7 Distributing the Product

In all areas of marketing, links must be made between the customer and the product. These links are known as Distribution Channels. Airlines use a variety of these channels. All of them are giving rise to particularly intense debate at the present time, because the different channels result in different costs, and because they vary in the extent to which they allow airlines to exercise proper and necessary control of the market. It is also an area where radical and controversial change is occurring, as carriers become increasingly adept at exploiting the potential open to them from on-line distribution,

The purpose of this chapter is to consider these controversies, and to analyse current developments in the field of airline distribution.

7:1 Distribution Channel Strategies

7:1:1 Types of Distribution Channel

In any industry, firms can choose from different types of distribution channel. Some may opt for the *direct* route. This is where the producer makes direct contact with the final customers for its product, without any intermediaries being involved at all. This channel philosophy is normal in the industrial marketing of big-ticket capital goods. It certainly has been usual in the field of aircraft manufacturing, though the rise of the specialist operating lease companies has now in many cases provided an intermediary between the aerospace firms and their final customers, the airlines.

In marketing activities involving less costly items a direct approach can still be adopted. For example, some firms choose to deal direct by selling their goods through mail order, backed by extensive advertising aimed at final customers, or increasingly, over the Internet.

Direct channels bring the advantage that no mark-ups or commissions have to be paid to channel intermediaries. They also allow producers to keep complete control of their marketing activities, and to be in touch with the true sources of demand for their products. The problem is that they may make it difficult for the producer to achieve sufficient geographical coverage, though in many areas (for example, insurance), this is being overcome as a result of peoples' increasing willingness to buy over the telephone or on-line. In many industries, producers make use of *wholesalers*. These are firms which buy in bulk from a range of producers, using their buying power to gain appropriate discounts. They then in turn sell on the goods, either by adopting a direct sell policy themselves, or by in turn using *retailers*. Retailers buy from wholesalers, and sell to the final customer for the product.

The essence of both wholesaling and retailing from the producer's point of view is risk-taking. Discounts will have to be given to allow an opportunity for mark-ups to be added and profits to be made by the intermediaries. In turn, though, the producer's risks are reduced because once the goods have been sold to a wholesaler or retailer, unsold goods cannot normally be returned.

The remaining type of channel relationship is that of the *agency*. Such a relationship is common in service industries where there is only an intangible rather than a tangible product offered for sale. In such industries, producers often require wide geographical coverage, but find it costly or impossible to provide this in their own. They therefore use agents, who are paid commission each time they sell on behalf of a particular firm. The agent is able to make a living by selling a variety of products on behalf of many firms, in what should be a mutually beneficial relationship. The problem, of course, is that because agents are selling on behalf of many firms, they may be tempted to use their market leverage by working harder to sell the products of the firms which pay them higher commissions. Suppliers may in turn leapfrog each other's commissions in an attempt to secure agents' support, resulting in an inexorable rise in commission costs. Exactly this process was prevalent in airline marketing in the 1990s.

The aviation industry illustrates all of these different forms of channel relationship. In many ways, the role of the aircraft leasing company is that of a wholesaler. Firms such as ILFC and General Electric Capital Aviation Services buy large numbers of aircraft from the manufacturers and are given substantial price discounts for doing so. They then lease out these planes to their customer airlines, and in buoyant times make substantial profits as a result. They do, though, assume significant risks. In a market downturn, large numbers of aircraft may be returned to them by lessees, and, due to a glut of capacity in the market it may be difficult or impossible to place these aircraft with new customers or sell them in order to realise their residual value. Indeed, in the major recession of the early 1990's, the then-largest operating lease company, GPA, could not survive and was taken over on the edge of bankruptcy.

Another example of a producer/wholesaler relationship has been that between charter airlines and tour operators in the European package holiday industry. The principle here has been that airlines have produced plane-loads of capacity which have then been sold to tour operators. In turn, the operators have added accommodation, surface transfers and other features of a holiday such as cultural tours or sporting opportunities, to make up a complete package. The tour operators have then been responsible for retailing these packages to the final customer.

In terms of agency relationships, it is of course the travel agency system which has been the dominant distribution channel for airlines in the past, and it remains so in many less developed aviation markets. The percentages are now declining markedly in many countries, but for many years airlines found that over 80% of their tickets were sold by travel agents. The trend until recently was in fact for this percentage to rise, with the forces of deregulation allowing the travel agency industry to cement its position as the industry's dominant distribution channel. Deregulation often meant rapid changes in airlines' schedules and fares. Often, the bemused consumer was forced to turn to an agent in order to find up-to-date information without the chore of contacting each of the airlines serving a route individually.

In recent years, of course, direct selling has become more and more significant as traditional airlines have supplemented direct selling through sales shops and call centres with an increasing emphasis on web-based business. New airlines have appeared which largely or totally ignore the travel agency industry.

