

Understanding Online Travel Agencies' Cost Drivers and Ways to Optimise Business in Europe



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HERMES
Management Consulting

Index	
<i>Abstract</i>	5
<i>Research Methodology</i>	5
Sample	5
<i>Introduction</i>	7
Market Overview	7
<i>Executive Summary</i>	10
<i>Study Results</i>	11
Average Agency Revenue Structure	11
Average Agency Cost Structure	16
Traditional costing analysis.....	16
Activity Based Costing Analysis	18
Introduction	18
Marketing & Acquisition	19
Online Search & Booking.....	24
Offline: Call centre, Fulfillment and Customer support.....	26
Back Office: Invoice, Collection and Payment Preparation	28
Support Activities.....	28
Procurement.....	28
Technology Management.....	29
Firm Infrastructure and Human Resources Management	29
Profitability and Productivity Analysis.....	30
<i>Conclusions and Recommendations</i>	32
Revenue Diversification	32
Cost control in the marketing area	33
Cost control through automation and outsourcing	34
Customer experience enhancement	35
Provider negotiation	36
Better mechanisms for tracking trends and competitive positioning	36
<i>Appendix</i>	37
Methodology - Details	37
About Hermes Management Consulting	40



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Abstract

This White Paper reviews the results of an independent research study of Online Travel Agencies (OTAs) conducted in Europe from November 2008 through to July 2009 by Hermes Management Consulting (Hermes). The financial data used in the study is from 2008.

The research was commissioned by Amadeus in order to:

- Better understand average revenue and cost structure of the OTAs
- Analyse OTAs business models, processes, cost drivers and productivity levels
- Understand OTAs needs, identifying opportunities to add value and optimise business

A similar Activity-Based Costing (ABC) study was carried out in Scandinavia in 2006. This time the scope was widened to include five OTAs from France, Germany and the Netherlands as well as Scandinavia. This innovative study will open windows of opportunity for European Online Travel Agencies. The purpose of this paper is to communicate the results of the research, and offer recommendations on how OTAs can improve their margins and better meet the needs of their customers.

Research Methodology

Activity-based costing is used to identify, describe and assign costs to business activities and to report on the operations of OTAs. Since the ABC analysis determines the 'true' cost of a product or service, it is more effective at identifying opportunities to improve business processes than traditional accounting. During the project the financial data of the participating OTAs was reviewed and their business processes were closely examined, thus allowing the main cost drivers to be identified.

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

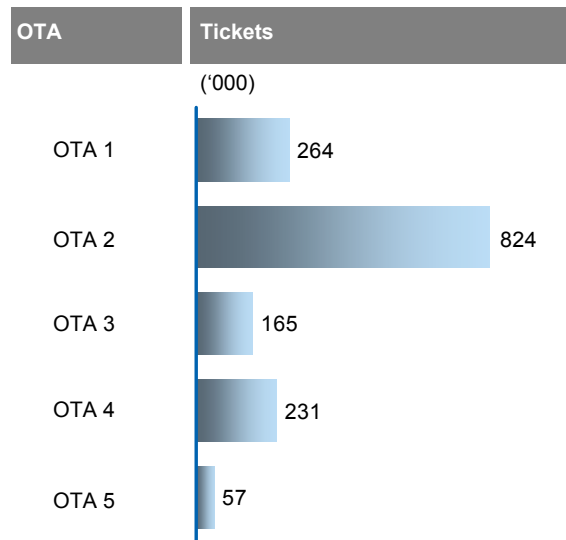
Sample

The sample is composed of **five mid-ranged OTAs** from France, Germany, Sweden, Norway and The Netherlands (See Chart 1). The OTAs represent a mix of local, regional and pan-European players each of which, on average, generates 308,000 tickets per year. A ticket is composed of approximately 2.2 air segments.



Although the participating agencies are mid-sized businesses, they represent a fair picture of the European OTA landscape. Most of the participating OTAs operate in one or two markets, targeting essentially leisure customers.

