

Carrying the load

How deregulation will impact the GDS heavyweights

When Sabre was introduced in 1960 it was the first real-time business application of computer technology and enabled American Airlines to move to a fully automated passenger reservation system. Today there are 4 major Global Distribution Systems (GDS) – Sabre, Worldspan, Galileo and Amadeus – essentially electronic databases of travel information allowing multiple travel providers to display and manage their inventory. There are also several smaller GDS primarily servicing Asian countries such as Axess and Abacus.

Initially carrying mostly airline inventory, GDS are now the conduit for hotel bookings, car hire, cruises, tours and more recently holiday packages. The systems provide users, primarily travel agencies, with schedules, availability, prices, reservation and ticketing capabilities. Travel agencies can print airline tickets and boarding passes.

In the early 1980s the United States (and some 5 years later the European Community) introduced regulation of the GDS. The purposes of the Codes of Conduct were to prevent the airline-owned GDS from influencing contracts and bookings against their rivals, and by implication, reducing passenger choice. The significant requirements of the code provided that:

- For airlines that owned GDS, they were required to give all GDS the same information, fares and commissions;
- GDS could not place restrictions on contracts with travel agencies; and
- All GDS had to provide unbiased display of hotel content.

In order to provide differentiation and win travel agency accounts the GDS competed by increasing non airline content and through development of faster efficient technology.

A changing world

Until some 5 years ago the world of travel was relatively simple. Airlines and other suppliers input data into a GDS which displayed information to agents who made bookings on behalf of consumers. That distribution chain has now been torn apart.

Airlines and hotels now sell increasingly via their own web-sites direct to consumers. Increasing use of travel internet web-sites does not necessarily change the number of bookings processed by the GDS as they also power the inventory and reservation capability of many of the on-line travel sites. However it does change the power base and relative profitability of the various channels. With less reliance on agents, airlines have been able to slash commissions (see box opposite) and in the case of the low-costs carriers, some of whom only sell through their web-sites, deprive GDS and agents of product and commission altogether!

The BA deal

At a recent industry conference (TravelMole.com 16 March 2004), Ian Heywood Head of Corporate Sales for British Airways stated that the carrier had been trying to reduce fees to GDS providers for 10 years. He believes that "the model is broken" Now, ahead of deregulation, it had negotiated with each of the GDS (for its UK agency customers only) to provide the GDS with full content, that is all available fares, but at reduced fees to BA for a period of 3 years.

Ian Heywood stated that they had merely bought time to create a new business model following deregulation in the US and Europe. In addition a large number of carriers have followed BAs lead in Autumn 2003 and have cut commission payments to agents to only 1%.

As of March 1 2004, BA reduced the charges paid to GDS for bookings via the GDS from UK agency customers. In return business agents will get the full range of lowest fares. This reduced fee to the GDS has prompted different responses from the GDS.

In the aftermath, Galileo has decided to charge a flat fee to agents of 50p per sector, Amadeus announced a modified tiered pricing to airlines that increased long-haul travel fees and reduced short-haul – effectively keeping fees flat overall. European economy flights will incur a 95p charge. Worldspan will charge 45p per sector. In each case the agents can choose not to opt in but then will not get all BA fares including web fares and will pay the full BA surcharge of £3.00.

Controversially, Sabre is not charging anything at all for BA flights and has guaranteed this for 3 years. Clearly a revenue gap exists for the GDS.

These developments and the fact that most GDS are now independent of airlines persuaded the US Department of Transport to scrap most current GDS regulations as of January 31 2004 and from 31 July 2004, GDS will also be allowed to display bias in listing of airline flights on the basis of the airline.

European deregulation

The Brattle Group report to the EU recommends a less dramatic deregulation that would still require parent carriers to participate equally in all GDS in their home markets only. Similarly the airline-owned GDS must provide improvements in service to all participating carriers in the owner-airlines home markets. This would affect only 3 airline carriers – Lufthansa, Air France and Iberia all investors in Amadeus. In any case most major carriers choose to participate in several GDS. However airlines are now free to negotiate different fees to distribute through the GDS. This is leading to more innovative pricing strategies.

