

The Future of Travel Management Companies in Latin America



Scenario Planning for Multinational Business Travel Companies in Latin America

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HERMES
Management Consulting

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Scenario Planning for Multinational Travel Companies in Latin America

About Scenario Planning

Many have tried to understand the future purely through prediction, even though the record to date is poor. Forecasters extrapolate from the past, imposing the patterns they see in the past onto the future, and tend to neglect the oft-quoted statement that 'a trend is a trend is a trend until it bends.' The scenario approach recognizes that only some matters may be subject to forecasting, whereas others are essentially unknown. Scenarios are concerned more with strategic thinking than with strategic planning; and, more specifically, with the quality of that thinking.

Scenario Planning is a structured process of thinking about and anticipating the unknown future. It aims to examine possible futures, its impact on individuals, organization or societies, to identify strategic directions that would be beneficial regardless of how the future unfolds.

Abstract

What should travel agencies do if **airlines** continue **decreasing** the **commissions** and **overrides**? How to acquire a **higher productivity**? What **new services** will **travel agencies need** in the future?

These are some of the main concerns that travel agencies managers in Latin America actually have. However, everyone of these issues can develop in a different way, depending on the market evolution in the next years .

This White Paper consolidates and reviews the results of an independent research study conducted in 2008 by Hermes Management Consulting (Hermes) in Latin America (Brazil, Mexico, Colombia, Argentina and Chile). The study was commissioned by Amadeus in order to:

- Understand Latin America's business travel market evolution and trends
- Identify the key issues affecting multinational TMCs in the next 3-5 years
- Develop scenario(s) on possible developments of the market and their impact on the economics of a model TMC

The purpose of this paper is to review the study previously conducted and offer an analysis of Latin American business travel trends identified along with recommendations on how travel agencies can more effectively meet the needs of their customers. It is the first time that a study of its kind has been conducted across Latin America and thus represents a new window of opportunity for travel agencies in the region.

Methodology

A sample selection of travel agencies, suppliers (airlines, hotels) and corporations were identified in each country and interviews were conducted (more than 50 interviews in 5 different countries) with each one in order to understand the main industry's trends for the following 3-5 years and the key issues affecting the different scenarios. This allowed the different scenario(s) for the next 3-5 years to be identified.

In addition, an economic model for an average TMC was developed in order to understand and estimate the impact of the different strategies and possible market developments on the economics of a generic TMC.

A detailed explanation of the research methodology is provided in the appendix.

Overview of the Latin American Business Travel Market

During the last years, the Latin American travel industry has experienced 3 great external shocks impacting the industry structure, the conduct and the participant's performance:

- Rapid internet adoption enabling the use of online channels
- Airlines' cost cutting efforts resulting in:
 - Declining revenues to TMCs.
 - Further consolidation of TAs
- Record high oil prices only accelerating these trends

The industry's structure is under a great transformation:

- **Demand** has experienced a high growth in business travel, aligned with economic growth. Multinational corporations negotiate directly with suppliers and demand sophisticated travel management from TMCs, while SMEs mostly aim for access to negotiate and seek the best prices
- **Competence** between travel agencies is stronger than some years ago. OLTAs still have room for growth in the leisure segment, but are targeting SMEs empowered by the rise in Internet penetration. Also, the direct channels are increasingly becoming more important, due to the airlines' efforts to reduce distribution costs
- Providers, mainly driven by their efforts in reducing costs and the appearance of LCCs (Low Cost Carriers), have reduced commissions and "pushed" towards disintermediation in the distribution channels

Facing all these industry changes, the travel agencies market has consolidated, and travel agencies have diversified into new businesses, developing new revenue sources to try to retain profitability. Also, by expanding, travel agencies were better positioned to negotiate directly with suppliers.

TMC's profitability has eroded, because they have not been able to compensate their loss revenues from the airlines with "client-oriented" revenues.

External shocks

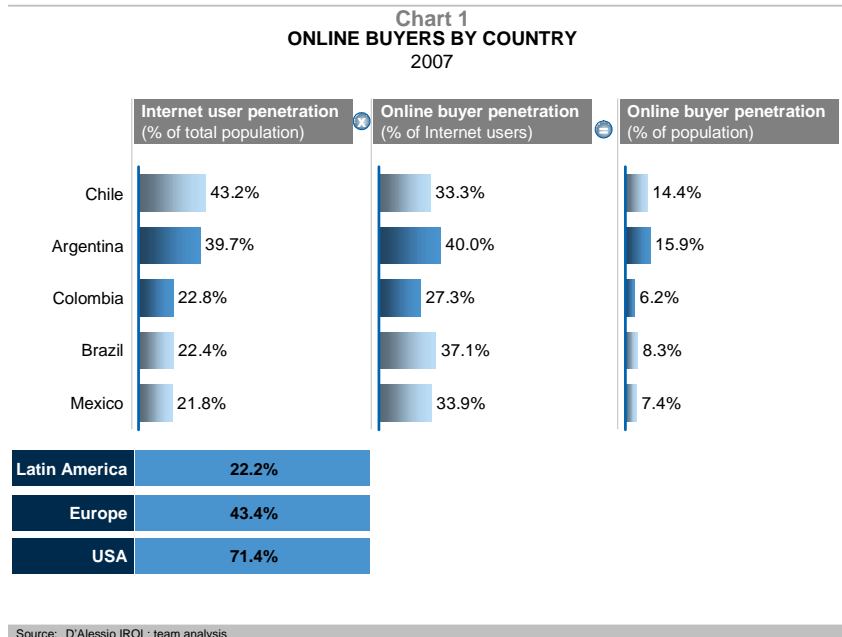
Rapid growth in Internet penetration

Internet user penetration in Latin America is 22% of the population in 2007, lower than in Europe (43%) and USA (72%), although Chile (43%) and Argentina (40%), the countries with highest Internet penetration, show levels comparable with that of Europe (see Chart 1)

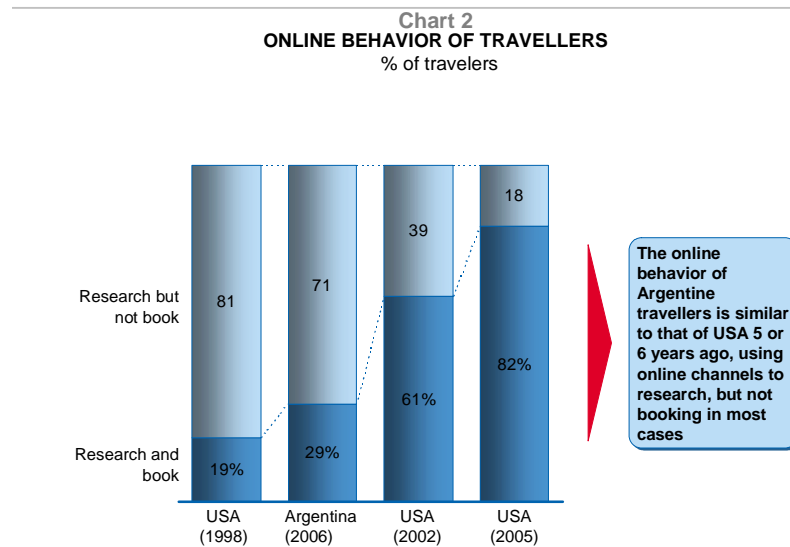
Online buyer penetration¹ is the main driver, especially for Argentina (highest) and Colombia (lowest), although online buyer behavior is still low in comparison with more

¹ Online buyers/Internet users

developed markets, such as USA.



In the case of Argentina, the online behavior of online travelers is similar to that of USA



5 or 6 years ago (see Chart 2)

Global mandate from Multinational Corporations (MNCs) that have implemented successfully self booking tools elsewhere (mainly Europe and USA) and Internet penetration, which is high in corporations and growing rapidly in consumers, are the main enablers for the adoption in Self Booking Tools in Latin America.

On the other hand, content fragmentation, especially in Brazil and Mexico, is the main barrier for self booking tools' adoption across the region.

