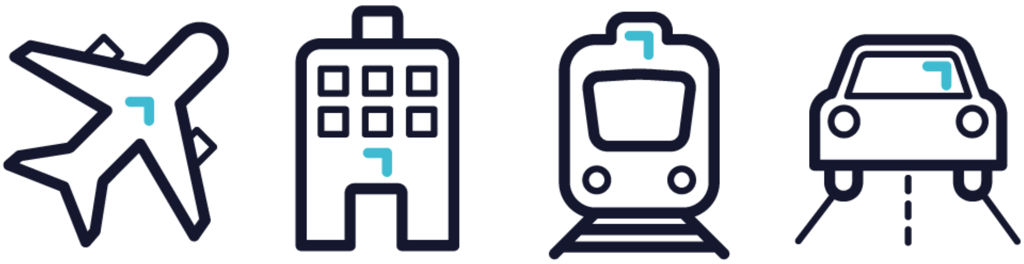
GTMC
the voice of business travel

IMPAIRED VISION

The True Value Of The Indirect Channel



GTMC

50TH ANNIVERSARY
1967 –2017

We are GTMC

Our vision is to be the voice of business travel.

Our mission is to promote business travel as an investment, a commercial strategy and a driver of economic growth.

WE ARE UNIQUE
As the only representative body for Travel Management Companies and the business travel community, there is no one like us.

WE ARE REPRESENTATIVE
The needs and expectations of the business travel community are at the heart of everything we do.

WE ARE RELIABLE
We represent over 80% of managed business travel in the UK. We have direct access to the views of 30,000 frequent business travellers.

WE CHALLENGE MINDSETS
Our nationally representative research gives us a statistically robust understanding of business travel issues, trends and opportunities in the UK business travel industry.

WE ENCOURAGE INNOVATION
We recognise those who are using technology to drive innovation, growth, efficiency and improve customer experiences.

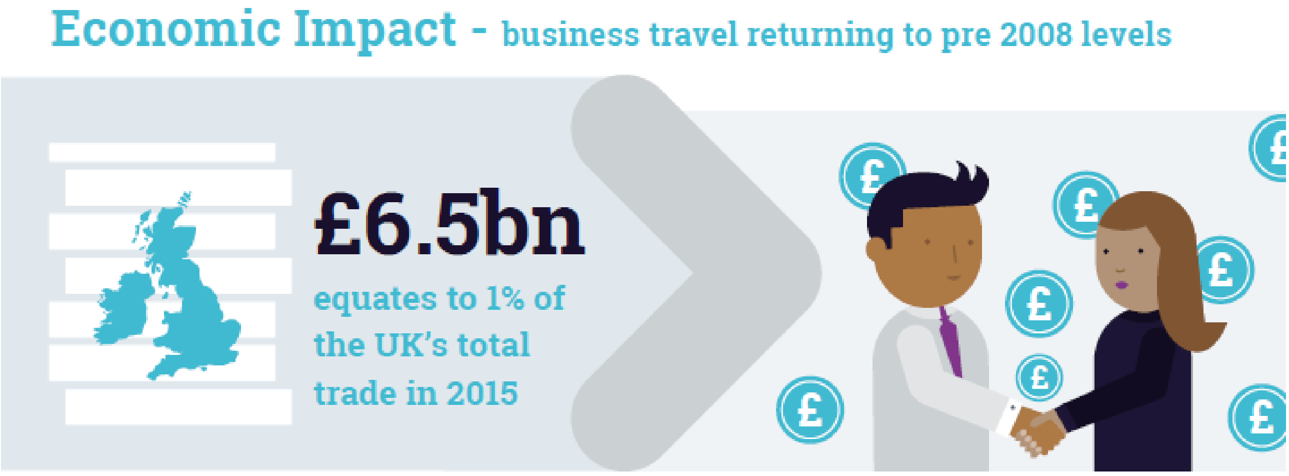
WE HELP TO CREATE AN ENVIRONMENT FOR A SUCCESSFUL FUTURE
We connect people, developing relationships and insight that give us a focused approach to lobbying. We consistently promote the importance and need for business travel.

Why some airlines, hotels, rail and car rental suppliers don't understand the true value of the indirect sales channel.

Introduction

The importance of business travel to the UK economy has never been clearer. Oxford Economic estimates that business travel accounts for £6.5 billion (around 1% of the UK's total trade), and that a 1% rise in business travel boosts UK trade by around £400m.