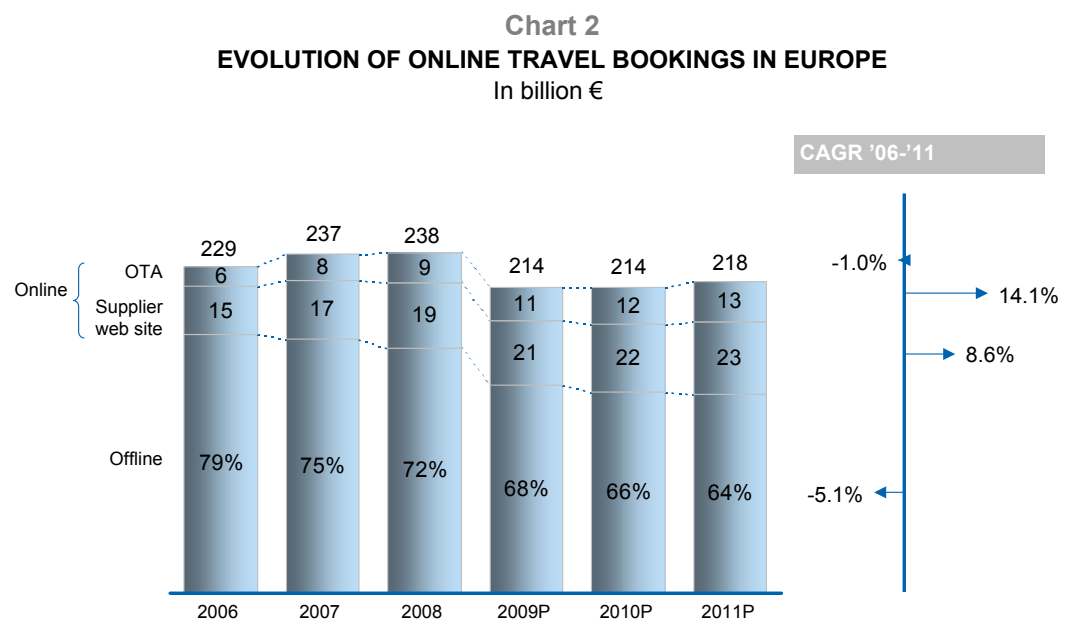
Chart 1
OVERVIEW OF PARTICIPATING OTAs



Introduction

Market Overview

The European travel market is the world's largest regional travel market in gross bookings, amounting to €238 billion in 2008.

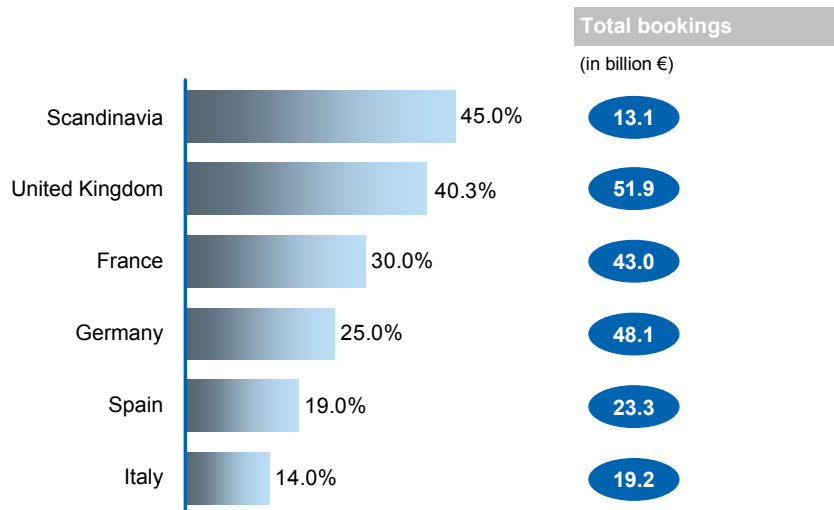


Source: PhoCusWright Europe Online Travel Overview 5th Edition (November 2009)

Supplier websites have always had a bigger share of the online market (close to 70% in 2008). However, the Online Travel Agency market is expected to grow more than the supplier side. By 2011, OTAs will represent 36% of the total online share. In terms of penetration rate, the online market in Europe was expected to reach 32% in 2009, some way to go before reaching the US average of 38%. However, it is worth mentioning that two European markets, Scandinavia and the UK, have a higher penetration than the US at 45% and 40% respectively, according to PhoCusWright.

One of the main characteristics shaping the European online market is its diversity.

Chart 3
LEISURE AND UNMANAGED ONLINE BOOKING PENETRATION BY COUNTRY
 2009, in %



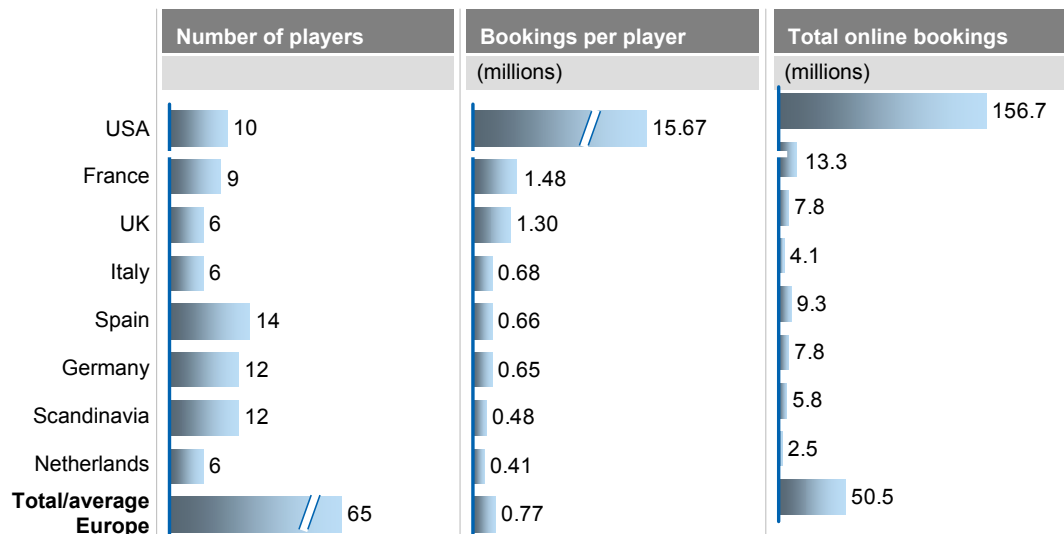
Source: PhoCusWright's European Online Travel Overview 5th Edition (October 2009); Hermes' analysis