7:1:2 The Concept of "Super-Profits"

A significant section of this book will be devoted to the question of distribution channels, and the casual reader might ask why this should be so. The reason is simple: control of distribution channels is one of the most powerful drivers of profits in any industry, and this is especially the case in the airline business.

The concept of the control of distribution channels is a straightforward one. In any channel where wholesalers, retailers or agents are involved, producers must ensure that they are in a position to control the rewards received by these channel intermediaries. If a wholesaler, retailer or agent is in a powerful position, they will not be able to do so. Instead, the intermediaries will be able to play one producer off against another, only supporting those who outdo the others in terms of their offer of mark-ups or commissions. In turn, producers will receive only the rewards needed to keep them in the business from year to year. The "Super Profits" – profits over and above these basic rewards – will accrue to the intermediaries who are able to exercise control.

There are a number of danger signals which indicate a probability that producers will lose effective channel control. One is that each intermediary controls a significant share of the market. For example, in the UK grocery market, the scene is dominated by three giant supermarket chains, Sainsbury's, Tesco and Asda/Wallmart. Today, any producer of grocery products has to ensure that it goods are stocked by these firms. If they are not, then they will not be able to reach something like 70% of the UK market. The supermarket firms are thus in a strong bargaining position, a position emphasised by their robust profit performance in recent years.

The other worrying indicator of problems for producers is that their product is perceived as a "Commodity" rather than a "Brand". The subject of Brands Management is now a crucial one in Airline Marketing and the whole of the next chapter is devoted to it. Briefly, though, a commodity situation is one where customers perceive the products of competing suppliers to be identical. The brands case is the opposite of this, where customers see significant differences between the products of alternative suppliers.

The commodity situation is the ideal one for wholesalers, retailers and agents seeking to establish and retain control of a distribution channel. This is because customers have no strong preference as to which firm's products they buy. Therefore the intermediaries will be in a perfect position to play one supplier off against another, because it will be irrelevant from the customer's point-of-view as to which producer is supported.

In some industries, commoditisation of the product has become so complete that the only way forward for producers wishing to protect their "Super-Profits" is to own, or at least franchise, their own distribution channel. This is the case, for example, in the petrol (gasoline) industry where in most countries the firms which refine petrol also own (or franchise)a network of filling stations. It is very difficult indeed for a stand-alone refiner of petrol to earn a reasonable return, given the clear perception of many people that petrol is a commodity. One's car run exactly the same whichever brand of petrol is put into it.

Another sector where ownership of the distribution channel by producers has become the norm is in that of the European package holiday/charter airline area. Seats on charter airlines are often perceived as a commodity by vacationers, in the sense that very few will specify the airline with which they wish to travel when booking their holiday. Indeed many people do not know the identity of their airline until they arrive at the airport on their day-of-departure. Because of this, it is difficult for independent airlines which have no links to their distribution channels to survive. Such airlines can often make reasonable profits when demand is buoyant and capacity limited, as will generally be the case during the up-swing period of the Trade Cycle. They will find life much more difficult in a recession, when capacity will exceed demand and where market power will swing strongly to tour operator intermediaries. These firms will easily be able to play the independent charter airlines off against each other because passengers have no great preferences as to which airline they fly. The result will be strong profits for the tour operators and weaker ones for the airlines, to the point where some of the airlines may not be able to survive. A case-in-point was the UK airline Dan-Air, which disappeared (through a take-over by British Airways) in the recession of the early 1990s, for exactly the reasons described.

A better situation in the market of airlines and tour operators is where the airline either owns, or is owned by, its distribution channel. For example, the UKs biggest charter airline, Thomsonfly, Thomson Holidays (Britain's largest tour operator) and Lunn-Poly, the travel agency with the biggest high-street presence, are all subsidiaries of the same parent company (the German firm TUI). The airline therefore knows that through such vertical integration it has a guaranteed outlet for its production even at times when market conditions are difficult.

One final point needs to be made in this introductory section about distribution channel management. In almost all sectors of the economy there are very substantial differences in the capital invested by producers and by intermediaries. This is certainly the case in the field of travel. Airlines have to invest truly vast amounts in aircraft in order to grow and develop their businesses. For example, today the purchase of just one wide-bodied aircraft, may involve an outlay of perhaps \$180 - \$200 million. A fleet of these planes will require a risky investment of billions of dollars. In contrast, investments made by tour operators and travel agents will be tiny by comparison. This is becoming even more the case as the travel agency business becomes an increasingly on-line one without the need to invest in costly high street shops. It is absolutely essential that airlines should be in control of their distribution channels so that they can earn the "Super-Profits" which will give their shareholders a fair return on their money. As we shall see, there are now worrying signs that the rise of search engines such as Google provides an even more potent threat to this control than has existed in the past.

7:2 The Travel Agency Distribution System

7:2:1 Advantages and Disadvantages

Having established the general principles, it is now necessary for us to look in more detail at the particular issues raised by the past general reliance on the travel agency distribution channel in the airline industry.