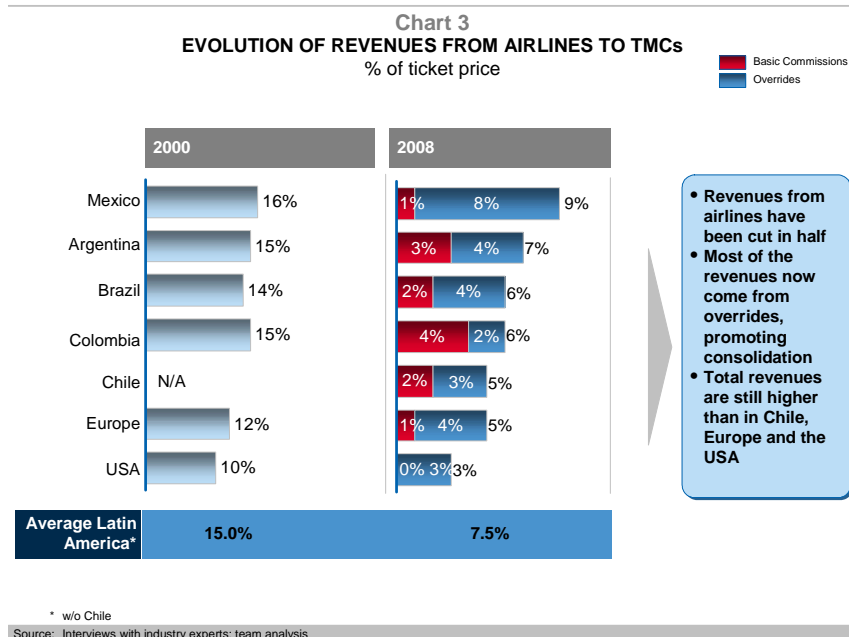
Airlines' cost cutting efforts

Fuel accounts for 50% of total cost of airlines and is mostly out of their control, and is expected to continue increasing in the following year. All they can do is use fuel efficient aircrafts, and for this reason many airlines are ordering new generation aircrafts to replace the less efficient ones.

On the other hand, airlines are focusing on cost cutting in every possible category:

- **Personnel** through automation of processes (online check-in and self check-in the airports)
- **Services** (reducing the meals offered during flights)
- **Distribution** by going direct (online distribution through their web pages, reducing commissions to TAS, booking fees to GDSs and service fee of credit cards)

Average revenues from airlines to travel agencies have been cut in half during the last 8 years (15.0% in 2000 vs. 7.5% in 2008), still higher than in Europe (5.0%) and USA (3.0%). Most of the revenues actually come from overrides (while in the past came from basic commissions from the airlines), promoting consolidation of travel agencies (see Chart 3). However, it's expected that airlines keep cutting basic commissions and especially incentives, following the trend of the USA and Europe, in order to continue reducing costs.

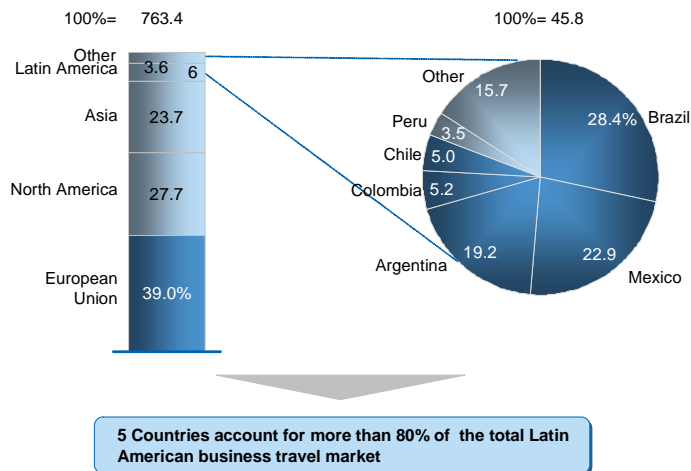


Structure

Demand

Latin America accounts for 6% of total business travel market in 2007, with the 5 main countries (Brazil, Mexico, Argentina, Colombia and Chile) accounting for more than 80% of total Latin American business travel market (see Chart 4).

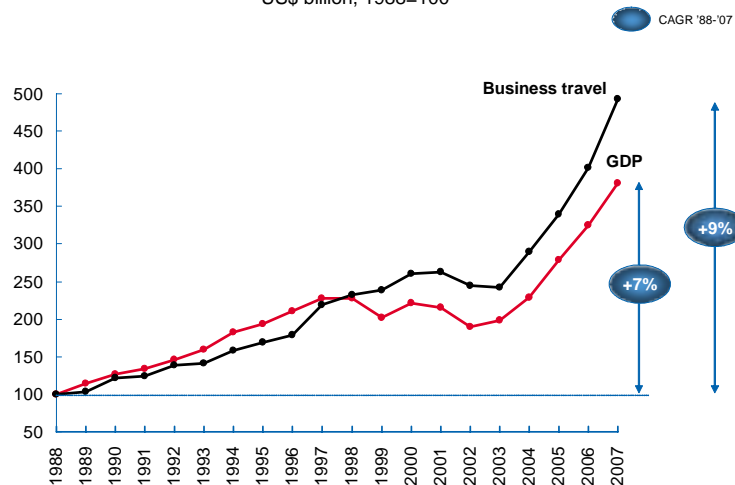
Chart 4
BUSINESS TRAVEL MARKET BREAKDOWN
US\$ billion, 2007



Source: World Travel & Tourism Council; team analysis

Business travel in Latin America has grown at an annual average rate of 9% since 1988, aligned with the GDP's growth of 7% (see Chart 5)

Chart 5
EVOLUTION OF GDP AND BUSINESS TRAVEL MARKET IN LATIN AMERICA
US\$ billion, 1988=100



Source: International Monetary Fund; World Travel & Tourism Council; team analysis

There are mainly two clients segments, Multinational Corporations (MNCs) and Small and Medium Enterprises (SMEs), not only differentiating because of their travel spending volumes, but also because of their needs.

- MNCs

Basically looking for **travel management** from the TMC, where the main issues are the following:

- Consistent **service across the region** and/or worldwide with reputable providers (leading TMCs), using regional/global RFPs

- Enforcement of **travel policy**
- Management and maintenance of **traveler profiles**
- Expense **management, MIS** (statistics and reports), **complex invoicing** with cost centers, help desk
- Generally adopting or considering **self booking tools**
- **Integration** of **self booking tool** with **ERP**
- **Security** information of passengers

Those MNCs with a travel manager will focus on optimizing total travel expense, and how a TMC can help them achieve it (to the extent that TMCs are differentiated). On the other hand, those MNCs where the buyer is Purchasing or Finance tend to focus more on transaction fees only

- SMEs
 - **Best price**
 - Access to **negotiated rates**
 - Most have **none** or very **simple travel policies**
 - If managed, may require a **very simple, standard fulfillment, invoicing, expense management, reports**

Competition

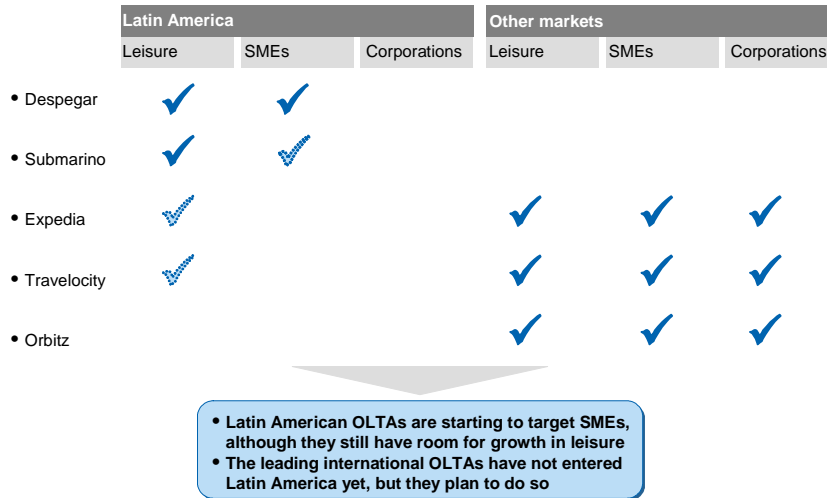
TMCs have a mix of fully owned and franchise operations in different countries in Latin America, due to:

- In some cases they didn't have time and/or resources to have fully owned operations in every country, in addition to the fact that Latin America is not a strategic region
- Because Latin America is viewed as a risky region, some TMC prefer to associate with big and local travel agencies which have good insight knowledge of the market, thus they can be present in all countries with a lower exposure to risk due to economic and political fluctuations

About 50% of the local operations of the multinational TMCs in Latin America's main markets are franchised operations

Knowing that SMEs are mainly focused on price and have none or very simple travel policies, Online Travel Agencies (OLTAs) are starting to target this segment of business travel, although they still have space to grow in the leisure market (see Chart 6).