One of the main differences is market maturity, as each market is in a different phase of its online growth cycle. The UK (40%) and Scandinavia (45%), thanks to their high internet penetration rates, were the first markets for Online Travel Agencies to establish a presence and are therefore the most mature. France (30%), Germany (24%), Spain (19%) and Italy (14%) are considered to be the growth markets in the region.

Another characteristic of the European market versus the US market is the number and type of players in each market. The European market is made up of approximately 65 players, which is quite fragmented compared with the US, which has no more than 10 players. However, in the US 99% of the total business is done by the four largest OTAs; in comparison the 'Big 4' in Europe only represent 55.6%.

The US 'Big 4' generate 38.8 million air bookings on average whereas one of the 'Big 4' in Europe generate 7 Million bookings. In Europe, the average air bookings per player is different by market, averaging out to 770,000 air bookings (approximately 350.000 tickets).

Chart 4
NUMBER OF ONLINE PLAYERS AND ONLINE BOOKING VOLUME COMPARISON BY COUNTRY
2010



Source: Amadeus IT Group; Hermes' analysis

The role played by OTAs changes considerably according to market dynamics. Each individual market has different cultural, technological, regulatory, demographic and buying dynamics. These differences can be seen in the type of products sold by OTAs, and in the way products are displayed and marketed. European OTAs can be segmented in three different groups, 'global' such as Expedia, 'regional' (Opodo) and 'local' (GoVoyages in France). The structure of each market varies considerably, some markets are very concentrated and others are fragmented.

European Online Travel Agencies have evolved tremendously since they first started their operations in 1998. They have made huge inroads in technological innovation, content management, consumer shopping experience and operational efficiency, amongst others. They are also been the only travel agency segment to show an incredible resilience during economic downturns. However some issues still need to be addressed for European Online Travel Agencies to prosper:

(i) **Staying competitive:** The European online landscape is highly competitive with not only a large number of OTAs but also other players such as supplier websites, tour operators, consolidators and offline travel agencies. Metasearch companies have added to this competitiveness by making price comparison very easy. Price has become the only competitive weapon but tends to commoditise travel products.

(ii) **Ensuring customer loyalty:** As price is the main driver for purchasing travel online, the European consumer is very accustomed to clicking between various websites to search for the best deals on their air tickets which is perceived as a commodity by end-consumers. On average a European consumer searches through 4.97 websites (source: PhoCusWright European Consumer Travel Trends Survey) before making a booking. The only way for Online Travel Agencies to survive is to stop competing on price and to find other differentiating factors such as content, service, technology etc.

(iii) **Profitability:** This is one of the challenges facing European most mid-sized OTAs. Their margins are minimal or non-existent: this is due to high costs and low prices they are forced to offer in order to stay competitive and to the current product mix they offer. A lot of these Online Travel Agencies are no longer start-ups and are facing pressure from their investors and shareholders to turn around the situation.

This white paper will highlight some of these challenges in more detail and will try to propose sustainable long-term solutions to these issues.

Executive Summary

The Activity-based costing (ABC) study aims at better understanding mid-sized European OTAs' average revenue and cost structure, as well as their processes and activities. As a result, the ABC analysis clearly identifies opportunities to add value and optimise business. Here are the results from five participating OTAs from France, Germany, The Netherlands and Scandinavia.

The current situation can be reversed if the following three main challenges are overcome:

Revenue diversification: cross selling non-air

Most OTAs need to increase their revenue sources and focus on higher margin products. OTAs are still **air centric, with air tickets** representing 86% of their gross sales despite delivering a low margin of 6.6%. Non-air products generate 12.8% margins but only account for 14% of their gross sales. There is an obvious need to increase the non-air offer (hotel, packages, insurance, cruise etc.) and therefore improving cross-selling from air products, leading to better margins and customer loyalty. Advertising as a new source of revenue should also be considered.

Enhanced Customer Experience

As conversion rates for the studied OTAs are very low, OTAs need to stand out by offering savvy travellers an experience that will make them want to book more and increase loyalty. Technology needs to be adapted to respond quickly to customer demands and trends.