Publicly all the GDS have welcomed deregulation, so what form will the future take for the major players?

What deregulation means for the GDS

GDS have generally welcomed deregulation and the opportunity to have commercial discussions with airlines for the first time.

However, lower fees from airlines reduces the unit gross margin (fees from airlines less incentive payments to agents) and, if the cost is not to be passed to the travel agencies in additional fees or lower incentive payments, additional sources of revenue must be found. GDS are looking to rebalance the equation and diversify away from the traditional model by adding value through:

- reducing operating costs;
- increasing bookings through web-sites – their own and third party sites;
- providing technology solutions to suppliers such as airlines; and
- encouraging agents to book other travel supplies that still provide GDS with an income through increasing product (e.g. packaged holidays) and better technology (dynamic packaging).

For the GDS companies, it is then a question of pursuing increased revenue opportunities and reducing distribution costs. Do they concentrate on their core business of servicing travel agents or seek new business opportunities?

Agency relationships

Traditional “brick & mortar” travel agents have been the user base of the GDS. Now agents are welcoming the opportunity to negotiate with GDS on the basis of content and cost whilst at the same time they are also concerned at the loss of commission from airlines as a result of direct bookings, reduced commission rates and the growth of low-cost carriers.

At the moment most travel agencies contract with one GDS supplier. Consolidation in the agency sector will allow the stronger agency groups to negotiate lower fees and increased incentive payments. On the other hand they will also be attracted to those GDS who through innovation of functionality, better settlement and vouchering, increased and better content description enable the agency to make more bookings. Whilst changing a GDS supplier has, in the past, been a monumental task, technology is helping to reduce the burden. The future may also permit technology that allows agents to go with whatever GDS is right at the time.

The GDS want to encourage agents to book flights through them as the agent will book additional car hire, accommodation and cruises on which it will earn booking fees. For this reason, GDS are looking at ways to get the low-cost carriers on board at presumably little or no cost to the carrier. Agents will be able to package such fares up in other services, or charge service fees for the transaction, to earn income. GDS are also wary of introducing screen bias in displays as this may also turn off agents and corporates who value GDS neutrality. However, Sabre through its Exclusives programme has introduced screen biasing for hotels.

For the GDS, incentive payments to travel agents are a large expense line (Sabre – “our largest single expense line”) and these are likely therefore to come under pressure. However, no GDS wants to be the first to reduce incentive payments which have become more important as commissions from airlines have reduced and charges introduced for wider access to fares.

As a way forward, on May 2004 Virgin launches its new scheme to pay differential commission levels to agents who sign up to the scheme. Virgin places agents within Platinum, Gold, Silver or Red bands depending on the revenue they generate for Virgin.

The bands determine the level of commission and benefits agents receive. GDS have to be capable, however, of being able to charge agents differential fees.

A greater threat posed by the consolidation of travel agencies to the GDS could be a move away from GDS altogether. In the States, Carlson Wagon-lit launched a direct connection system with Continental, Delta and United Airlines. Consortium travel agents are also developing their own booking systems in the US. For hotels distribution providers such as Active Hotels and Octopus can provide the travel agents with better description, photographs and ease of use than traditional GDS.

Strategies in the future?

Table 1: GDS worldwide bookings comparison

	2000	2001	2002	2003	2004(e)
(Bookings in mms)					
Amadeus ⁽¹⁾	393.9	386.1	395.6	383.1	402.3
Galileo ⁽²⁾	350.9	306.2	286.0	267.4	276.7
Sabre	466.6	430.8	397.4	364.3	376.5
Worldspan ⁽³⁾	172.6	195.6	191.8	194.0	205.6
Total bookings	1,384.0	1,318.7	1,270.8	1,208.8	1,261.1
Growth in total bookings (%)		(1.5)	(3.6)	(4.9)	4.3

(1) Does not include Germany's Start Leisure Bookings.

(2) Cendant acquired Galileo in late 2001. Estimates prior to 2001 are based on Galileo public filings.

(3) Worldspan was sold in mid-2003. Estimates are for 2002 and 2003 based on public filings and CIBC estimates.