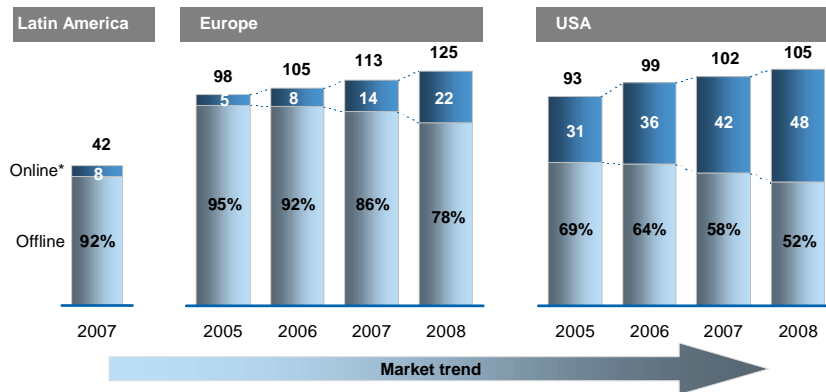
Chart 6
BUSINESS TRAVEL COVERAGE BY OLTAS
 2008



Source: Interviews; team analysis

Online channels have increased their penetration during the last 4 years in the USA and Europe, although it's still lower in Europe (22%) comparing to that of the USA (48%). Their penetration in Latin America (8%) is comparable to that of Europe 2-3 years ago (see Chart 7)

Chart 7
EVOLUTION OF CHANNEL BREAKDOWN OF BUSINESS TRAVEL
 US\$ billion



- Online channels have increased their penetration during the last 4 years in the USA and Europe, although it's still lower in Europe
- Their penetration in LATAM is comparable to that of Europe, with a 1 year lag

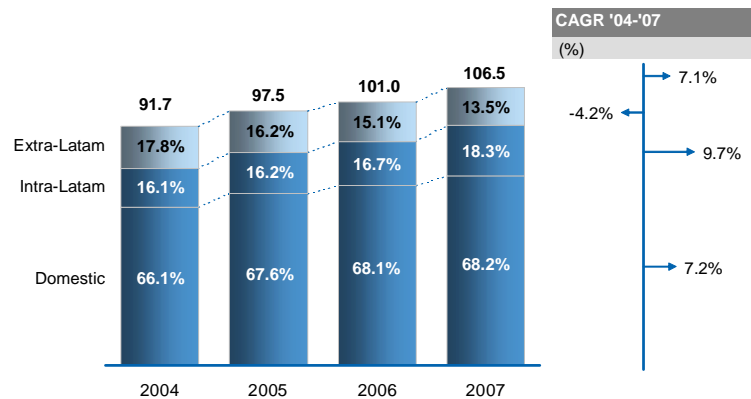
* Direct and indirect (airlines, traditional travel agencies and OLTAS)

Source: PhoCusWright's Online Travel Overview; team analysis

Suppliers

Total Latin American traffic has grown at 7% per year in the last 4 years, similar to the world's average (8%). Intra-Latin American and domestic traffic increased their share, accounting for 86% of total Latin American traffic in 2007 and pushing the regional growth (see Chart 8)

Chart 8
EVOLUTION OF AIR TRAFFIC BY REGION
 In millions of passengers, Latin America

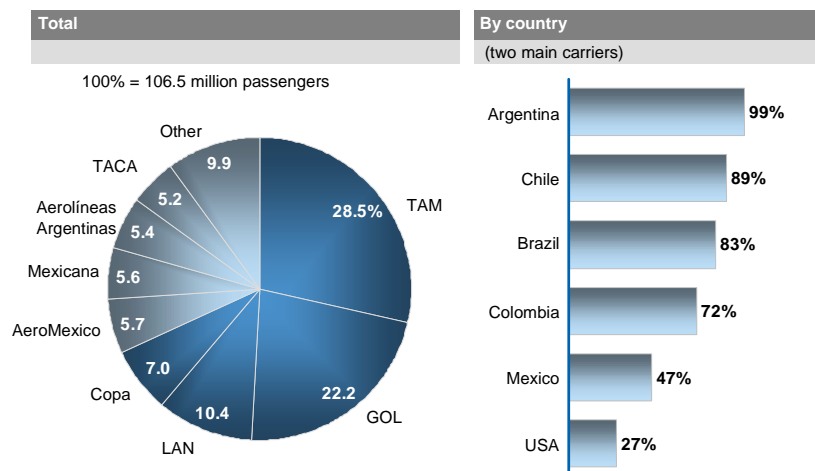


- Total Latin American traffic has grown at 7% per annum in the last 4 years
- Intra-Latam and domestic traffic increased their share, accounting for 86% of total Latin American traffic

Source: ALTA, IATA; team analysis

The airline market in Latin America has consolidated in the last 5 years, where the main 4 airlines account for 68% of total market in 2007, and it's expected to consolidate even more in the next years. Argentina, Chile and Brazil are the most consolidated markets, where the two main carriers account for more than 80% of domestic traffic (see chart 9)

Chart 9
MARKET SHARE OF AIR PASSENGERS IN LATIN AMERICA
 Percent, 2007



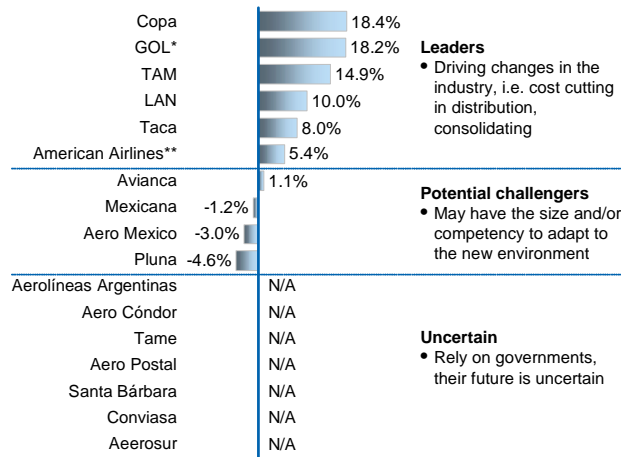
Source: ANAC, JAC, DGAC, interviews, websites; team analysis

With rising oil prices, changes in the industry are accelerating:

- The **leaders**, with EBIT margins between 6% and 18%, will become more efficient and consolidate their dominant positions. They are driving changes in the industry, i.e. cost cutting in distribution, personnel and services (as mentioned before). It's also expected that they continue to consolidate, probably having 3 or 4 big regional players in the next 3-5 years

- Some **potential challengers** will become leaders. They may have the size and/or the competency to adapt to the new environment
- There could be casualties among those who **don't adapt** to the new environment. These mainly rely on government, thus their future is uncertain

Chart 10
EBIT MARGIN BY AIRLINE
 % of gross sales, 2007



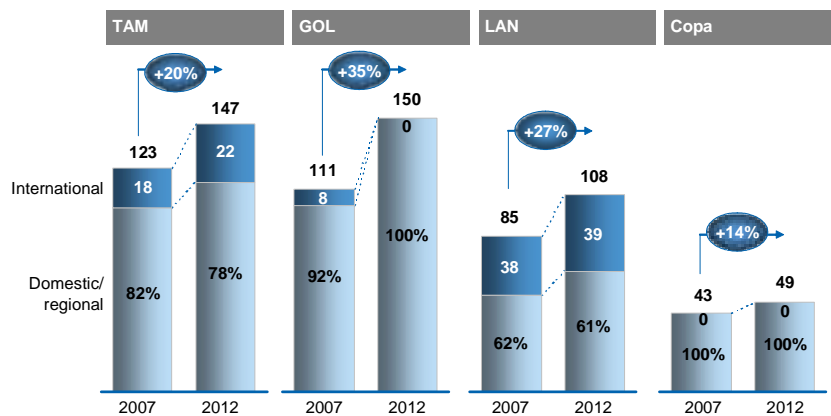
* Data for 2006
 ** Latin American operations in 2006

Source: Company reports; team analysis

Also due to the increase in operational costs, mainly driven by fuel, the break even load factor has increased in the last 5 years (54% in 2003 vs. 63% in 2007). However airlines have managed to increase load factors (65% in 2003 vs. 71% in 2007), by optimizing their operations, which leaves them in a strong position with the trade

The main carriers in Latin America (TAM, GOL, LAN and Copa) are expanding their fleet, but only TAM and LAN will keep long-range aircrafts, while GOL is retrenching to domestic/regional aircrafts after Varig's acquisition (see Chart 11)

Chart 11
PROJECTED FLEET EVOLUTION OF MAIN CARRIERS
Number of passenger aircrafts



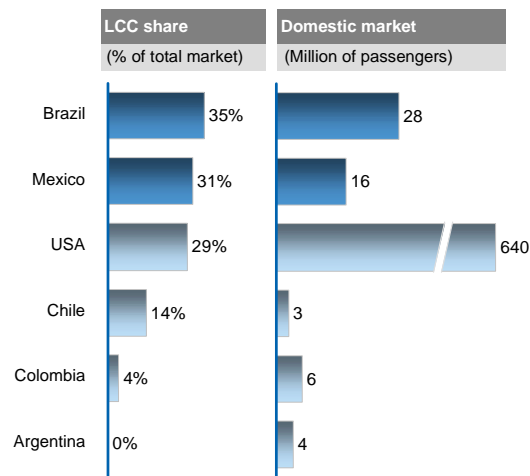
Source: Companies reports; team analysis