Cost Control through Automation

Another challenge is efficiency and this can be improved by outsourcing non-core activities and increasing automation. Although Online Travel Agencies have improved substantially over the last few years, increasing automation in all areas of their value chain will enable them to decrease their costs. Online travel agencies still have significant manual intervention in the booking process. Only one-third of all bookings (32.3%) are touchless, i.e. have no human intervention. Call centre is still the main channel to handle bookings (45.6% of total tickets issued) despite costing 30% more - €42 per ticket versus €34 when the booking is fully automated. Online travel agencies must **automate their processes** even more to offset the related costs to minimums.

Marketing Costs

Marketing is not only the main cost driver (54% of their total cost) but also does not seem to be efficient enough and, more importantly is not monitored. By looking a bit closer, OTAs seem to indiscriminately buy media space without being able to measure impact. We found out that they are spending on average more than 50% of their total marketing cost on search engines which is the most expensive online channel, generating the least revenue with a very low conversion rate of 1%. There is a clear need to increase their online marketing performance by enhancing Search Engine Optimization (SEO) tools, improving the focus of their campaigns and advertisements as well as acquiring tracking and reporting tools. Acquiring new and retaining existing customers, which falls within their marketing activities, is a very difficult goal as prices drive customers' choice. However, **creating loyalty programs or adopting CRM solutions could help establishing a customer relationship** and build a pool of frequent shoppers.

Consequently, Profitability appears to be a challenge most mid-sized European OTAs are facing. Several years after inception many continue to make losses. Based on the ABC analysis, **on average**, two out of the five mid-sized OTAs appear to lose €0.7 on every ticket issued. By comparison, it is interesting to note that offline leisure agencies achieve an EBIT of €10.6 per ticket booked (10%), better and healthier than the negative margin recorded by OTAs (-1.7%).



The potential that online represents is considerable and will require OTAs to react quickly not only so that they can face the competition but also enter new markets that are shaping the future OTA landscape in Europe.

Study Results

In order to support the study, financial data of the participating agencies (P&L) was exhaustively reviewed and the business processes they performed were closely examined. Revenues are represented in € (Euros) per ticket. A ticket unit includes a combination of all services provided by OTAs and represents the average transaction per customer. Tickets always include an airline ticket but may also include additional products such as hotel bookings, car rental, insurance, etc.

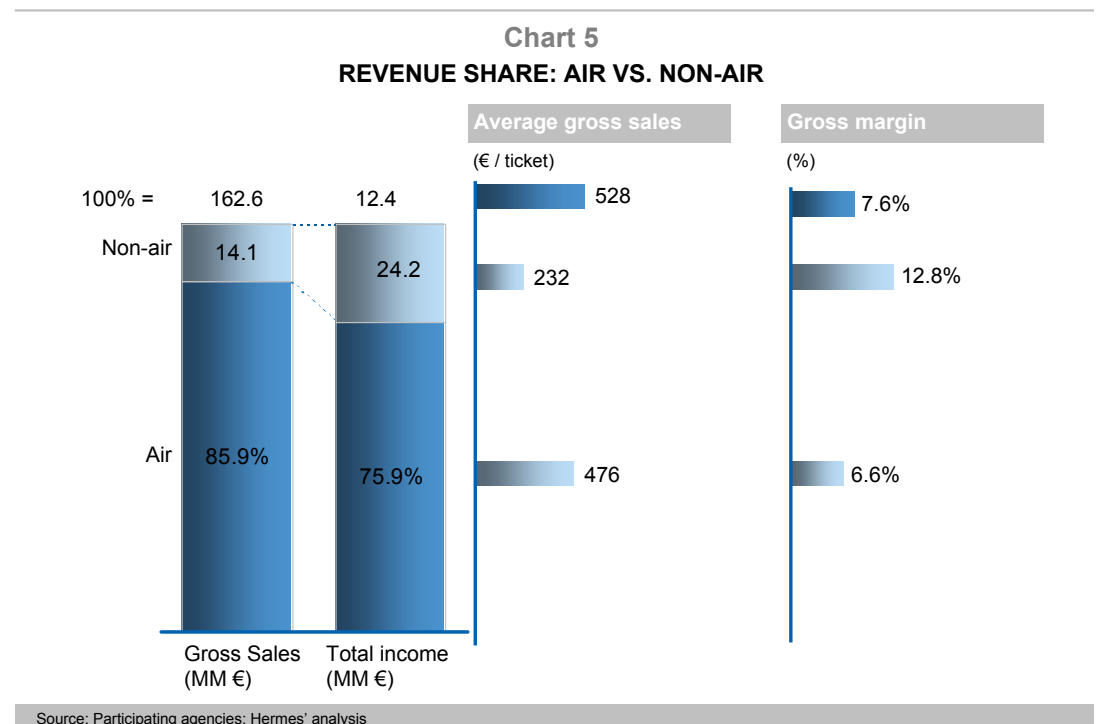
Throughout the white paper some comparisons are made with the data results of a similar study conducted in Scandinavia in 2006. To make the comparison relevant, the data is adjusted with relevant inflation indexes.