In this context, it cannot be emphasised too strongly that this reliance always brought airlines very important benefits. Exactly as one would expect with an agency relationship, one of these was geographical coverage. An airline would have found it prohibitively expensive to have its own sales shops in every high street and shopping mall around the world. Yet some passengers liked a personalised source of tickets, and someone they could turn to for advice and help. A travel agent provided such a presence by selling tickets on behalf of all airlines and tour operators, and by also offering services such as hotel, car rental and theatre bookings. Agents could – and still can – identify and explore specialist niche markets such as those dealing with hobbies like golf and winter sports, and those focussing on particular ethnic groups.

A second advantage of agency relationships was that they were not a heavy overhead burden on the airlines. It is true that all airlines had to incur the costs of agency support in the form of such things as training for agency staff and special telephone lines to deal with agents' enquiries. The principle though of the agency relationship was that the airline only had to reward the agent when the agent concluded a piece of business on its behalf. This was in contrast, say, to an airline-owned-and-operated sales shop in a city centre, which was an overhead cost burden on the carrier at all times, whether or not any business was actually being transacted.

A final point about the traditional airline/agency relationship was that agents undoubtedly relieved airlines of a great deal of the costly administrative work associated with air travel. For example an agent would issue tickets, assist with visa applications and deal with passengers' queries about airport check-in times, baggage rules etc. If they had not done so, carriers would have had to employ extra staff and resources. Generally, too, airlines paid their staff higher salaries than the poor levels of pay which were generally prevalent in the travel agency sector. Travel agents could therefore probably carry out this work at lower costs than would have prevailed if airlines had done it themselves.

Despite these obvious and strong advantages, the airline/travel agency relationship was the subject of increasing disquiet during the 1990s, and is now undergoing revolutionary reform.

Table 7:1 presents data on the commission costs of British Airways between 1990 and 2004. It is especially valuable data, because it separates out commissions from other selling costs. Normally, it is not possible to do this, as many industry data sources only present an aggregate cost category of "Ticketing, Sales and Promotion" which includes reservations and advertising costs alongside those of commissions.

Table 7:1 British Airways: Commission Costs 1986 – 2004

YEAR	BRITISH AIRWAYS		
	Total Operating Expenses £m	Commission £m	%
1986	2,644	223	8.43
1987	2,947	269	9.12
1988	3,559	332	9.32
1989	4,029	391	9.70
1990	4,373	467	10.67
1991	4,444	506	11.38
1992	4,772	563	11.79
1993	5,289	650	12.28
1994	5,580	768	13.76
1995	5,878	821	13.97
1996	6,612	916	13.85
1997	7,421	864	11.64
1998	7,339	847	11.54
1999	7,210	825	11.44
2000	7,702	817	10.60
2001	6,857	627	9.14
2002	6,491	524	8.07
2003	6,434	431	6.70
2004	6,682	365	5.46

Source: CAA Annual Statistics.

The Table shows that during the 1990's the situation was a disturbing one, and one which was typical of almost all airlines. During the 1990's, commissions increased in absolute terms of monetary payments. They also rose sharply as a proportion of the airline's operating costs. (Admittedly, partly because other costs fell, especially the costs of aircraft fuel).

There were a number of reasons why this should have happened. As has already been stated, during this period the proportion of tickets written by agents rose still further, as the travel agency industry was able to use the confusion associated with deregulation to further cement its control. Also, this was when more and more tickets were being paid for using credit cards, and carriers were having to pay out increasing commissions to credit card companies. Nonetheless, we are safe to draw a conclusion that for UK airlines at least, the travel agency distribution system became very expensive. The same conclusion could be reached for the US domestic market, another where disaggregated data were available.

Rising commission costs were in themselves worrying. They might have been justified, though, from an airline viewpoint, if they had resulted in investment going into improving the distribution channels so that carriers were being better served by them. Unfortunately, one's suspicion was that this was not the case, or at least that the level of investment by the travel agency industry was inadequate to sustain such a conclusion. Increasing commissions were often used by travel agents to finance an intensive market share battle between themselves rather than for investment to provide airlines with better distribution services. Such competition took on two forms. Firstly, in pursuing market share in the business travel market, agents were often prepared to pass on a proportion of the commission they earned to their retail customers in the form of discounts, either to build the loyalty of their existing clients, or to buy that of the clients of other agencies. Secondly, with sales to the leisure market, the manifestation of higher commissions came in the form of a proliferation of sales outlets as firms opened more and more retail shops to strengthen their geographical presence in the market relative to that of their rivals.

In both cases, airlines' money, paid out in higher commissions, was used to finance agents' battle for market share. This was not an acceptable situation, especially bearing in mind the huge investments (mainly through aircraft purchases) made by airlines in the future of the industry, and the comparatively small investments made by agents.