With business travel spend gradually returning to pre-2008 levels, together with foreign direct investment, the collective impact of that 1% rise in business travel on UK productivity could be an increase of up to £390m in gross domestic product (GDP). Post Brexit the need to export to non EU countries will be even greater and therefore the value of a professional and knowledgeable Travel Management Company will be of even greater value to British business.



Corporate travel is growing despite the misguided belief that reducing business travel brought about by technology, via Skype, audio conferencing and other meeting alternatives reduces costs without damaging client relationships and putting revenue at risk. In 2016 the International Air Transport Association (IATA) predicted that global air travel will double to 7.2 billion passengers by 2035. In Europe alone, 580m extra journeys will be made by air.

With this in mind, the role played by travel in generating trade and productivity can only become increasingly important, as will the focus of buyers and suppliers alike on the best way for flights, hotels, car rental and every other travel product should be purchased and distributed.

Meanwhile, technology has been a major contributor to the disintermediation of travel. The growth of Online Travel Agents (OTAs), the emergence of mobile and self-booking tools has enabled leisure and business travellers to serve themselves by giving them access to content and functions previously available only to suppliers' agents. But does this make them experts and how much time (and therefore company money) does this practice consume?

More travel-savvy than their predecessors, business travellers are now used to making their own buying decisions and have the tools to do so, bringing them into potential conflict with company travel policy. Airlines, hoteliers and other travel providers have recognised this and, enabled by technology, are actively and consciously targeting the business traveller.

Whilst this technology has brought more consumer choice, it has also highlighted the value provided by travel management practitioners.

Value Of Travel Management

Travel management balances employee needs with corporate goals, financial and otherwise, delivering financial controls, savings, policy compliance, traveller safety, efficient processes and transparency to the corporate.

Although the main value of the Travel Management Company (TMC) and other intermediaries to buyers continues to be attributed to finance, policy and traveller safety, travel management goes far beyond simple search-and-book functionality. Travel management also includes the provision of travel content, the flexibility to deal with changing itineraries, ticketing, fulfilment and payment to workflow and systems integration, payments to travel suppliers, travel policy compliance, duty of care and data converted to analysis and information, essential to the management of a successful programme.

Of particular importance when compared to direct channels is the ability to assist travellers when plans are disrupted because of strikes, weather or terrorism and the provision of impartial and expert advice.

Suppliers often define that value differently. The global travel industry is fragmented; spend on distribution by hotel and car rental brands is estimated by Travelport at $610 billion a year.

TMCs bring together a disparate range of branded and independent providers. They enable suppliers to personalise their products and services, help business consumers to understand different rate types and ancillary services and enhance supplier-generated content by tailoring this to each corporate's specific needs.

So why do leading supplier brands have strategies where channels to market compete?

How It All Started

Whilst cost pressures will always be fundamental in any supply chain, the disintermediation of travel is being driven in the main by technology-enabled benefits.

In 2005, then-boss Rod Eddington announced that British Airways was cutting commission payments. He cited the airline' s need to manage its distribution costs, estimated at around £554m a year, at a time of reduced revenues, falling yields and low-cost carriers eroding market share. However these distribution costs did not disappear; they were simply transferred from the end-supplier to the customer.

Ten years later, Lufthansa announced a €16 surcharge for bookings made via GDS, directly attacking a TMC channel reliant upon the GDS platform. In the same vein IATA's New Distribution Capability (NDC) has encroached onto GDS turf by providing an industry-wide standard platform that opens the market to new-entrants who are in turn accelerating the rate of change.

Disintermediation has not been restricted to the airline sector. The past decade has witnessed an ongoing tug-of-war between hoteliers and the Online Travel Agents (OTAs) like Orbitz and Expedia. The issue has been partly of hoteliers' making because they left the OTAs unchallenged in developing pay-per-click campaigns, remarketing tactics and by harnessing the power of social media. Today, Expedia and Priceline are estimated to represent 5% of Google's global revenues.

Over the past 4 - 5 years, most major hotel chains and independents have caught up. They have embraced the potential from mobile, social media and transactional sites and started to address the dominance of the OTAs in the distribution landscape. Morgan Stanley estimates that, of global hotel industry revenues of $570 billion in 2015, the OTAs collected $16 billion in commissions of

15 – 25%. The result has been campaigns such as Hilton's *Stop Clicking Around* and Marriott's #itpaystobookdirect initiative.

There are now so many more choices of channel that hotels can decide which ones produce the most valuable business at the lowest cost. However there are plenty of signs that the OTAs are taking more, not less, market share from suppliers. According to Phocuswright, OTA bookings increased by 10% in 2015, compared to 5% for suppliers – and show no sign of slowing down.