In line with what is happening in the USA and Europe, LCCs are increasing their participation in Latin America. Already, LCCs dominate the domestic market in Brazil² (40% of market share) and have sprouted in Mexico. LCC penetration in Brazil and Mexico is higher than in the USA, due to GOL's dominance in Brazil and the government's incentive policy in Mexico (see Chart 12). They have not developed yet in Colombia, even though the domestic market is larger than the international market, and it presents the third biggest domestic market in Latin America. In Argentina (due to government regulation) and Chile (due to LAN's presence) although there are potential attractive domestic markets, LCCs are not expected to develop during the next 3-5 years

Domestic travel is going to the LCC model, even for full-service carriers, and international travel will stay full-service, regardless of the airline

² TAM is not considered as a LCC

Chart 12
MARKET SHARE OF LCCs BY COUNTRY
Percent of domestic traffic passengers, 2007

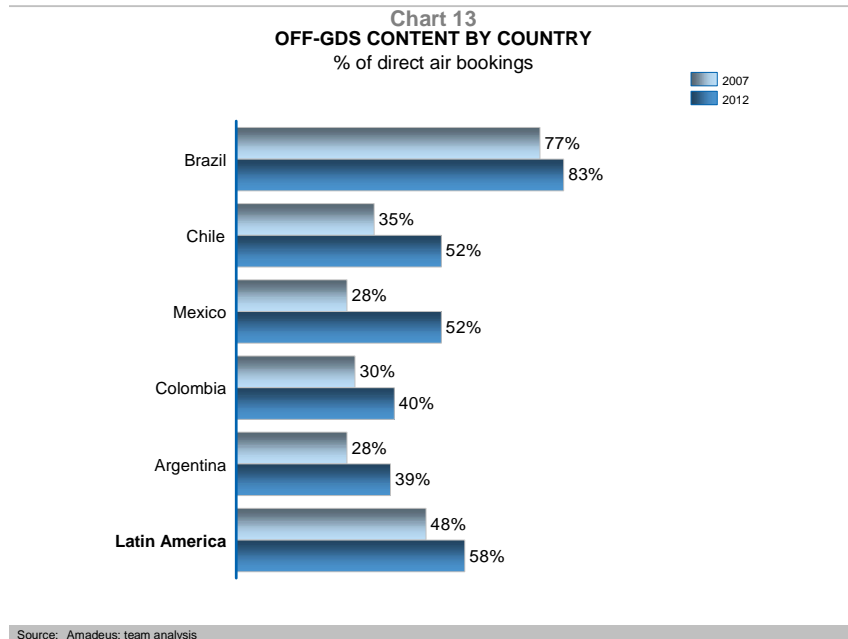


Source: ANAC, JAC, DGAC, interviews, websites; team analysis

The rise of LCCs puts more pressure on full-service carriers, and therefore on indirect channels to reduce costs. Therefore, full service carriers are moving part of their content out of GDSs. They are also disintermediating the chain through direct sales, either online, call centers or their own offices.

This results in Brazil being the most “disintermediated” market in the world, with 77% of air content off-GDS. Other countries, such as Mexico (due to LCCs) and Chile (on behalf of LAN’s direct sales strategy) also show a high level of disintermediation (see Chart 13)

Also for hotels and car rentals, although with a lower participation in total bookings and revenues for the travel agencies, the same content fragmentation problem occurs. Only 15% of total hotel content is present in the GDS in Latin America, and about 1% of air bookings through the GDS also includes hotel bookings (compared with 6% of Europe and 28% of the USA)



Content fragmentation increases costs to travel agencies, by reducing the productivity of the travel agents that should spend more time for each booking. The difference in productivity between a booking done through the GDS and off-GDS is about 14%.

Conduct

There has been a worldwide consolidation of TMCs in the past 2 or 3 years, and it's now starting to occur in Latin America (TMC account for 26% of total business market), although it is still lower than in more developed markets, such as Europe (32%) and the USA (36%) (see Chart 14).

In the coming years, consolidation will strengthen, especially in those markets that are still fragmented, like Latin America. Because content fragmentation is pushing travel agencies costs up and productivity down, the worst performing TAs will be driven out of the market.

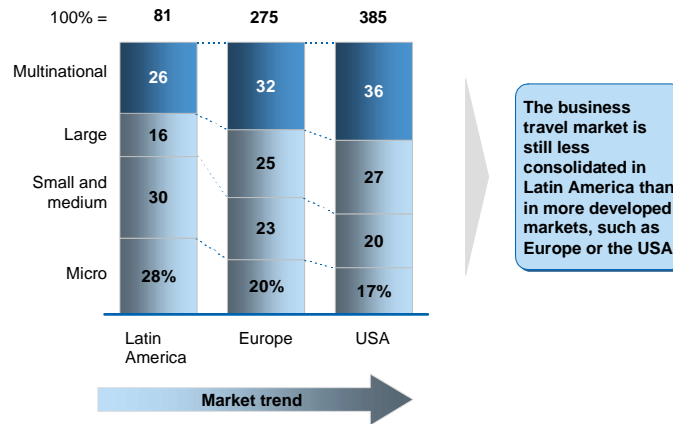
TMCs have already started to migrate fully to a service-fee model because their client is not the airline anymore and is now the traveler or the corporation instead. Although there are still basic commissions from airlines, they are expected to go to 0 in the short term, thus pushing the revenue source towards a service-fee model even further, and developing even more other revenue sources, such as SMEs, consolidation business and MICE.

In order to replace the lost basic commissions from the airlines, large TAs and TMCs have started to aggregate the buying power and provide fulfillment to smaller TAs, thus generating a new source of revenue for them and allowing smaller TAs to survive, acting somehow as consolidators.

As mentioned before, many TMCs are affiliated or have franchised operations in different countries with local travel agencies. This, and the higher profitability, is the main reason for having other revenue sources not traditionally related to business

travel, such as leisure and inbound travel.

Chart 14
MARKET SHARE BY SIZE OF TRAVEL AGENCIES
Million of segments, 2007



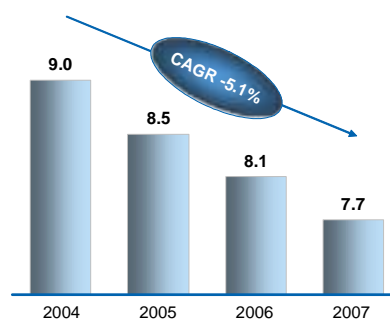
Note: Micro: Less than 10 thousand segments per year; SME: Between 10 and 100 thousand segments per year; Large: More than 100 thousand bookings per year
Source: MIDT; team analysis

Performance

Total travel commissions and fees have declined in the last few years (see Chart 15), showing:

- That the loss of revenues from airlines has not been offset by higher customer fees
- Intense price competition

Chart 15
EVOLUTION OF AMEX'S WORLDWIDE TRAVEL COMMISSIONS AND FEES
Percent of gross travel sales



Source: Annual reports; team analysis

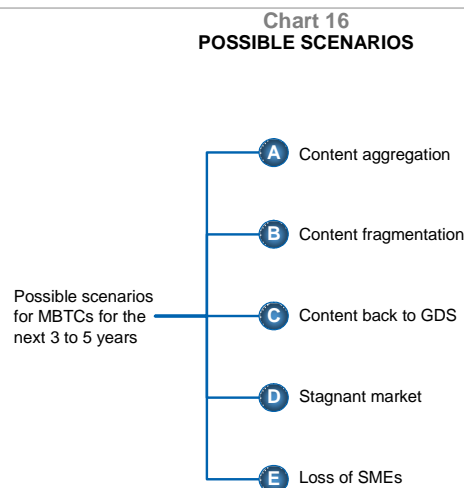
Possible scenarios

The interviews conducted were the primary source to identify drivers and their uncertainty. The impacts of drivers on MBTC business defined the priorities/critical uncertainties.

The themes with high impact and uncertainty, also known as “pivotal” are the following:

- **Business travel growth in Latin America**
- **Revenues from airlines**
- **Content fragmentation**
- **Revenues from GDSs**
- Adoption of **self-booking in multinational corporations**
- **Buying behavior of SMEs**

These 6 themes were used to define the different scenarios for the business travel market in the next 3 to 5 years (see Chart 16)



Source: Team analysis

A. Content aggregation

The market is expected to continue growing at an average annual rate of 5-7%, with the revenues from the airlines falling to 1%, following the actual trend, not only in Latin America but also in Europe and USA. GDS incentives will drop 20%, mainly driven by the airlines' effort to reduce distribution costs and by the high competition in the travel industry.

Although content fragmentation is expected to increase (up to 35% compared to the actual level of 25%), it will be solved with IT developments. Higher Internet penetration together with the solution to the content fragmentation problem will allow the adoption of self booking

tools, reaching a penetration of 40%.

