with existing ITA customers on broadly similar terms, and probably be forced to renew them as well, although over time newer entrants such as Everbread could take a share of the market. Google will have truly entered the travel business as the regulators interfere more and more with its operation.