Where Are We Now?

The travel distribution landscape is changing, thanks to mobile technology, artificial intelligence and big data, all of which have blurred the traditional boundaries between B2B and B2C markets, changing the expectations of the customer in the process.

From the travellers' perspective, whether travel is sourced through direct or indirect channels is irrelevant so long as their needs are being met, or there is a personal benefit by choosing one channel over the other.

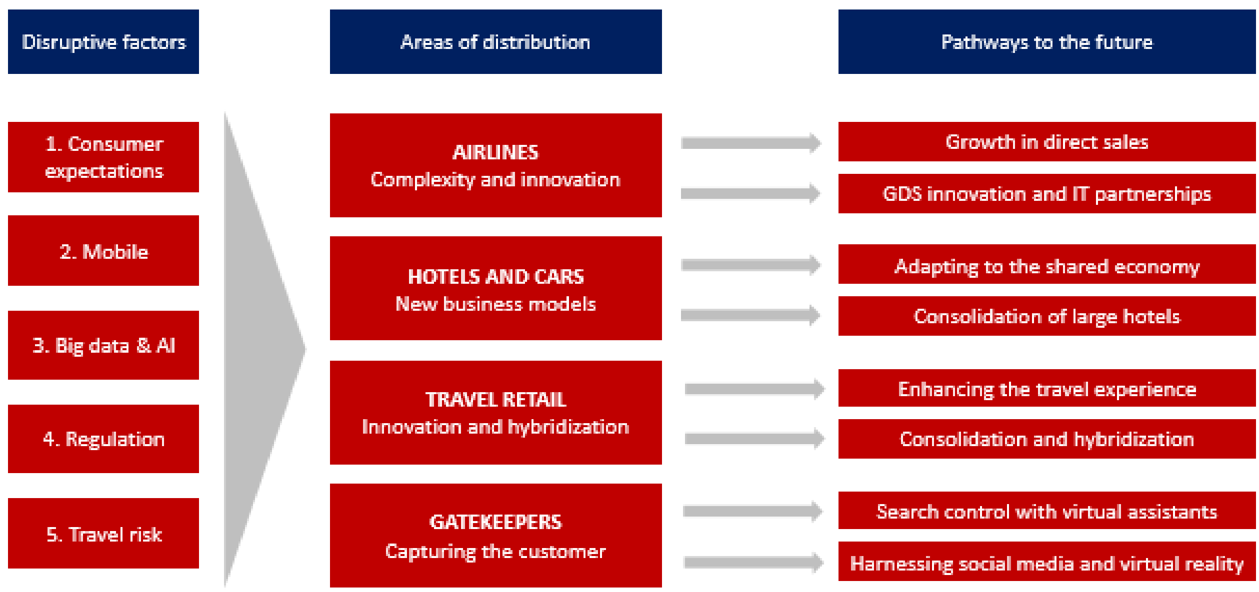
For most Travel Managers, HR is now as important a stakeholder as Finance in the travel management eco-system. Traditionally rigid policy enforcement, focussed on driving compliance and managing behaviours, is giving way to more dynamic policies. These are designed to give flexibility and choice to the traveller whilst continuing to manage, measure and control both cost and risk.

Millennials have been targeted in order to shift the balance towards the direct channel. From their perspective, why should they forego a preference for Airbnb simply because their company is paying the bill?

Many TMCs have therefore recognised that they have to satisfy millennials' preference or demonstrate to their clients why it should be blocked. If that message does not get through, maverick behaviour grows. The reason usually cited is safety, rather than cost-driven. The question many travel managers face is whether safety is a compelling enough reason to keep travellers within policy.

Into this mix has come the emergence into mainstream business travel of shared economy providers, increasing travel risk and the rise of Google/Facebook to create a series of challenges for TMCs.

Fig 1: Disruptive factors and potential pathways for the future of travel distribution
Source: LSE Consulting



Technology has also changed how the customer is defined and is as significant a force for change today as was the removal of commission payments in 2005.

Historically, the travel manager, not the traveller, was regarded as 'the customer'. The former's priorities are to buy business travel at the most cost effective rate and ensure their travellers are as safe as possible. The latter's priority is to be in the best possible physical and mental condition to execute the objectives that drove the need for the trip itself. Cost, whilst a factor, is often of secondary importance, resulting in misaligned priorities.