B. Content fragmentation

The market is expected to continue growing at an average annual rate of 5-7%, with the revenues from the airlines falling to 1%, following the actual trend, not only in Latin America but also in Europe and USA. GDS incentives will drop 20%, mainly driven by the airlines' effort to reduce distribution costs and by the high competition in the travel industry.

Content fragmentation is expected to increase (up to 35% compared to the actual level of 25%), still without a solution, neither from the IT providers nor from the GDSs. Since content fragmentation is not solved, although the higher Internet penetration, self booking tools are not widely adopted (reaching a penetration of 10%).

C. Content back to GDS

The market is expected to continue growing at an average annual rate of 5-7%, with the revenues from the airlines falling to 1%, following the actual trend, not only in Latin America but also in Europe and USA. GDS incentives will drop 20%, mainly driven by the airlines' effort to reduce distribution costs and by the high competition in the travel industry.

Content fragmentation is reduced through opt-in fees (15% compared to the actual level of 25%). Higher Internet penetration together with the solution to the content fragmentation problem will allow the adoption of self booking tools, reaching a penetration of 40%.

D. Stagnant market

Stagnant demand (0% growth for the next 3-5 years), leads to stable revenues from airlines, pushing their sales through the indirect channels also. GDS incentives also remain stable.

Due to the recession, IT providers are focused on developing new solutions to solve the content fragmentation issue, allowing self booking to be widely adopted (40%).

E. Loss of SMEs

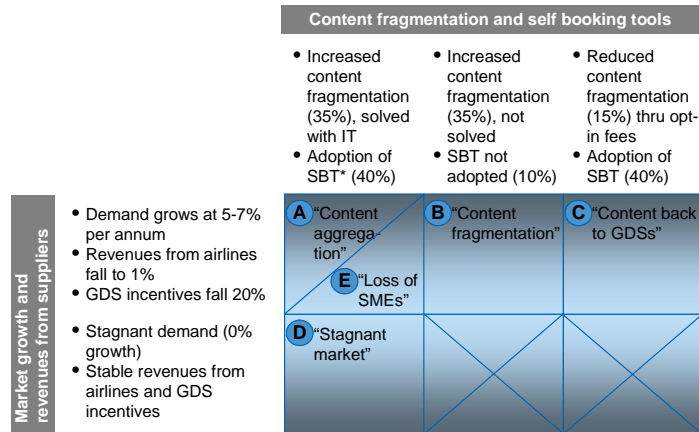
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Although content fragmentation is expected to increase (up to 35% compared to the actual level of 25%), it will be solved with IT developments. Higher Internet penetration together with the solution to the content fragmentation problem will allow the adoption of self booking

tools, reaching a penetration of 40%.

The higher Internet penetration and adoption of self booking tools will boost OLTAs, allowing them to enter the SMEs segment

Chart 16
POSSIBLE SCENARIOS

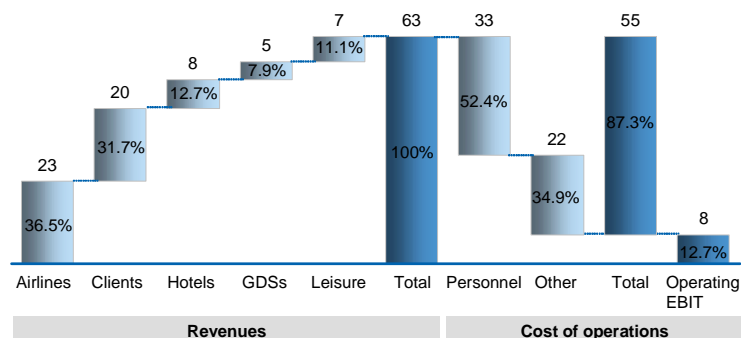


* Self booking tools
 Source: Team analysis

Economic impact of scenarios

An economic model for an "average" TMC was developed, in order to analyze and quantify the economic impact of the different scenarios.

Chart 17
PROFIT AND LOSS STATEMENT
 Million US\$, 2008

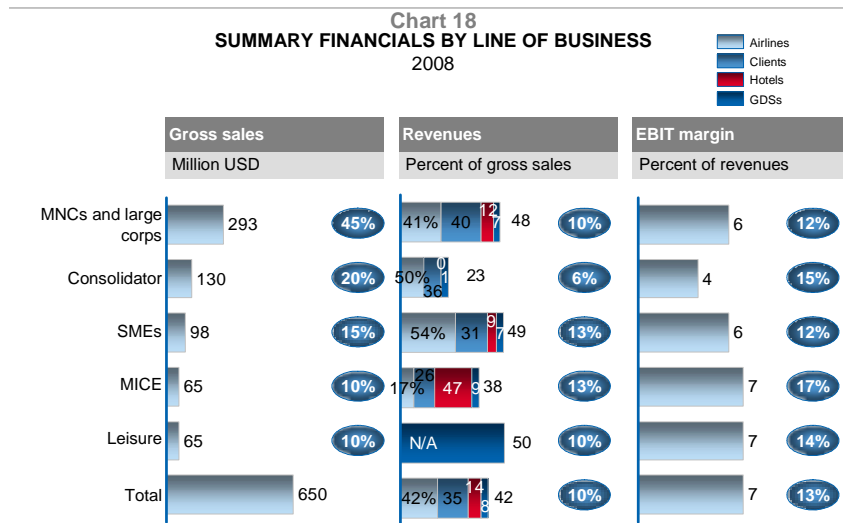


Source: Amadeus, IMF, ABC studies in Brazil, Mexico, Argentina and Colombia, interviews; team analysis

With annual sales of US\$ 650 million, this "average" TMC concentrates 25% of total world market for TMCs, with 3.3 million of air segments sold in Latin America, and about 25% of content off the GDSs. In Latin America it shows annual income of US\$ 63 millions, mainly due to airline commissions

(37%) and client service-fees (32%), while the total cost is about US\$ 55 million (mainly of personnel – 52%), with an EBIT of US\$ 8 million (13% of total income – see chart 17)

MNCs and large corporations account for 45% of gross sales, with average revenues of 10%, mainly due to airline commissions and client service-fees (see Chart 18). The consolidation business represents 20% of gross sales, although with lower revenues (6%). The other business units, although with higher revenue margins (between 10% and 13%), account altogether for 35% of total sales.



Source: Amadeus, IMF, ABC studies in Brazil, Mexico, Argentina and Colombia, interviews; team analysis

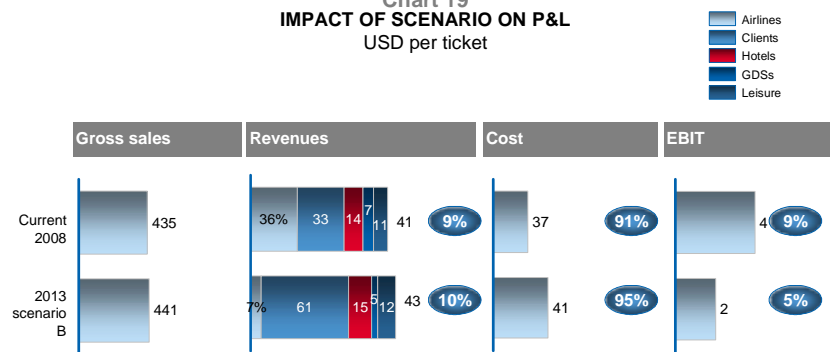
Although 5 different scenarios were defined for the business travel market in the next 3-5 years, scenario “**B. Content fragmentation**” will be used to analyze the impact that the different variables have on the economics of a typical MBTC. Scenario B was chosen because it’s considered “the most likely to happen” if the actual trends continue.

In this scenario, fragmentation is increased without a solution from the IT providers, and self booking tools are not adopted. Business travel market grows at an annual rate of 5-7%, while revenues from airlines and GDS incentives are diminished.

The lower revenues from airlines and GDS incentives will push MBTCs to start charging their clients more aggressively, and will change even more the business model switching the sources of income (actually about 33% of the income are from service fees, in the next years it will be 61% - see Chart 19)

The higher content fragmentation decreases the productivity of the travel agents, and considering that personnel accounts for more than 50% of total costs, the higher costs results in a lower EBIT margin (5% vs. 9%)

Chart 19
IMPACT OF SCENARIO ON P&L
USD per ticket



Source: Amadeus, IMF, ABC studies in Brazil, Mexico, Argentina and Colombia, interviews; team analysis

What could MBTCs do to afford these possible scenarios?

For the **income**, they could enhance even more hotels and other products, with higher profitability. As mentioned before, the industry trend is to a higher consolidation. This represents an opportunity to those agencies that manage to survive, because they can gain market share and enter the consolidation business.