Source: CIBC World Markets

The four majors have largely sought to improve market share by widening content (particularly in leisure), improving technology and service for the agents and widening roots to market through developing and acquiring on-line travel sites.

Amadeus

Amadeus believes it has the most agency friendly business model. Its current strategy is aimed at improving its leisure offering to agents. Last year Amadeus bought a German company Start now renamed Amadeus Tours giving access to 170 tour operators and allowing Amadeus to sell leisure business into the German market and earlier this year, the company bought a 20% of UK technology provider Comtec for £2m to improve leisure content to travel agents in the UK. Comtec also provides software systems to the big four tour operators in Europe – Mytravel, TUI, Thomas Cook and First Choice – and online agencies such as lastminute.com and Expedia.

Amadeus was the last GDS to acquire a consumer facing web-site and in June of this year it took its stake to 55% of Opodo from 9 European airlines all of whom remain shareholders. According to Philippe Chereque, vice-president of strategy, the acquisition forms part of the company's strategy to look at further acquisitions of on-line travel agencies.

Amadeus also earns revenue through processing bookings for airline web-sites and ticket offices (27% of 2003 bookings). Therefore it is not as exposed to shifts to direct airline bookings as perhaps some of its competitors. Amadeus also offers outsourcing of airline IT functions via its New Gen platform. BA, Qantas Lufthansa and Finnair are already migrating.

Sabre

Sabre intend to absorb the reduction in fees from BA "indefinitely" and instead the company will move from a loss making position by taking cost out of the business, increasing its product range and winning market share by having the best content. According to Sabre it has moved from being "a distributor of fares and booking facilitator, into an organisation that helps travel agents market themselves and negotiates with travel providers for the best range of fares and travel content...". The company intends to focus also on improving the technology tools available to agents and consumers. It plans to sell dynamically packaged products to agents through its online Pronto system.

New revenue streams will be sought through extending the merchant hotel rates available to consumers through Travelocity Merchant Hotel program and the travel agent through the Sabre GDS. Although it will not remove the incentives available to agents it intends to look at the structure of its incentive program as a result of the new airline pricing models.

A key differentiator for its web-site Travelocity in Europe is its high street presence. The company is present in 5 European markets under various brands – UK, Germany, Sweden, Norway and Denmark and has a high street presence in Germany (JV Travel Overland with 16 shops) and France with the purchase in March 2004 of VFinances, a holding company including 10 high street agencies in key French cities. A French language web-site including dynamic packaging capabilities will go live this year. The company has, however, ruled out having retail outlets in the UK in the foreseeable future.

Worldspan

Worldspan will continue to seek a role powering the technology behind the internet distributors of which it claims more than 60% of all on-line agency airline bookings worldwide. E-commerce sites such as Orbitz, Expedia.com, priceline.com and Hotwire use Worldspan technology. The company will also seek to improve both traditional GDS technology but also developing other technology solutions for both suppliers and agents.

Worldspan also offers a tour operator product called Tourselect.

Worldspan is the only GDS without a consumer facing on-line agency.

Galileo

Cendant Travel Distribution provides supplier to consumer services such as switches (WizCom and Trust International) that link hotels and agents to company central reservation schemes, travel agency web-sites (Highwire), consumer on-line portals (Trip.com, CheapTickets and Lodging.com as well as the GDS, Galileo.

Table 2: GDS Transactions since 2000

Date	Target	Acquiror	Deal consideration (£m)	Deal description
Jun-04	Opodo Ltd	Amadeus Global Travel Distribution SA	41	Partial acquisition
Mar-04	VFinance	Travelocity Europe	n/a	Acquisition
Feb-04	Comtec	Amadeus Global Travel Distribution SA	2	Partial acquisition
Nov-03	Dillon Communication Systems GmbH	Sabre Travel Network	14	Partial acquisition
Nov-03	Travel 2/Travel 4	Cendant Corporation	n/a	Acquisition
Oct-03	World Choice Travel inc	Travelocity.com	30	Acquisition
Jun-03	Worldspan	Travel Transaction Processing Corp	630	Acquisition
Feb-03	Start Amadeus	Amadeus Global Travel Distribution SA	64	Partial acquisition
Jun-02	Trust International AG	Cendant Corporation	n/a	Acquisition
Apr-02	Sigma	Cendant Corporation	64	Acquisition
Mar-02	Site59	Travelocity	28	Acquisition
Oct-01	Galileo	Cendant Corporation	1,600	Acquisition
Sep-01	Travelocity Europe	Travelocity.com LP	34	JV
Oct-00	Vacation.com	Amadeus Global Travel Distribution SA	59	Acquisition
Oct-00	GetThere	Sabre	n/a	Acquisition

Source: Mergermarket/Deloitte analysis.