All in all, the situation of airlines with respect to their distribution channels was a very mixed one by the end of the 1990s and was ripe for reform. The travel agency distribution system brought them important advantages, advantages emphasised by the domination of travel retailing which the system achieved. There were, though, significant problems too. The question for airline business strategy was therefore very clear. How could distribution channels be developed so that the advantages were retained, whilst the problems and shortcomings were alleviated?

7:2:2 Today's Distribution Channels

The situation regarding distribution channels today can be traced to a process of reform which dates back many years. In 1996, some airlines began to make radical changes. Market conditions at the time were very buoyant, something which is always likely to favour producers at the expense of intermediaries. At the same time, it began to become clear that the Internet held out the promise of being an alternative distribution channel which could challenge the dominance of the travel agency system. It was already being used by some of the new entrant Cost Leader airlines, which were achieving substantial cost savings as a result, further increasing the pressure on traditional carriers.

The first signs of change came when Delta Airlines announced that for domestic ticket sales in the USA, payments of commission would be capped at a maximum of $50, whatever the percentage calculation of the fare might be. The effect of this was to significantly reduce the amount of commission paid on expensive First Class and Flexible Coach tickets. Within a very short time, Delta's initiative was followed by all the other major airlines in the USA, and, despite many predictions to the contrary, it stood the test of time. Indeed, the process of reform has been both strengthened and widened. Commissions have been reduced or eliminated in many markets today. Where travel agents are still being rewarded directly by airlines, this is now often done using the so-called "Task Based" approach. With this, agents are not paid a percentage of the price of the ticket they sell. Instead, flat rate payments are made for each task the travel agent has undertaken – so much for making the booking, for issuing the ticket (an increasingly rare payment, as the use of electronic tickets proliferates) and for dealing with payment. The effect of such policies has been to reduce the travel agents' rewards significantly, again especially on First and Business Class tickets, and on Flexible Economy fares, where high prices had meant especially high payments to agents.

The overall effect of such reforms has been little short of revolutionary. The proportion of airline tickets being sold by traditional travel agents has fallen, as airline websites have become more popular and a new breed of on-line travel agents has appeared (a development to be referred to in the next section). At the same time, the relationship between airlines and travel agents has changed fundamentally, as agents have had to seek new sources of revenue.

This has been especially the case in the business air travel market. Here, in many markets, agents have changed their role into being one of a travel consultant for their clients, rather than an airline sales agent. They have argued, justifiably in some cases, that they have specialist skills in booking travel, in negotiating corporate deals with airlines and other travel suppliers, and in tracking and tracing travel spending to ensure that the firm gets the best value-for-money from its travel expenditure. In return for such skills, travel have asked for, and have been paid, management fees by their commercial clients.

Reflecting this change, many former travel agency firms have now re-christened themselves Travel Management Companies, to better reflect the working methods that they now employ.

The changeover from commission-based rewards to management fees paid by clients has had mixed results for airlines, but on balance it has proved to be a correct policy. It is true that agents are no longer the airlines' ally in selling higher-yielding tickets. Any form of reward for intermediaries based on commissions can be annoying for those who pay them, with often a feeling that the commission does not accurately reflect the work done. Commissions do, though, give a common interest to both principal and intermediary to secure the highest possible revenue. Management fees can have the reverse effect. In order for a travel agent to justify their work, and to ensure that they retain their travel accounts, they must show their commercial clients that they have managed the travel budget well, and that they have achieved the greatest possible cost savings. This may mean that they encourage booking on low yielding promotional fares, even if restrictive conditions apply to them, or book people on Cost Leader airlines via these airlines' websites, even though they receive no commission for doing so.

Despite this possible adverse consequence, changing the basis for the rewarding of travel agents has been a necessary and long overdue reform. As the data for the later years included in Table 7:1 suggests, it has saved airlines large sums of money which they otherwise would have lost to the travel agency industry, and has given them a better control over their distribution channels than would have been the case had the reforms not come about.

7:2:3 The Future of Distribution

Despite the changes of recent years, the question of distribution channels for airlines is one which is still in a state of flux. Can we yet forecast what the mature situation will be?

It is already clear that the future is going to see a greater proportion of airline seats sold using direct distribution channels. Airline call centres, sales offices and airport ticket desks will continue, but the growth in direct sales will not be explained by them. Clearly, most of this growth will come from the increased use of airline websites. Internet access is spreading rapidly around the world, and use of the Internet is now a regular part of daily life for hundreds of millions of people. These people are, of course, drawn disproportionately from groups who are likely to be regular air travellers. Also, airlines are increasingly adopting the simpler reservations and ticketing procedures, which are necessary to make internet booking commonplace. The newer Cost Leader airlines have always done this, and the "Legacy" airlines that they are threatening are increasingly responding.