On the **productivity** side, travel agencies could include the hotels in the GDSs to increase the productivity of the travel agents. Additionally, they could develop IT solutions, such as multi-sourcing front-office including hotels and car rentals, as well as air tickets, standardize technology across the region or consolidate the back-office systems.

Appendix

Methodology

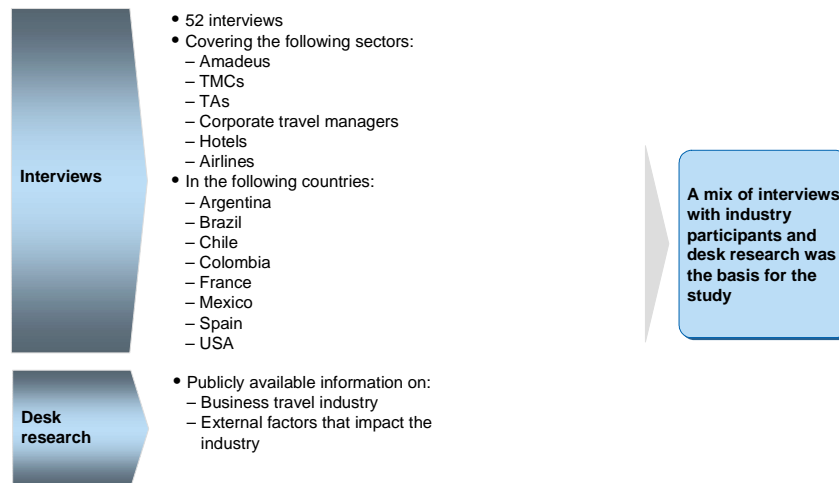
52 interviews were conducted with industry participants from the following sectors:

- Amadeus
- TMCs
- Travel Agencies
- Corporate travel managers
- Hotels
- Airlines

In the following countries:

- Argentina
- Brazil
- Chile
- Colombia
- France
- Mexico
- Spain
- USA

Chart 20
SOURCES OF INFORMATION

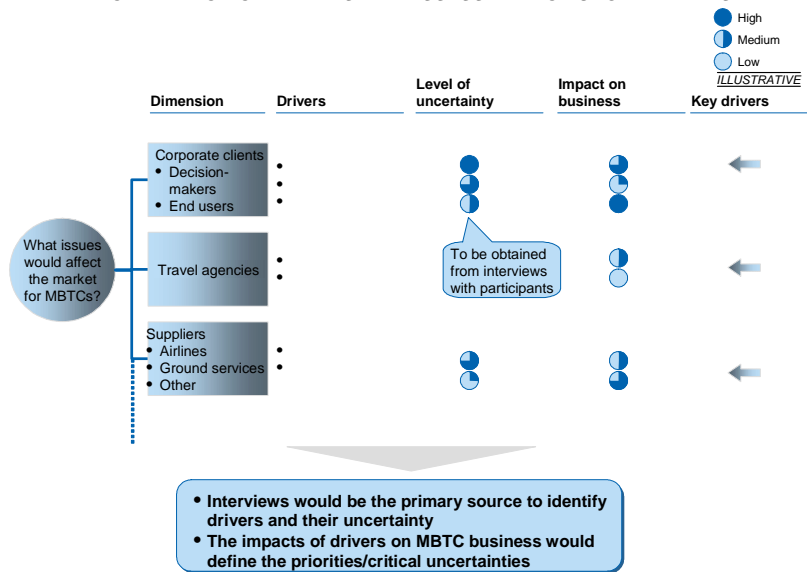


Source: Team analysis

In addition, desk research was done with publicly available information on the business travel industry and external factors that impact the industry.

Drivers were identified and the impacts of these drivers on MBTC business together with the uncertainty were used to define the key drivers affecting the business travel market in the next 3 to 5 years (see Chart 21).

Chart 21
PRIORITIZATION OF DRIVERS AND ASSESSMENT OF UNCERTAINTIES

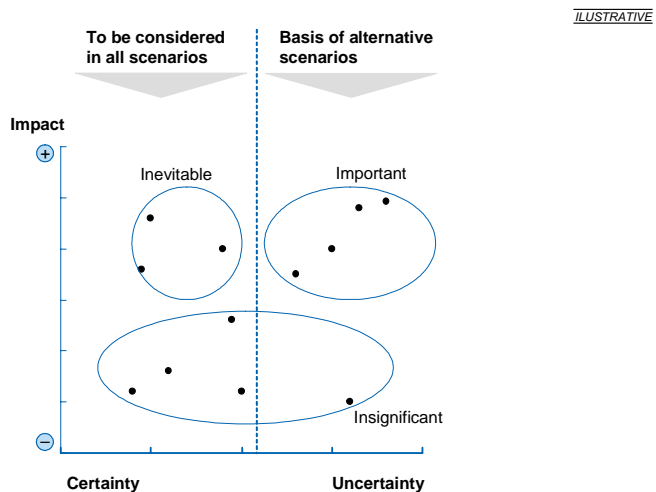


Source: Team analysis

Splitting drivers based on impact and uncertainty allowed to frame the definition of scenarios (see Chart 22):

- Those with high certainty and high impact (“inevitable”) must occur in all scenarios
- Others with high impact and high uncertainty (“important”) are the basis to build alternative scenarios
- Drivers with low impact may be discarded/set aside for simplicity

Chart 22
PRIORITIZATION OF DRIVERS AND ASSESSMENT OF UNCERTAINTIES (Cont.)



Source: Team analysis

Key factors in the scenarios

Demand

5 factors will determine the demand for business travel in the following 3 to 5 years:

- a. **Evolving needs of multinational corporations**
- b. **Buying behavior of SMEs**
- c. **Adoption of online booking tools in MNCs**
- d. **Environmental concerns**
- e. **Secure transportation**

a. Evolving needs of multinational corporations

Actually, MNCs require travel management from the MBTCs, although MNCs are expecting more sophisticated services for the following years, such as: more sophisticated solutions, systems integration with existing ERPs, handling of all travel related content, like hotels, ground transportation and value in optimizing total travel expense.

This could have a high impact for the MBTCs because it implies reviewing the entire business model and the way to serve their clients (see Chart 23).

Chart 23
KEY ISSUES FROM THE DEMAND SIDE

● Very high
 ○ Very low

	Description	Current state	Possible developments	Impact	Uncertainty
Evolving needs of MNCs	<ul style="list-style-type: none"> • More sophisticated solutions, systems integration with existing ERPs • Handling of all travel related content, like hotels, ground transportation • Value in optimizing total travel expense 	<ul style="list-style-type: none"> • Travel management 	<ul style="list-style-type: none"> • More sophisticated travel management 	●	○
Buying behavior of SMEs	<ul style="list-style-type: none"> • Most travel is domestic • Seek access to negotiated rates, best available fares, don't have travel policy • Buy more like leisure travelers • Some value personalized service more • The larger / lightly managed don't need technical integration, some standard tools would suffice 	<ul style="list-style-type: none"> • Price seekers 	<ul style="list-style-type: none"> • Advanced travel management • Basic travel management • Online purchasing from airlines, OLTAs 	●	●

Source: Interviews; team analysis

b. Buying behavior of SMEs

Actually, SMEs are “price seekers”, focusing almost exclusively in reducing prices. They seek access to negotiated rates (best available fares) and don't have travel policy. Most of their travel is domestic, and they buy more like leisure travelers than like MNCs. Some of the SMEs specially value personalized service more than MNCs do.

In the next years, the buying behavior of SMEs could evolve to:

- A basic travel management, looking to analyze all the travel expenses, not just looking for the lowest priced ticket
- A more advanced travel management, somehow starting to buy as MNCs
- Online purchasing from airlines and OLTAs

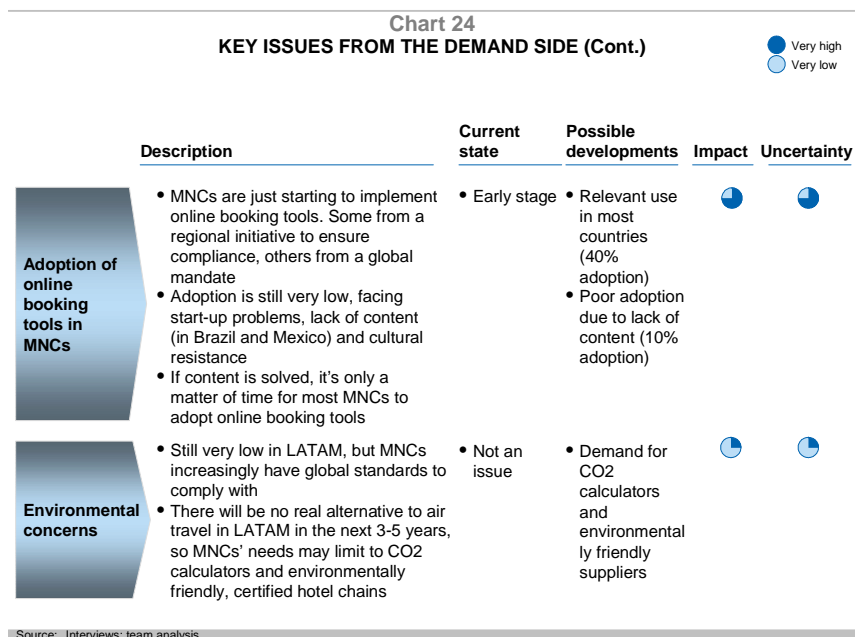
Although it's not clear which of these will end up being the main buying habit for SMEs in the next years, all of them would imply to modify the actual business model, either by offering different services to different clients (if SMEs start demanding travel management services, the service offer should be different to that of MNCs) or by developing online channels to compete with airlines and OLTAs.

c. Adoption of online booking tools in MNCs

The adoption of online booking tools in Latin America is at an early stage. MNCs are just starting to implement online booking tools, some from a regional initiative to ensure compliance and others from a global mandate.

