

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.

## **USAir and American – Different but the Same**

**T2R Staff**

### **The Facts**

In the same week US Airways has announced that it will introduce a direct connect channel for travel agencies to sell its ancillary products and American Airlines has been prevented by a judge from withdrawing its inventory from Orbitz, at least in the short-term.

### **The Analysis**

The phoney war of distribution has been going for some time in North America. Direct distribution via airline.com web sites has become the dominant channel in the region. T2RL research shows that in 2008 41.4% of airline seats in North America were sold by airlines at their own web sites and a further 13% via online travel agents such as Expedia, Orbitz and Travelocity. Despite this shift online, which enabled the halving of distribution costs over a decade, airlines remain marginally profitable at best.

Eventually realisation dawned on airline management that cost-cutting was, at best, only a partial solution to their ills. The move to a largely transparent online market means that revenue enhancement by means of higher fares is not possible. Innovation was required and the widespread adoption of unbundled products, branded fare families and the sale of ancillary products are all results of that innovation.

These novel methods of revenue enhancement are well suited to the online distribution environment where the airline is able to exercise close control over the presentation of products and the collection of charges. Life becomes more difficult when distributing via the travel trade.

Large corporations almost invariably use Travel Management Companies (TMCs), such as American Express, to manage their travel requirements. There are multiple reasons for this. TMCs have the expertise to make travel bookings quickly and efficiently, they have access to negotiated fares and rates that save the corporate clients money, they have tools that enable the enforcement of corporate travel policies and processes to manage expense reporting and the provision of business intelligence around the travel budget. For all these reasons corporate clients are very unlikely to move away from the TMCs in the near future.

TMCs work via Global Distribution Systems (GDSs) for many of the same reasons that corporations work with TMCs. The GDSs supply most of the tools that TMCs need in order to deliver on their propositions to corporate clients. In particular the GDSs allow TMCs to create and manage the complex multi-airline itineraries that are required by global corporations.

The GDSs are built on a foundation of data and communications standards created by the airline industry over the years since the IATA Traffic Conference of 1948. These standards provide a very powerful and robust system that allows hundreds of millions of bookings to be processed every year with minimal error rates. On the other hand they are very slow to change and are built entirely around straightforward sales of airline tickets. The sort of innovative products seen in recent years simply cannot be accommodated in the standard GDS environment.

As a result airlines are currently unable to sell their new products via the GDSs and hence via the TMCs to corporate clients. Despite several years of lobbying by the airlines the GDSs have been unable or unwilling to adapt to the new commercial realities, often citing the lack of standards for the new products to justify their conservatism. This is not an entirely specious argument. The required standards really do not exist and implementation of non-standard products would represent a real risk to the integrity of the GDS model. IATA's Electronic Miscellaneous Document (EMD) standard is but one part of the puzzle and as yet almost no airline is ready to exploit it. Despite this, the airlines – which provide almost all of the GDSs' revenues – point out that they are being required to take risks in order to survive. They believe that the GDSs should be prepared to do the same.

And so the phoney war arose. Air Canada was one of the leaders in the adoption of branded fare families and managed to extract a concession from Galileo to enable travel agents and TMCs in Canada to access its products via a front-end switch, bypassing the main GDS functions. Northwest Airlines launched a travel agency portal and tried to require agents to use it in preference to the GDSs. However Northwest had not prepared the ground effectively and retaliation by the GDSs forced it to backtrack within days.

Now however hostilities seem to be starting for real. American Airlines has created a web portal and API toolkit as the only way that its ancillary and unbundled products may be booked, whether by consumers directly or by travel agencies and TMCs. In a related action it has notified Orbitz, an online travel agency powered by Travelport's Apollo GDS, that it will withdraw its inventory. This is playing hardball and the fact that Travelport rushed to the courts for temporary relief shows that it is taken very seriously indeed. At the same time US Airways has also announced a web portal with broadly the same functionality but it has been very clear in its public statements that this will sit alongside the GDSs with no compulsion to use it.

The implications seem quite clear. American Airlines is one of the very small number of airlines that can genuinely influence the actions of the major TMCs. Its newly immunised joint business with British Airways and Iberia and its position at the heart of the Oneworld Alliance mean that it simply cannot be ignored. It is betting that it will succeed where Northwest failed. It will use its XML-based portal to distribute products at least until such time as the GDSs are able to offer a viable and cost-effective alternative. Airlines such as US Airways must position themselves to take advantage of whatever change in the landscape comes about as a result of the American action. The new US Airways web portal does precisely that – and at remarkably low risk to the carrier.

## The Speculation

The American Airlines action represents a real threat to the GDS industry in North America. Amadeus is not significantly exposed to this market but it is time for the management of Travelport and Sabre Travel Network to step up and commit their companies to rapid and far reaching product developments that will keep them relevant to their airline customers. This

may well mean developing products before standards are available or indeed creating standards as they go along. Some of the development could turn out to be throw-away and some of it could threaten the integrity of their systems. It will be high risk. But the risk of doing nothing is that the TMCs and online travel agents are pushed into developing or buying technology to exploit the web portals of American and the airlines that follow in their wake. Furthermore the airlines can sweeten the deal with incentives to keep momentum rolling. Once that happens there may be no going back and the GDSs will be relegated to irrelevance in significant market segments.

We estimate that in 2008 808 million passenger segments were sold in North America, of which 384 million were booked through the three GDSs. Approximately 105 million bookings were made by online agents and another 50-60 million by the TMCs. Together they represent about 20% of the market. Data for last year are not yet finalised but current indications are that the market remained flat between 2008 and 2009 so the numbers will be about the same.

History shows that what happens in North America tends to spread eventually to the other regions of the world, although the Asian market in particular can be very slow to follow. Failure to respond effectively to the threat of what American Airlines is doing now could force major transformation for the entire GDS industry. Amadeus and Sabre both have strong businesses in airline IT systems that could compensate for loss of GDS revenue - provided the relationship between high GDS booking fees and low charges for Passenger Services Systems (PSS) is gradually reversed. Travelport only sells significant IT services to United and Delta and would be the most vulnerable of the three to a shift in value from GDS to PSS.

The GDSs bring too many advantages to the whole travel distribution industry for these statements to be made lightly but the onus is on them to take urgent action to remain relevant to airlines operating in a new and very difficult world. Just ask Google!