Having said this, it is not the case that the future will see an end for the travel agents' role in airline distribution. Many better-managed agents will be able to defend their position by adopting policies which their clients will perceive as adding value. We have already looked at the business travel agents who are repositioning themselves as travel consultants rather than airline sales agents. On the leisure side, the better agents may be able to find niche positions by specialising in particular activities such as winter sports, golf, trekking etc. Clients may then continue to support them because they value their expertise.

The best opportunities for the travel agency industry in the future will stem from the one advantage that they will continue to hold over airline websites. When a passenger consults an airline site, they will only usually be told about travel options and fares on that airline (and, perhaps, on its codeshare partners). In order to find out the best option out of the many that are available, they may have to spend a considerable amount of time looking at the websites of all the competitor airlines in the market. If, however, they consult a good travel agent, the travel agent will be able to display all the flight and fares options that are available and make a "best-buy" recommendation.

This is a service which a traditional off-line travel agency can offer in some form, but it becomes an even more powerful one when it is made available over the Internet. Recent years have seen the rapid growth of a number of very large and well-capitalised on-line travel agencies such as Travelocity (begun by American Airlines, but subsequently sold) and the Expedia service pioneered by Microsoft. This has in turn raised disturbing possibilities for airlines. Their websites have allowed them to loosen the formerly very tight hold that large travel agency chains held over them, but the rise of firms such as Expedia and Travelocity has raised the spectre of a new domination, this time by on-line rather than off-line agencies. Such a threat induced airlines to respond. In both the USA and Europe, consortia of airlines set up what amounted to their own on-line travel agencies, branded Orbitz in the US and Opodo in Europe, though again in both cases, these firms have now been sold by the consortia that owned them, presumably as a way of raising cash. In a wider number of cases, airlines have taken the apparently bizarre course of displaying not only their own flights on their websites, but also those of their competitors. They have done so as a way of providing their customers with a comprehensive booking tool, and as a way of countering the claims of on-line travel agents that only they can do so.

Overall, it is possible to reach a more optimistic conclusion about airline distribution (at least on the passenger side of the industry) than would have been possible only a few years ago. The use of the internet and the reform of the reward systems for travel agents have both made useful contributions to the correcting of what was formerly a totally unsatisfactory situation.

7:3 Global Distribution Systems (GDSs)

7:3:1 History and Background

For nearly twenty years, the subject of so-called Global Distribution Systems has been a controversial one in the airline industry, and it remains so today. The purpose of this section is to examine the reasons for this debate and to look at the future of GDSs.

Until the early 1970s, contact between airlines and their distribution outlets was mainly by telephone. As was noted in Section 5:4:1, this was both time consuming and costly, and became unsustainable as the industry grew. As the 1970s proceeded, the first, pioneering, carriers set out to automate airline/travel agency contact. In order to do so, direct links were provided from each agency location into the airline's reservations computer. Instead of phoning, agents could use the keyboard of a Visual Display Unit to make bookings direct with the airline concerned. Besides saving a great deal of time, this also gave the agent visual confirmation that the required reservation had been made.

In the USA, the leading airlines behind this move were United Airlines with its Apollo system, and American with SABRE. By the end of the 1970's these airlines had been joined in Europe by carriers such as Lufthansa (with START) and British Airways (with BABS).

By today's standards, these systems were extremely basic. They were, though, accompanied by controversy almost from the beginning. It was soon learnt that they provided a cast-iron way for the airlines which owned them to increase their market share at the expense of their rivals. The reason was that travel agents had a clear tendency to book their clients if they could from the first screen of information about the flight options in a given city-pair market. Indeed, booking was made from the first screen on over 90% of occasions. Over 50% of the time, the booking made would be that of the flight at the top of the first screen.

Given these facts, the option for the owner of the system was obvious. They needed to make sure that their own flights were the ones which were displayed most prominently. By doing so, they could obtain a handsome return on their investment through an increased market share. Generally, therefore, they were prepared to provide the systems free, or for a nominal rental, to the agents who used them. Also, though the flights of other airlines were shown, generally bookings were made on these airlines in small numbers, and little or no charge was made for such bookings. Indeed, other airlines' flights were only included because of the agent's requirement for a comprehensive system which would enable then to book all their client's requests on one system.

By the mid-1980s, the question of these early, biased, systems was becoming a controversial one. In the USA in particular, the airline industry had by this time been deregulated, and complaints were made by some airlines that bias in Computer Reservation Systems was significantly hindering the operation of the supposed free market in aviation. This complaint was, of course, raised most vociferously by the airlines which did not have a significant presence in the GDS industry. At the same time, those that did have such a presence – notably American Airlines – argued that the returns they were getting through biased displays merely reflected the investment they had made and the risks they had taken.

The outcome of the debate was that GDS displays – ironically in a supposedly deregulated industry – became subject to regulation by the US government, a move subsequently followed by the European Commission in respect of GDS operations within the European Union. The regulatory regime in both cases had essentially the same purpose, though there were differences in detail – to ensure display neutrality. This purpose was largely achieved. Though the question of the fairness of the rules continued to be debated, any subsequent bias in the systems was at a far lower level than was the case during the 1980s.