Adoption is still very low, facing start-up problems, lack of content (in Brazil and Mexico) and cultural resistance.

For the next years, it depends on the content fragmentation issue whether online booking tools are adopted or not. If content is solved, it's only a matter of time for most MNCs to adopt online booking tools (see Chart 24).



d. Environmental concerns

Actually, environmental concerns are not an issue in Latin America. However, MNCs increasingly have global standards to comply with.

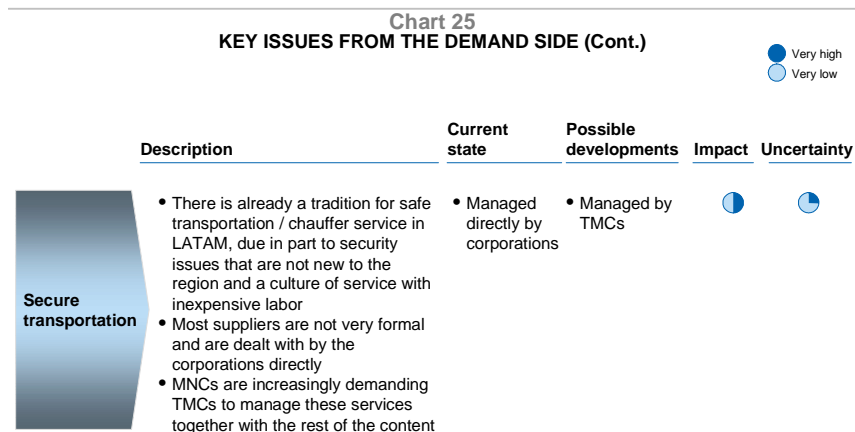
There will be no real alternative to air travel in LATAM in the next 3-5 years, so MNCs' needs may limit to CO2 calculators and environmentally friendly, certified hotel chains.

e. Secure transportation

Currently, the transportation for business travelers is managed directly by corporations, mainly due to:

- A tradition for safe secure transportation / chauffer service in LATAM, due in part to security issues that are not new to the region and a culture of service with inexpensive labor
- Most suppliers are not very formal and are dealt with by the corporations directly

Despite this, MNCs are increasingly demanding TMCs to manage these services together with the rest of the content, although this will have a low impact in the TMCs business model (see Chart 25).



Source: Interviews; team analysis

Competition, new entrants and substitution

4 factors will determine the demand for business travel in the following 3 to 5 years:

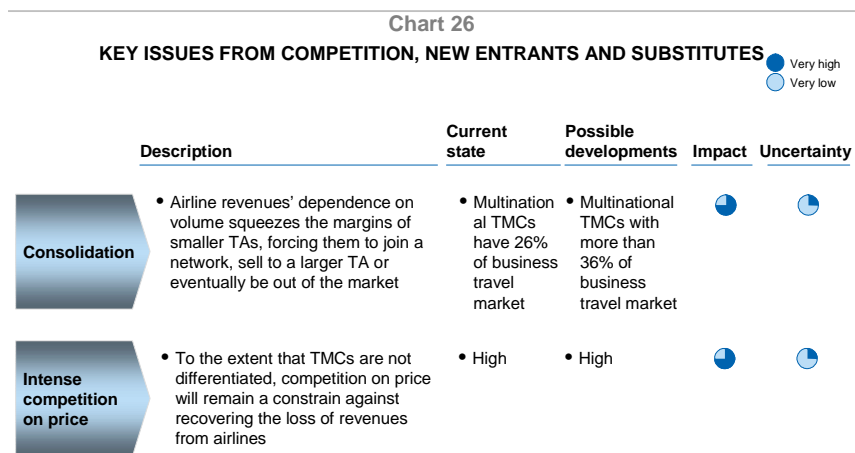
a. Consolidation of travel agencies

- b. **Intense competition on price**
- c. **Disintermediation**
- d. **Substitutes for travel**

a. Consolidation of travel agencies

Actually, multinational TMCs account for 26% of the business travel market, although it's expected to increase in the next 3 to 5 years.

Airline revenues' dependence on volume squeezes the margins of smaller travel agencies, forcing them to join a network, sell to a larger TA or eventually be out of the market.



Source: Interviews; team analysis

b. Intense competition on price

Currently, there is a high competition on price, to the extent that TMCs are not differentiated, thus competition on price will remain a constrain against recovering the loss of revenues from airlines.

The impact in the business model of the travel agencies is high, because a differentiation strategy based only on price competition below prices, eroding profitability (see Chart 26).





c. Disintermediation

Airlines have strong incentives to develop their direct channels for SMEs and unmanaged corporations, but not for MNCs. Generally, MNCS deal directly with the airlines, with net tariffs.

Actually, some airlines sell directly to leisure, unmanaged SMEs, although it's expected that most airlines will use extensively the direct channels for leisure and unmanaged SMEs.

The possible evolution in disintermediation in the business travel has a high impact in the travel agencies because it could represent lower revenues from the airlines, switching the sources of income from the airlines to the clients.

Chart 27
KEY ISSUES FROM COMPETITION, NEW ENTRANTS AND SUBSTITUTES (Cont.)

Description	Current state	Possible developments	Impact	Uncertainty
Disintermediation <ul style="list-style-type: none"> Airlines have strong incentives to develop their direct channels for SMEs and unmanaged corporations, but not for MNCs 	<ul style="list-style-type: none"> Some sell direct to leisure, unmanaged SMEs 	<ul style="list-style-type: none"> Most airlines with extensive use of direct channels for leisure, unmanaged SMEs 		
Substitutes for travel <ul style="list-style-type: none"> Developments in VC, CC, and other collaborative technologies have not reduced demand for travel so far, and aren't expected to do so 	<ul style="list-style-type: none"> Not an issue 	<ul style="list-style-type: none"> Not an issue 		

Source: Interviews; team analysis

d. Substitutes for travel

Although there have been developments in VC, CC, and other collaborative technologies, they have not reduced demand for travel so far, and aren't expected to do so

Supply

5 factors will determine the demand for business travel in the following 3 to 5 years:

- a. Airline consolidation
- b. Content fragmentation
- c. Revenues from airlines
- d. Revenues from GDSs
- e. Hotel consolidation

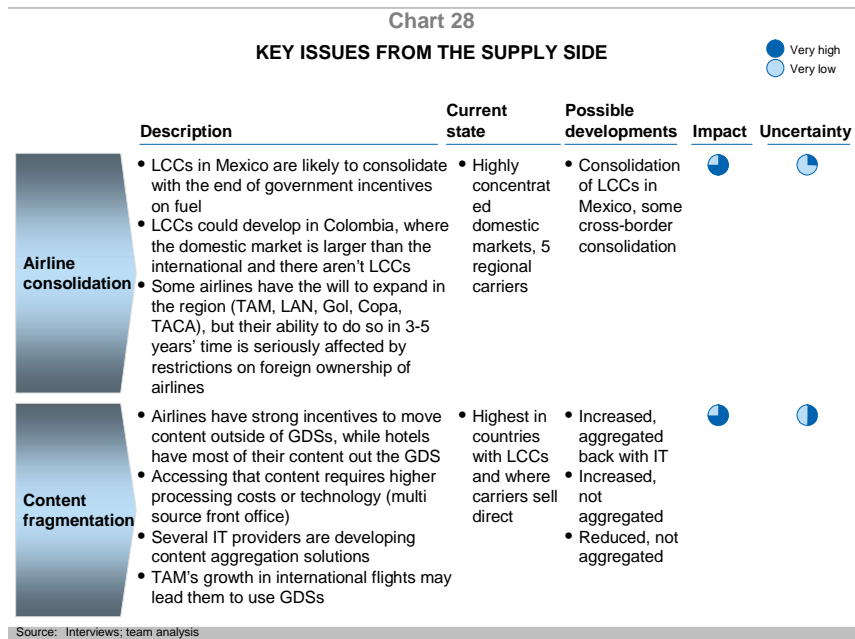
a. Airline consolidation

Air domestic markets in Latin America are highly concentrated, with the two main airlines accounting for more than 70% of the domestic market in all the main markets (except for Mexico).