As part of the large parent company, Galileo intends to use its buying power to provide greater content including tour operator content. In November 2003 the company purchased Travel2/Travel4 a long haul operator and recently offered travel agencies which sign up to Galileo in Australia to opt-in to the full content program, complete access to the same Qantas fares.

Some larger travel agents however may regard Cendant's participation in all aspects of the chain as a threat to independence.

What next?

Despite their size, the major GDS operators find themselves in a tough market with growing competition and increasingly assertive suppliers and agents.

They are looking to respond to this in two ways:

- to seek to secure and develop their relationships either with customers or with product through the acquisition of tour operators or on-line agencies; and
- to continue to evolve their technological platform either through innovation or acquisition to maintain their leading position in this area.

It is our view that the activity will be focused on acquisition by the big four rather than further consolidation between them, despite all the speculation for an Amadeus/Worldspan merger.

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GDS profiles

Amadeus

- Founded 1987.
- Original owners: Air France, Iberia, Lufthansa.
- Current ownership: Quoted on the Madrid, Paris and Frankfurt stock exchanges. In February 2004, Lufthansa reduced its stake to 5.1% from 18.3% in a move that analysts suggested the company could herald sector consolidation. Air France (23.36%) and Iberia (18.28%) remain the largest shareholders.
- Headquartered in Madrid, Spain.
- 2003 revenues, €1.9bn and net income of €148.6m.
- Customer base: 65,250 travel agents; 10,500 airline offices.
- Inventory: 469 airlines; 58,000 hotels; 50 car rental agencies; ferry, rail, cruise and insurance providers.

Worldspan

- Founded 1990.
- Original owners: Delta Airlines, Northwest Airlines and Trans World Airlines combining the companies' existing reservation technologies that has been developed since 1968.
- Current ownership: Worldspan was sold in June 2003 to Transaction Processing Corp, a vehicle set up by Citigroup Venture Capital and Teacher's Merchant Bank for (\$745m) €900m; In April 2004 the company announced plans for an IPO, which has subsequently been aborted.
- Headquartered in Atlanta, Georgia.
- 2003 revenues of \$896.9m down 2% on 2002; Full year net earnings were \$13.7m, down 87% compared to 2002.
- Customer base: 16,000 travel agencies.
- Inventory: 465 airlines, 55,000 hotels; 40 car rental agencies; 40 tour & cruise lines.

Sabre

- Founded 1960.
- Original owners: American Airlines and IBM.
- Current ownership: Sabre Holdings is the New York listed parent of Sabre Travel Network, Travelocity and Sabre Airline Solutions; owns 50% of Travelocity Europe.
- Headquartered in Southlake, Texas.
- 2003 revenues \$2.05 billion; Full year net earnings were \$83m compared to \$214m for 2002. Bookings processed through the Sabre GDS were 8% down on 2002 at 366 million.
- Customer base: 56,000 travel agents.
- Inventory: 400 airlines; 60,000 hotels; 53 car rental agencies; 9 cruise lines, 36 rail companies, 232 tour operators.

Galileo

- Founded 1993.
- Original owners: 11 North American and European airlines – floated in 1997 on NY and Chicago Stock exchanges.
- Current ownership: Acquired by Cendant in 2001 for US\$ 1.8bn after bidding battle with Amadeus.
- Headquartered in Parsippany, New Jersey USA.
- 2003 revenues: Not known.
- Customer base: 44,000 travel agents;
- Inventory: 470 airlines; 56,000 hotels; 24 car rental agencies; 430 tour operators, and all major cruise lines.