Once displays became regulated, it was inevitable that a further issue would arise. Airlines which had invested heavily in GDSs – and American Airlines was by this time claiming that it had spent more than a billion dollars on SABRE – expected to get a return on their investment. If biased displays were ruled out, how was this return to be obtained? The answer soon became clear. The system owners began to charge other airlines substantial fees for every booking made, at an initial level of about $2.80 per flight sector booked

The effect of booking fees was dramatic. Suddenly, Global Distribution Systems were transformed into highly profitable businesses, with American Airlines in particular soon conceding that its involvement in GDS was the most lucrative of all its activities – much more so than the airline itself. At the same time, booking fees provided American with the resources it needed to continue to invest in SABRE. At that time, more than 40% of the travel agents in the USA were using SABRE, giving the system considerable power in that market. There were rumours circulating of American's intention to achieve such dominance on a global basis. Had they done so, their ability to levy higher and higher booking fees would have been immense.

To address the perceived threat of SABRE, it was necessary for other airlines to make counter moves, and in Europe two groups of carriers came together to form consortia, each with the aim of setting up a system with the functionalities and customer base necessary to compete with SABRE. The result was the formation of the AMADEUS and GALILEO consortia in 1987. Both these systems were up and running by the early 1990s, when a series of mergers and acquisitions finally lead to the emergence of a mature industry structure. As one would expect in an industry where there are very large Economies of Scale, this structure was an oligopolistic one. SABRE was a dominant player, as were GALILEO and AMADEUS, both having strengthened their position through mergers with US-based systems in the early 1990s. The fourth and smallest player was WORLDSPAN, a system jointly set up by three US airlines, Delta, Northwest and TWA. (As has been noted, Worldspan is now soon to disappear in a merger with Galileo).

The most recent developments have seen changes in the ownerships of the GDS industry. Airline enthusiasm for the internet as a distribution channel – brought about in part because of the high charges they were incurring in GDS booking fees – has resulted in a lower proportion of bookings coming through the traditional travel agency/GDS channel. This has ended what might be called the "golden age" of GDS profitability. At the same time, airlines having an ownership stake in one of the GDSs have been under pressure to raise cash in order to maintain liquidity. The result has been that these stakes have almost all been sold off. In some cases, this has been through an Initial Public Offering (for example, with the American Airlines holding in Sabre), or through a trade sale (Galileo is now a wholly-owned subsidiary of the US-based Cendant Corporation).

The selling off of airline stakes GDS's has given the industry a degree of unity of purpose about them. Before, those airlines which had an equity stake in a GDS (and which were therefore benefiting from the substantial dividend income they were then receiving) took a different attitude to the question of booking fees than those who did not. Today, almost all airlines have a common interest in lowering booking fees to achieve more cost-effective distribution. Recently, too, in America at least, the GDS industry has been deregulated, with in particular an ending of the requirement that GDS owners must treat all airlines equally. This, together with a reduced regulation of displays, has allowed negotiations to begin around questions of trading display standards and content against booking fees.

7:3:2 Current Issues

Though the subject of bias in Global Distribution Systems is now somewhat less controversial than it was, there are still some substantial debates in progress.

Amongst the most contentious of these is the question of funding of the GDSs. Airlines now argue that they pay, through their booking fees, a disproportionately high level of total costs, whilst the travel agency industry pays far too little.

In principle, both airlines and travel agents benefit from the availability of a GDS. Airlines certainly gain from the wide distribution of their product, but agents also find that their costs are significantly reduced because of the much greater staff productivity they can achieve. The original suggestion was that GDS costs should be met to an equal degree by airlines and agents, reflecting these mutual benefits. This has not turned out to be the case. With the economics of a GDS so dependent on the volume of throughput, the GDS firms have had every incentive to try to steal market share from their rivals. In order to do so, it became a common tactic to allow travel agents the use of a system for a very low rental or, in many cases, if throughput in terms of the number of bookings made is sufficient, for the GDS companies to actually pay them for using their system. The result was, in many countries, an intense market share battle, with agents being offered bigger and bigger incentives to switch from one firm's system to another. In turn, a larger and larger share of GDS costs have in practice been paid by airlines through booking fees – current estimates are that more than 90% of GDS income is being derived in this way.

The dominance of airline funding of Global Distribution Systems has in turn led to two further controversies. The travel agent will often have a deal which ensures that the GDS will be made available free-of-charge, or for a nominal rent providing a sufficient number of bookings are made. Then, the agent with a sense of humour will have a clear incentive to make false and fictitious bookings if the number of true bookings they have is insufficient to reach the relevant break-point. Not surprisingly, such practices have provoked outrage on the part of those airlines that have been the victims of them, for the booking fees levied by the GDS companies have been based on the sectors booked, not on the number of passengers carried. Because of the controversy, the GDS firms have had to divert significant resources to policing false and passive bookings and, because they have done so, the problem now seems to be more under control.