The development of mobile platforms, alongside the arrival of the millennials has enabled suppliers to engage directly with business travellers. Once contact is established, the technology enables the end-supplier to identify exactly who they are, their preferences and what they can offer to drive brand loyalty. Blurred lines between B2B and B2C has meant that the traveller is now of equal stature, so the needs of both stakeholders have to be met by travel management providers.

Herein lies both opportunity and challenge. The different travel categories (air, hotel etc.) all provide different solutions aimed at specific parts of the customer journey. The opportunity is the fragmented supply chain; the challenge is maintaining controls without diluting the benefits or and options the direct channel offers to the traveller.

The Problem

The airline sector is becoming increasingly retail-orientated as full service carriers fight low cost carriers for market share. LSE Consulting believes the former, and particularly those with strong brands, will choose to grow their direct sales, but say this approach has finite limits due to consumer demand for content aggregators such as the OTAs and TMCs.

The alternate pathway is the indirect channel of the intermediary. TMCs, GDS and aggregators contend that airlines' need to differentiate themselves enhances the need for distribution diversification, notwithstanding any regulation that might be imposed.

Accommodation and car rental providers have choices to make too. The emergence of sharing economy providers like Airbnb and Uber is forcing traditional operators to provide content to sharing platforms. However the popularity of OTAs in the leisure market is forcing hotels in particular to consolidate and sell more rooms direct to the traveller.

Neither the airlines, hotel companies, car rental nor other travel providers cannot offer a complete solution that feeds directly into corporate finance systems. Irrespective of NDC, any consolidation of hotel and car hire into an airline web site can only service a segment of the market. Airlines may provide a level of convenience but they cannot offer real choice at market rates.

In effect, TMCs offer a service that end suppliers cannot. They need to combine the personalised nature of the direct channel approach with the control of a managed travel programme.

The problem is that the supplier community doesn't seem to have understood that message, and instead continues to promulgate a mind-set based around costs (and cutting them) rather than the value of distribution partners. It's not a problem exclusive to the travel industry. As Duetto research points out, *"other industries have faced, and embraced, the same situations. For example, Apple has their own brick and mortar stores, but many other retailers sell iPhones. In the past, it didn't really matter where you bought your iPhone—it would cost the same and you'd be presented with the same options."*

How Do Suppliers Expect Corporates To React To Direct Sales Activity?

Suppliers face a conflict of interest. They focus on direct sales because of the perception that the costs are lower and the returns higher. Hotel investment in direct sales is substantial, exemplified in 2016 by Marriott International's offer of exclusive discounter rates and free Wi-Fi to loyalty members when booking direct.

However these numbers could be misleading. Many TMCs use supplier websites to make sure their customers get the best deal and content. This method is non-productive and ultimately costs the customer in transaction fees.

These suppliers' target is the proportion of corporate spend that takes place outside policy, estimates of which range from 40 – 50% of hotel bookings and 28% of air bookings (from analysts IDC) to 39% of UK business travellers (GBTA), to 64% amongst millennials (PhocusWright).

At the same time, suppliers must tread carefully to avoid upsetting corporate or agency relationships. The balance between offering corporates a choice that can benefit them whilst benefitting shareholders seems increasingly hard for many suppliers to strike.

Myopic Thinking

Members of the GTMC (Guild of Travel Management Companies) manage around 80% of policy-compliant spend. Chief Executive Paul Wait believes that travel suppliers – and travellers booking direct – are focussing disproportionately on the direct channel.

"*Airlines, hoteliers and other travel providers are looking solely at cost in order to prove their argument that direct channels are better because they are cheaper. Instead they should be looking at value"* he says.

British Airways and Singapore Airlines plan to introduce a charge for the acceptance of credit cards. However US airlines rarely charge such fees because, says Wait, *"credit cards are necessary for airlines to do business. They are the most convenient way for business travellers to pay. Why create a barrier, especially when that $600m cost actually equates to just 1.16% of total airline revenues?"*

Airlines move to transfer their costs of doing business has landed the customer with a significant extra cost. *"The question is,* says Paul, *what the airlines does for its extra fees, and whether it is a fair cost."*

"Airlines can't operate without credit cards. How could they handle the cash? Instead, suppliers should aim to make their customers feel good about what they have purchased, regardless of what they pay" believes Wait.

Bad Profits

Paul Wait sees this as a case of bad profits. Fred Reichheld created the concept of bad profits in his book *The Ultimate Question,* referring to income generated by deceiving or misleading the customer. He quotes examples of products sold with deceptive messaging and confusing pricing strategies. Reichheld's theory is that bad profits are earned at the expense of customer relationships, spelling disaster in the long run.