In addition, comparisons to traditional offline leisure agencies – also sometimes referred to as 'brick and mortar' travel agencies – are also used in this paper, based on several studies conducted in Europe between 2006 and 2009.

Average Agency Revenue Structure

On average, the participating Online Travel Agencies generate €162.6 million in revenue (gross sales) and €12.4 million in net income. If we break down the overall gross sales by number of tickets, we obtain an average ticket price of €528. The net income is €40.2 per ticket.

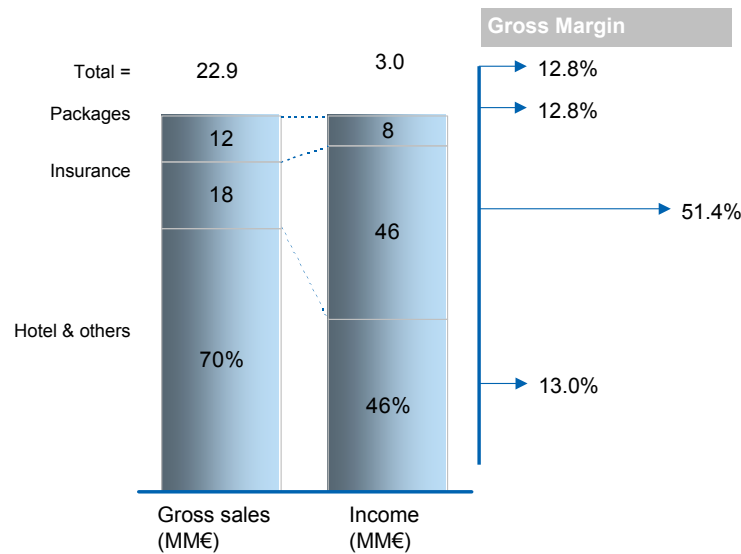
On average Online Travel Agencies, air tickets represent 85.9% of total sales, yielding a gross margin of 6.6%. Non-air delivers nearly twice the margin of air sales at 12.8% but only accounts for 14.1% of total sales.



Due to the high margins and low share it currently represents, non-air sales represent the biggest growth opportunity for OTAs.

If we compare the margins obtained from hotel bookings versus air in absolute terms, a hotel booking generates a profit of €31.6 per ticket versus €22.1 for air. Most of the participating OTAs obtain their hotel content via 3rd Parties or aggregators, which have lower margins than merchant content.

**Chart 6
NON-AIR SERVICES MARGINS**



Source: Participating agencies; Hermes' analysis

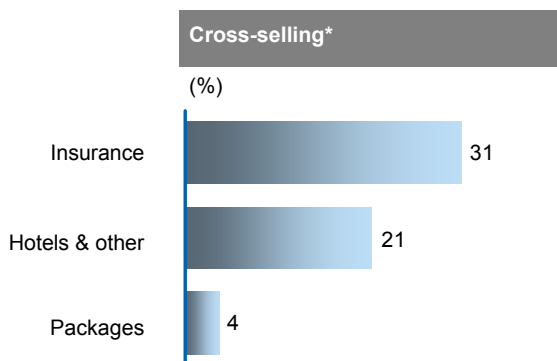
Packaging is another big opportunity for OTAs which is not being exploited by any of the participating agencies, currently representing only 1.1% of sales. Although the price of each package is low, margins represent 12.8% which in absolute terms amount to €42.2 per booking.

While air remains the main traffic driver, Low Cost Carriers (LCCs) represent a very small percentage of the OTA business. The majority of their sales are still full service carriers. Compared to the similar study in Scandinavia, there has not been much change.

For the majority of OTAs, Insurance is the product with the highest level of cross-sell at 31%, followed by hotels (21%) and packages (4%) (see Chart 7). It is also important to highlight the maturity of insurance - within the OTA segment - one third of all bookings have an insurance sale attached to it.

As shown, European OTAs are generating 86% of their sales from air, whereas the traditional leisure offline agencies do almost the opposite generating 76% of their sales from non-air products (see Chart 8).