The same certainty cannot be said for the second major problem associated with GDS funding. We have already seen how the travel agency system dominated airline distribution channels, and that until recently the system was costing airlines more and more. Because of this, it became a clear policy objective for many carriers to reduce their sales through travel agents. As discussed in Section 7:2:2, the use of the Internet, and the development of electronic ticketing are the technical developments which have made this possible.

As we have seen, in responding to this challenge to their dominance, better-managed travel agency firms are making what is, for them, an entirely logical move. They are repositioning themselves as travel management firms, able to assist corporate customers not only in the making of bookings, but in the negotiation of deals with airlines and other principles, and in the subsequent policing of expenditure to make sure that those who travel using the firm's money abide by its corporate travel policies.

Such a repositioning requires the travel agent to have a number of tools available in the form of computer systems to aid effective travel management. The GDS firms have been only too willing to develop these tools, hoping that by doing so they will be able to cement their relationship with their existing travel agency customers and also hopefully attract some new ones from rival GDSs. By a supreme irony, though, these system developments have largely been funded by airline booking fees, with the actions of the GDS firms helping travel agents to retain at least a proportion of their hold on airline distribution channels at exactly the time airlines have been seeking to reduce it.

A final issue for the GDS firms reflects the emergence of the so-called "Cost Leader" airlines referred to in Section 4:2:1. Airlines such as Southwest in the USA and Ryanair and Easyjet in Europe have grown significantly in recent years. Their strategy had been based on a low cost/low fares proposition. In order to lower their costs to the level which will make their low fares profitable, they have tried to simplify the product they have offered. In particular, they have generally use simple fares and reservations procedures, and have not offered interline or transfer services to their passengers, working purely on a point-to-point basis.

In the strongest contrast, the GDS firms have been proud to point to the sophistication of the services which, through the travel agent, they can provide to the passenger. A passenger today can contact their travel agent and make a very complex multi-sector booking on any number of different airlines, dealing at the same time with issues such as seat selection and special meal requirements. They can be given information about any fare which is on offer, as all the GDS firms maintain enormous fares databases. Finally, they can book any extra requirements they may have for such services as car rental or hotel accommodation.

Of course, the GDS firms argue that such sophistication comes at a price and they would claim that the booking fees charged represent very good value-for-money given the range of services on offer. The problem is that the customers of the low fares airlines do not need this level of sophistication yet are being asked to pay for it, because booking fees are levied on a flat-rate basis. Worse still, the booking fee, were it to be paid, would represent a very significant component of the fare the passenger had paid.

The upshot of this controversy is that, as we have seen, the GDS industry had been shunned by the low fare airlines. The oldest of them, Southwest Airlines, pays only for a low level of participation in one of the GDSs, SABRE and has no relationship with the others. It also tries to actively encourage bookings which allow it to avoid booking fees completely, through its own call centres or the Internet. In Europe, Easyjet is an example of a direct-sell airline, avoiding completely the travel agency distribution system. Through doing so, it has also avoided any need to be displayed in the databases of the GDS firms and has been able to add the elimination of GDS booking fees to the savings on commissions which it has achieved.

In such a changed world, the GDS companies have been shaken out of their complacency and are adopting a number of expedients. One of them, Amadeus, has embarked on a major diversification policy and now makes a considerable proportion of its income from the work which it does in the field of airline Information Technology consulting. It has also built a business in assisting airlines in their website development, thereby obtaining at least some revenue as a result of the Internet revolution. Each of the firms is also developing products with lower levels of functionality which, they hope, can be sold to the Low Cost Carrier sector. Though there would seem to be little prospect of them doing so to airlines - like Ryanair - which take the low cost theme to its extremes – they may be successful with airlines such as Jet Blue and Air Berlin that may come eventually to have at least some relationship with travel agents and corporate travel buyers.

As has been noted before, the final area where the GDS firms are having to respond to the new market realities is with respect to their booking fees. It has always been a subject of debate between the airlines and the GDSs as to who needed who the most. The GDSs have argued that without them, airlines cannot sell effectively. On the other hand, without airlines releasing their schedules and fares through the GDS system, no GDS business could exist. It is vital that the GDSs (and on-line travel agents for that matter) should be able to claim that the lowest fares available can be found on their sites. If passengers lose confidence in this proposition, they will stop visiting the sites. Because of this, airlines have now found a potent negotiating tool, by only allowing their lowest fares to be sold through GDSs in return for significant reductions in their booking fees. By a supreme irony, one of the carriers most active in pursuing this policy has been American Airlines. It was, of course, American, when it owned SABRE, which originally developed the business model for GDS pricing.