The travel industry is a prime exponent of bad profits, with the airline and car rental companies charging an ever-rising number of ancillary fees, rationalised externally as giving customers greater choice, but regarded by corporates and travellers as often outrageous fees for small items. Instead they should provide value by moving away from a model whereby the customer faces surcharges.

"Airlines talk about having passenger-centric strategies but in reality this means aiming to extract the maximum possible amount from each customer instead of delighting that customer with what they buy" says Paul Wait. *"This approach seems to be driven purely by cost. If this situation continues, the successful businesses of the future will not be in the airline industry. Those who are successful will provide value and a great customer experience."*

He believes that traditional airlines have been forced down the wrong path by the low cost carriers. *"How can it be right to pay more for a bag than for a seat? What is the bag getting that's better than what I am getting? The inference is that the bag is getting a better service. Their whole pricing ethos is wrong."*

Perceived wisdom suggests it is cheaper to book flights and hotels direct, although back in 2012 an IATA report estimated that the cost of a direct booking was up to 20 times that of an indirect one. Distribution costs typically account for 4% (for low cost carriers) to 8% (for full service) of airlines' operating costs, and yet competing carriers take different approaches. Both easyJet and Ryanair are focussing more on indirect distribution channels while Lufthansa concentrates on direct business. However it is a well-known and proven fact that the indirect channel delivers a significantly higher average ticket price or room rate than the direct channel.

easyJet's 2016 Annual Report says that the airline's targeting of business travellers through GDS & TMC channels realised a 6% growth in corporate business, translating into an additional 12.5 million passengers. This strategy is part of a balanced approach by easyJet, using GDS, aggregators and a direct API capability and over 300 TMC relationships to support the corporate customer. 99% of Ryanair's booking are still made through their website, but as they pursue the corporate market the share through the indirect channel will continue to grow.

Hotels say the direct online channel is up to 12 times cheaper than the OTA channel and up to 10 times cheaper than the GDS/travel agent channel. The cost of a direct booking via a hotel's own website is $10-$12 (including hosting, marketing and analytics) compared to US$40 to US$120 per OTA booking* (average 20% commission*) and US$24.50 to US$66 per GDS booking. (GDS fees of US$4.50 - US$6 plus average 10% commission*)

(* Based on 2 night stay and ADRs of US$100 to US$300 per night)

On the other side of the equation, the value of the financial controls, traveller tracking and leverage from aggregated spend that the TMC offers more than justifies the incremental distribution cost which would, under current un-bundled models, suppliers would inevitably re-charge to the corporate client if they had to replicate the management services of the TMC.

Paul Wait also questions some suppliers' accounting rationale. *"When you look at the real cost of direct booking, I doubt that all the costs of on-going technology up-dates, advertising, online searches and pay-per-click costs are being factored. I also question whether the full cost of advertising is being borne by the direct channel to which the advertising is driving responses."*

The inevitable conclusion is that costs are either being manipulated or not fully taken into consideration when comparing direct with indirect. The reality is that direct business is not cheaper to get, although the customer will usually get a lower price from a direct channel. Even with direct bookings, there is an element of service required – such as CRS or voice reservations – and attendant overheads that have to be costed in. Estimates put these costs for US major hotel brands at US$6 - US$10 per booking, all of whom have to provide customer service support.

The point is that suppliers are not comparing like with like. In Paul Wait's view, airlines at HQ level seem to be increasingly disconnected with the market place by focussing on generating more money by charging their customers for add-on services.

20-20 Vision

Instead, providers should be looking at every distribution channel for mutual support by ensuring price parity across all channels and by concentrating on enhancing the product and its inherent value. *"Suppliers shouldn't care where the customer buys from, just that they buy their product"* says Paul.

There's no doubt that suppliers are trying to force change, but they are looking purely at channel cost, not value, and are not loading in all the relevant channel costs to make accurate comparison.

Suppliers are also unable to provide what corporates need, namely traveller tracking and Management Information, or to support corporate duty of care obligations to business travellers. Many suppliers do not fully understand the role of the TMC in the science of travel management, or the value that this delivers to the corporate.

At a more fundamental level, suppliers who entice travellers into out of policy bookings under-estimate the impact of non-compliant behaviour, as well as the role TMCs perform in selling suppliers' services on their behalf, or the after-sales account management service they provide.