Chart 7
CROSS-SELLING FOR NON-AIR SERVICES

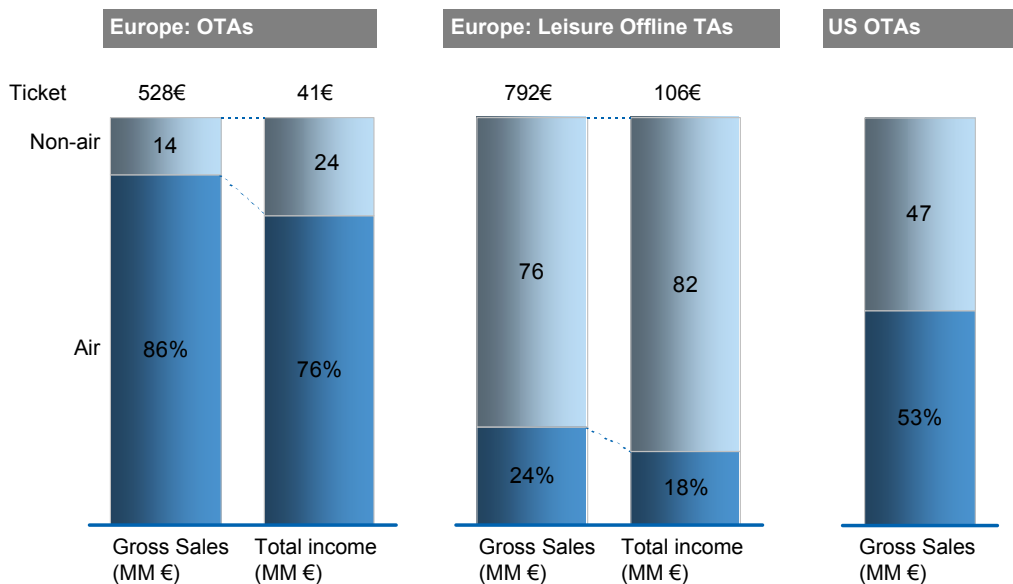


* # of tickets of non-air services every 100 air tickets

Source: Participating agencies; Hermes' analysis

The non-air opportunity for online becomes more apparent when we compare the sales mix of European offline leisure agencies. The average price per ticket sold by the OTAs is €528, lower than the offline travel agencies' average of €792. Offline leisure agencies generate a net income of €106 per ticket, more than the double the income obtained by OTAs.

Chart 8
REVENUE SHARE: AIR VS. NON-AIR



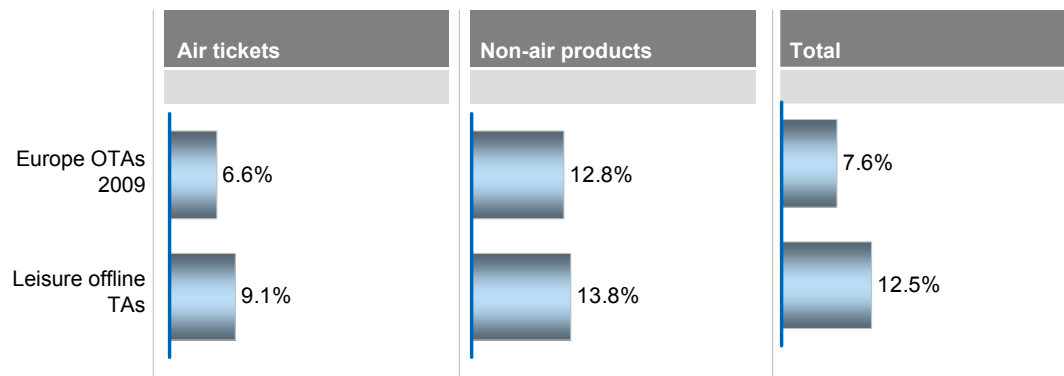
Source: ABC studies, Phocuswright US 9th Edition; Hermes' analysis



OTAs need to replicate offline agencies' business model with a higher incidence of non-air sales

By comparison, US OTAs generate nearly half their sales from non-air products. This is a very good benchmark, indicating that non-air products could be sold by OTAs given the right level of market maturity and the right push. However it is also worth mentioning that the hotel market is much more fragmented in Europe which makes it more difficult to gather the entire offer into one channel.

Chart 9
TOTAL GROSS MARGIN PER PRODUCT FOR TRAVEL AGENCIES
 Total revenues/gross sales (%)



Source: ABC studies; Hermes' analysis

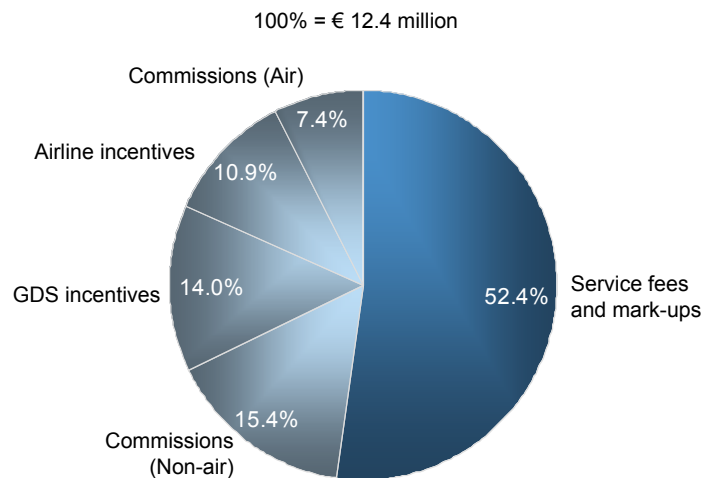
OTAs in Europe need to put more emphasis and focus on increasing their perceived value: get better content and improve the overall shopping experience for their customers to be more credible players and increase profitability.



Traditional agencies generate a significantly higher net margin than Online Travel Agencies - 12.5% versus 7.6%.