Some airlines have the will to expand in the region (TAM, LAN, Gol, Copa, TACA), but their ability to do so in 3-5 years' time is seriously affected by restrictions on foreign ownership of airlines.

LCCs are not very developed in the region except for Brazil, with a strong participation due to the appearance some years ago of Gol.

For the following years, some cross border consolidation from some of the main airlines is expected. Also, LCCs in Mexico are likely to consolidate with the end of government incentives on fuel, and could develop in Colombia, where the domestic market is larger than the international market and there are no LCCs.



b. Content fragmentation

Actually, airlines have strong incentives to move content outside of GDSs, while hotels have most of their content outside the GDS. Therefore, content fragmentation is higher in countries with LCCs and where carriers sell direct.

Accessing the content out of the GDSs requires higher processing costs or technology (multi-source front office), representing lower profitability for the travel agencies and a high impact for travel agencies in the following years.

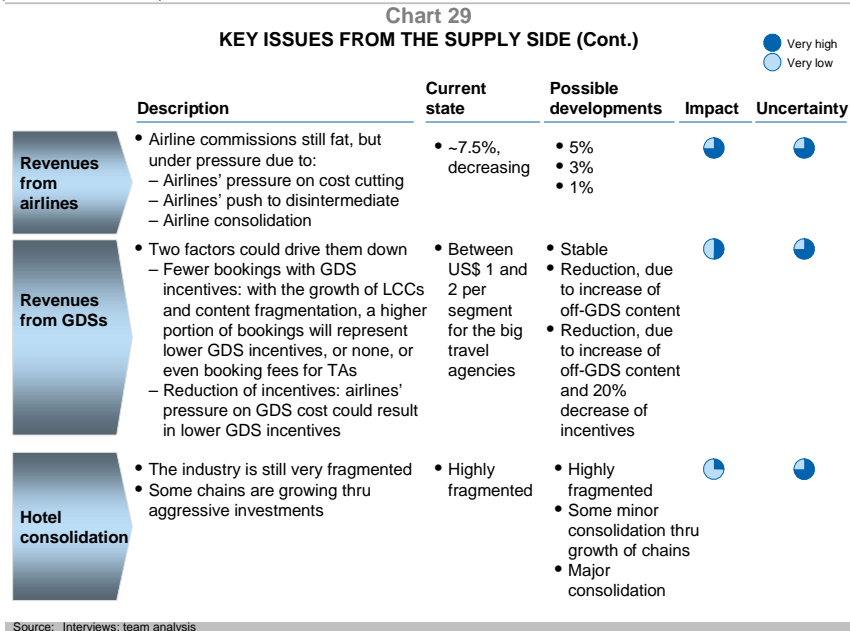
Several IT providers are developing content aggregation solutions (mainly multi-source front office). Also, TAM's growth in international flights may lead airlines to use GDSs again.

c. Revenues from airlines

Airlines commissions and incentives are still flat (about 7.5% of sales) but under pressure due to:

- Airlines' pressure on cost cutting
- Airlines' push to disintermediate
- Airline consolidation

For the next 3 to 5 years, revenues from airlines are expected to fall, although the new level of commissions and incentives is still uncertain (see Chart 29).



d. Revenues from GDSs

Actually, GDSs are paying between US\$1 and US\$2 per segment to the bigger travel agencies. However, two factors could drive them down:

- Fewer bookings with GDS incentives: with the growth of LCCs and content fragmentation, a higher portion of bookings will represent lower GDS incentives, or none, or even booking fees for TAs
- Reduction of incentives: airlines' pressure on GDS cost could result in lower GDS incentives

Although there is a general agreement that revenues from GDSs are going to fall, it's not clear yet how strong the drop will be, depending on different factors (see Chart 29).

e. Hotel consolidation

The hotel industry is highly fragmented, although some hotel chains are growing through aggressive investments.

Although it's still uncertain if the fragmentation is going to increase or not in the following years, as hotels don't represent a very high percentage of the actual business mix for MBTCs, hotel consolidation doesn't have a high impact in defining the different scenarios.

Socio, Political and Economic Issues

a. Business travel growth in Latin America

The economies and business travel are expected to maintain high growth rates. However, political and economic instability could affect some countries and the region, resulting in lower annual growth rates than those of the last years (see Chart 29).

Chart 30
 KEY SOCIO, POLITICAL, ECONOMIC ISSUES

	Description	Current state	Possible developments	Impact	Uncertainty
Business travel growth in LATAM	<ul style="list-style-type: none"> The economies and business travel are expected to maintain high growth rates However, political and economic instability could affect some countries and the region 	<ul style="list-style-type: none"> 13% CAGR ('02-'08) 	<ul style="list-style-type: none"> 13% 5-7% 0% 		
Regulation	<ul style="list-style-type: none"> Airline commissions and TAs are not highly regulated in LATAM In Colombia and Chile, with highly concentrated airlines and TAs, TAs have managed to impose booking fees to clients thru regulation to compensate for the loss of airline commissions. These fees risk being dismantled 	<ul style="list-style-type: none"> Not highly regulated 	<ul style="list-style-type: none"> Not highly regulated 		

Source: Interviews; team analysis

b. Regulation

The Latin American business travel market is not highly regulated, and it's expected to remain like this for the next 3 to 5 years.

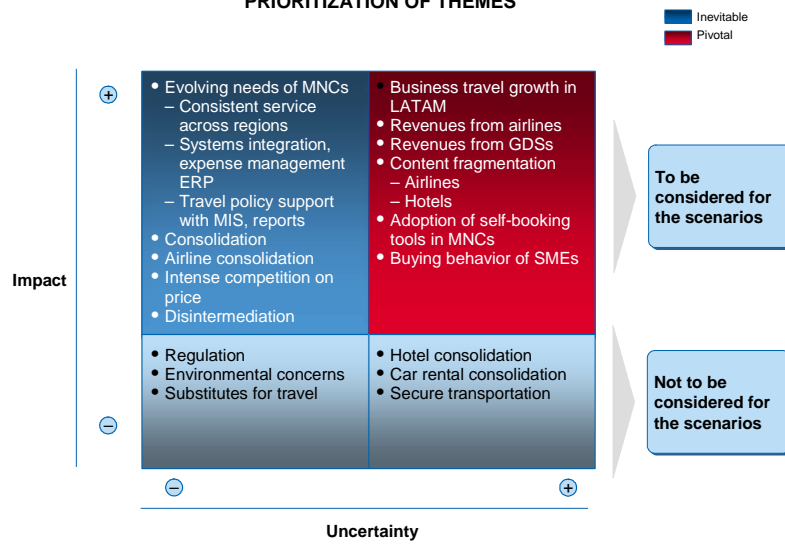
For example, in Colombia and Chile, with highly concentrated airlines and travel agencies, travel agencies have managed to impose booking fees to clients through regulation to compensate for the loss of airline commissions

Prioritization of themes by impact and uncertainty

To conclude, all the themes mentioned before were considered depending on the impact and uncertainty, to develop the different scenarios.

Those themes with high certainty and high impact (“**inevitable**”) must occur in all scenarios, while those with high uncertainty and impact (“**pivotal**”) are the basis to define the different scenarios (see Chart 30). On the other hand, those themes with low impact were discarded for simplicity.

Chart 31
PRIORITIZATION OF THEMES



Source: Interviews; team analysis

About Hermes Management Consulting

HERMES Management Consulting

Hermes Management Consulting (Hermes) is a Latin American consulting firm specializing in strategy, organization, operations and valuation studies. Hermes was founded in late 1994 by Osvaldo Gallo and Hernán Goyanes. Both founders are former senior members of McKinsey & Company, and have worked extensively for leading companies in Europe and Latin America.

Hermes has been very active in sector analyses, company valuations, mergers, corporate strategy and business plan development, as well as the identification and implementation of operational improvements. These projects have focused on the payment systems, supermarket, retail, consumer goods, health care, energy, logistics, apparel, telecommunications, tourism, entertainment and real estate sectors. Not only does Hermes have extensive experience in these sectors, it has also helped assess a variety of acquisition opportunities in numerous other industries.

Hermes has carried out strategy, organization, operational improvements and valuation projects, in Argentina, Brazil, Colombia, Costa Rica, Chile, Dominican Republic Ecuador, France, Greece, Guatemala, Italy, Malaysia, Mexico, Paraguay, Peru, Poland, Saudi Arabia, Spain, United States of America, Uruguay, United Kingdom and Venezuela.

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