The TMC provides the business traveller with a service that cannot be replicated or self-served. Direct channels are not geared to handle amendments to a trip (often 5 to 7 times per itinerary), or provide the same level of advice and guidance, at one fixed price. In a direct sales environment the supplier wants the customer to make one phone call or website visit. This is not the reality of corporate travel.

Good retailers are able to explain why a particular product best suits a particular customer. *"How would the airlines be able to satisfy diverse customer needs without the TMC network to do it for them?"* asks Paul Wait. *"How can they provide the payment choices? How can they help the corporates to meet their Duty of Care obligations, safety and security information and MI reporting? This is where the indirect channel adds value."*

Suppliers need TMCs to help them engage with, and influence, the corporate customer. Travel is in danger of becoming as much of an ordeal as renewing car/house insurance, which does not make for an enjoyable process. *"Most consumers want someone to take away the hassle away, but not all"* says Paul. *"It's not a case or providing one channel or the other; it should be the customer who decides how they want to buy, from whom, and in what way they consider provides best value."*

Too much current thinking amongst airlines, hoteliers and others is not customer-focussed but top/down in telling the customer what they are going to get, instead of finding out what the customer needs. Their assumption is that the customer will simply roll over and pay.

These suppliers believe they are in a dominant position and are trying to dictate to their customers, whereas the answer lies in corporates coming together and speaking with one voice.

Paul Wait believes that the some in the airline industry may be jealous of the motor industry, where the major manufacturers have 75% market share, compared to the airline industry where the big players only have 30% share. *"It's not unreasonable to think that some people within the airline industry believe they can get there by forcing change, fragmenting the market and making it difficult for consumers to comparison shop or even have choice". The problem is that car buyers have much more choice, from engine size and colour to equipment, so the vehicle is effectively built to the customer's specification. You can't do that with an airplane or hotel."*

"Some hotel chains are following the airlines' lead but are painting themselves into a corner. They are risking brand damage by adopting this anti third party stance I fear that the only way this will stop is with a change in senior management mind-set because their strategic position has become entrenched."

"Although this conflict is nothing new, as a result there is now a real war between direct and indirect channels going on, with a lot of propaganda trying to convince travellers what to do."

Eleven years after BA's Rod Eddington scrapped agency commission, the debate around reviving the model has re-ignited. *"It's up to the customer to decide where the value lies. But they have to have the choice to make the decision"* concludes Paul Wait.

The Shape Of Things To Come?

Suppliers will no doubt continue to invest time and resource in direct selling because of the perceived benefits and the scalability of the available technology solutions, especially mobile. Atmosphere Research Group estimates that airlines will grow their direct share from 33% in 2016 to 45% in 2021. Interestingly, Atmosphere also anticipates TMCs will grow their market share by 6% possibly at the expense of retail agencies, whose share will fall by 16% in the same period.

Corporate buyers will continue to prefer end-to-end, managed travel programmes that merges travel bookings with expenses to drill down the total cost of the trip by individual suppliers. They will specify programmes that track every traveller and their policy compliance. They will also demand programmes in which measuring ROI per trip is the norm not the exception.

To achieve those objectives, travel management systems must provide real-time measurement of supplier performance across the supply chain. They must power dynamic travel policies that allow travellers to make choices within agreed parameters, satisfying both CSR and Duty of Care requirements. They must also ensure that self-made bookings are funnelled through a live tool capable of making best value supplier decisions and mode choices based on hard Business Intelligence.

This is the value the TMC provides. It may not be a fits-all solution but there are few corporates of any size for which it does not.

In reality airlines, hotels, rail operators and car rental firms will not have a single channel to market. Practically they have to sell their product through both direct and indirect channels. The economics of both channels will vary based on market penetration, brand recognition and geography, meaning what may be ideal in a 'home' market will be impractical in a new or developing market.

The share of the market TMCs attract will ultimately be governed by the quality of their service measured against the quality of the service offered by the end supplier. Technology will continue to enhance that experience and the direct channel will continually evolve and improve.

Travel Management has traditionally been a conservative, process driven business sector. It thrived on being able to offer specialised knowledge and aggregated content to provide availability and cost of travel, information not widely available. Mobile technology has enabled individuals to be better informed and it is developing and offering added value at a fast pace, providing much of what used to be exclusive to the Indirect Channel.

Travel Management Companies have innovated throughout the 21st century and will continue to do so. In the end, it is the customer who will choose which channel best serves their need – not the supplier. Travel Management delivers real value to the corporate, the traveller and the supplier. Trouble is some suppliers at HQ level don't realise this yet.

Acknowledgements

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