The reason seems to lie in the apparent perception of value by end consumers, who believe a 'traditional' travel agent brings more value to their trip planning (personalised service) and simplifies it to the extent that they are willing to pay more for the extra advice and service.

Chart 10
SHARE OF REVENUE SOURCES



Source: Participating agencies; Hermes' analysis

Looking at the main source of revenue for European OTAs, service fees and mark ups account for more than half of their total revenue (52.4%). Airlines commissions and incentives reach 7.4% and 10.9% respectively. However the highest commission comes from non-air at 15.4%. Finally the GDS incentives represent their third largest source of revenue at 14%.

None of the OTAs reported revenues from advertising although they were all looking into advertising as a new source of revenue in the future.

The current business model relies heavily on service fees, but recent developments in the US and in some parts of Europe have shown that fees for air tickets are at risk due to the high competition on price.

If service fees are eliminated, European OTAs would need to find new sources of revenue:

- (i) Mark-ups would fill the gap left by the removal of service fees. OTAs would have to strive for better deals with suppliers to be able to mark-up higher than present.*
- (ii) A potential new revenue source could be advertising, if the OTAs find a way to monetize traffic to their websites.*
- (iii) If OTAs increase the ratio of non-air bookings, they can significantly increase non-air commissions as a percentage of total revenues.*

Over the coming years we should most likely see a shift in the role of air bookings versus other revenue streams. The role of air bookings might be limited to attracting traffic, while advertising, non-air sales and cross-selling should be the key areas to focus on to drive profitability.

Average Agency Cost Structure

We analysed the cost structure of the participating Online Travel Agencies in two ways:

- **Traditional costing analysis:** financial cost accounts were split up as they were presented in their P&L (personnel costs, marketing costs, communication costs etc).
- **Activity-based costing (ABC) analysis:** costs from traditional cost accounts were allocated to key processes and activities using specific criteria based on cost drivers.

Traditional costing analysis

Before we detail the different cost accounts that together represent the OTA cost structure, we can see from chart 11 that OTAs have a cost of €40.9 for every ticket they sell.

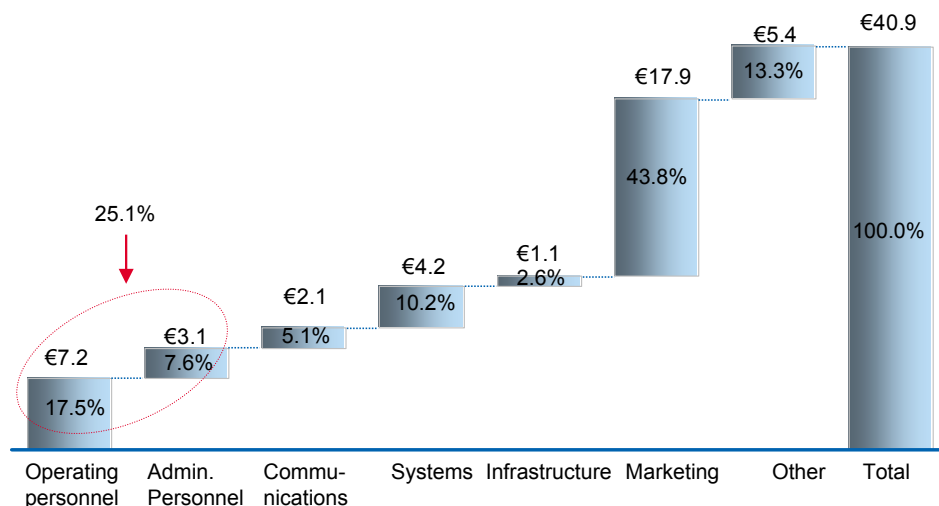
Marketing represents the largest cost for European OTAs, representing 43.8% of the total cost of every ticket sold. Therefore €17.9 out of the total €40.9 cost of a ticket sold is dedicated to Marketing. This is a major cause for concern, but also presents an opportunity for improvement, as we will see in detail later.

The second largest cost driver for OTAs is personnel, at just over one quarter (25.1%) of total cost. We see that operating personnel – those with sales related roles – represents a higher cost than administrative personnel (17.5% vs. 7.6%).

Systems and communications accounted for 15.3% of total costs, while other costs represented the balance.