There is one final development now taking place in airline distribution policy which has the potential to put all previous arguments about GDS pricing, bitter though they have often been, into the shade – the rise of search engines, especially Google. There seems little doubt that the firms that run these engines are already in a position of considerable power, and that this power is going to steadily increase. When someone begins a search by entering such things as 'Cheapest fare to……..', or 'Best airline to…….., what the search reveals will be highly significant in the booking that they finally make. It seems inevitably that airlines will have to pay large sums to the search engine owners to ensure that references and links to their sites are properly displayed.

7:4 Distribution Channels in the Air Freight Market

The question of product distribution is no less controversial on the freight side of airlines' activities – indeed it could be argued that airlines are further away from finding a solution for their freight distribution problems that they are for those on the passenger side.

We have seen that the equivalent to the travel agent in air freight is the air freight forwarder. Forwarders provide the same sales agency function as the travel agent does. They also have an important role to play in the handling and consolidation of freight.

As we saw in Section 6:3, forwarders have only a small role in the so-called "Express" market of small urgent packages. The Integrated Carriers that dominate Express have built powerful retail brands and have invested large amounts in ground handling systems, which largely negate the role of the forwarder. In the remaining markets of so-called "Heavy Freight", though, the domination of the forwarding industry is almost total. The proportion of heavy freight in the hands of forwarders is well over 90%.

Such a reliance on a single channel of distribution would be unhealthy in itself, but the structure of the forwarding industry makes it worse still. Forwarding appears to be an industry where there are substantial Economies of Scale, and where important advantages accrue to the largest firms. Fewer than 15 global forwarders now dominate the market, with this number tending to reduce steadily through time as a result of what appears to be almost continuous merger and takeover activity amongst the leading players. The degree of consolidation is now increasing still further as the Integrators and the largest forwarders begin to link together.

The result of airline reliance on one channel of distribution is entirely as one would expect. Profits in the airline sector of the air freight industry have been under great pressure in recent years. A serious market downturn in 2000 and 2001 was followed by overcapacity and falling yields on many routes with only a modest improvement coming about in 2004 and 2005. In the strongest possible contrast, reported profits of publicly-quoted air freight forwarders during this time had never been better. Overcapacity amongst the airlines benefited them as they were able to play one carrier off against another, lowering the rates that they paid and in turn increasing the profits they made on their consolidations.

Rather than getting less, forwarders ability to play one airline off against another may be increasing. A number of airlines are now forming consortia, the aim of which is to streamline the process of booking in the air freight industry by the use of the Internet. At the moment, booking is mostly an archaic process using the telephone and appears ripe for reform. Internet platforms such as that provided by the GFX company are revolutionary. They are certainly achieving a streamlining of the process, though the charges rendered by GFX promise a controversy comparable to that generated by Global Distribution Systems on the passenger side of the industry. The charges made by the GFX organisation on the airlines that use it have been high enough to discourage many carriers from joining, whilst the question of the display which each carrier's flights are given in the system is likely to be controversial. Most seriously of all, GFX may complete the commoditisation of the air freight product, with forwarders able to make an immediate comparison between the rates on offer from the different competitors in a market. Great power will then accrue to the lowest-pricing airline, giving an endemic tendency towards rate cutting, especially in an over-supplied market.

It is easy to conclude that the present situation with regard to distribution channels for air freight is unsatisfactory. Airlines have too little market power despite making the bulk of the capital investment in the industry. They have also failed to make the progress seen on the passenger side in recent years, where the situation today is a good deal better than it was in the late 1990s. Unfortunately, arriving at solutions to the problem will not be easy.

In the past, some airlines have attempted to address matters by buying into the forwarding industry, or by setting up subsidiaries to compete with forwarders in such areas as off-airport ground handling. These attempts have generally not been successful. Whatever benefits they may have brought in terms of improved market control have been outweighed by the fact that remaining independent forwarders have generally reacted angrily, regarding such moves as an invasion of their territory. The commercial damage that they have been able to inflict has generally outweighed the benefits.

A more promising initiative has been taken in recent years, most notably by Air France. This airline appears to have learnt from the computer chip industry, and the strategies of Intel. Intel does not manufacture its own computers, but maintains a strong position with those who do by investing a great deal in the development of a powerful brand for its microprocessors. Air France has developed brands in air freight based on time-definite deliveries and different segments of the market. The airline clearly hopes that these brands will be requested more when shippers and forwarders are contemplating which airline to use.

Overall, questions of distribution strategies are today amongst the most contentious in the whole field of Airline Marketing. It is essential that airlines should control their distribution channels as it is largely their money that is at risk through these channels. The problem is that safeguarding long-term channel control may conflict with short-term objectives to maximise revenues, especially given the powerful positions that the industry's wholesalers and retailers have been able to build.

SUCCESSFUL AIRLINES ……

✈ Acknowledge that effective control of distribution channels is one of the most important drivers of profitability in the airline industry, and act to establish and sustain such control.