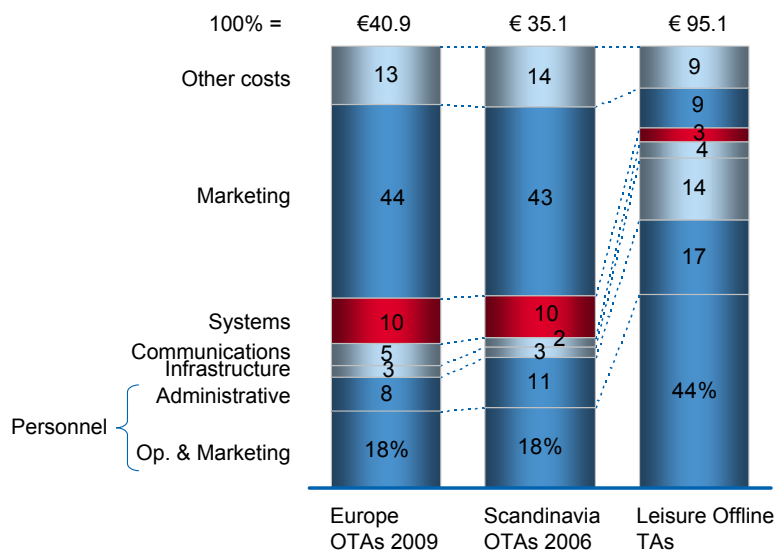
Chart 12 compares the traditional cost structure of the participating OTAs with the previous Scandinavian OTA and offline agencies studies. The chart shows that while the average price per ticket has gone up from €35.1 to €40.9, a difference of €5.8 per ticket, the overall cost structure is similar.

Chart 11
TRADITIONAL COSTS BREAKDOWN



Source: Participating agencies; Hermes' analysis

Chart 12
COMPARISON OF TRADITIONAL COST BREAKDOWN



Source: Participating agencies; Hermes' analysis

Looking at the details of this €5.8 increase, we can see that more than half, €3, comes from marketing expenses. The remaining €2.9 is distributed between the rest of the cost accounts – mainly Communication, Systems and Operating Personnel. The only cost pool that decreased from 2006 is Admin Personnel, probably due to increased automation & efficiency. In percentage terms, however, marketing's share of total cost has hardly changed.

Significant differences do emerge when comparing the European OTAs and their traditional offline competitors. Traditional agencies incur on a cost per ticket of €95.4 compared to an OTA's €40.9. The biggest cost driver for traditional offline travel agencies is personnel, which make up for 60% of total costs, or €57.8 a ticket. Marketing, the biggest cost driver for an OTA, only represents 9% of the cost for a traditional offline leisure agency.

Another major difference is Infrastructure cost which represents 14% of the total cost for traditional agencies but only 3% for the online players. In absolute numbers, traditional offline agencies spend €13.30 per ticket on Infrastructure compared with the OTAs' €1.23 per ticket. The difference has to do mainly with property rental cost that offline agencies incur especially because they need to operate in commercial locations. A 'premium location' could be seen in terms of promotion and marketing. Some OTAs are located in the centre and sometimes in the best area of cities but usually online agencies are out-of-town to be more cost efficient.

Activity-Based Costing Analysis

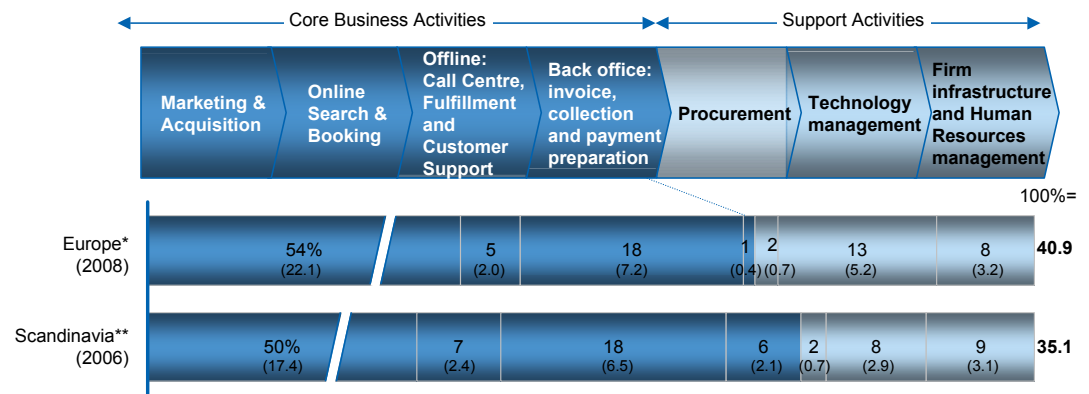
Introduction

The Activity-Based Costing (ABC) analysis is based on the principle of identifying a business' core activities and allocating costs to them. For Online Travel Agencies, the main activities identified are shown in the following chart. A detailed list of the ABC analysis categories can be found in the appendix under Methodology (Chart 23).



Marketing and Acquisition is the main cost driver for European OTAs, accounting for 54% of total costs

Chart 13
ABC ANALYSIS – COST BREAKDOWN BY ACTIVITY



Source: Participating agencies; Hermes' analysis

Once the processes and activities for the ABC analysis are mapped out, costs are allocated to each of the activities, taking into account the amount of resources used. Data such as revenues, costs, time dedicated to each activity, space occupied by each department and systems costs was gathered from accounts and through interviews. The results are illustrated in Chart 13.

For both European and Scandinavian OTAs, **Marketing & Acquisition** activities are the main cost driver – 54% or €22.1 per ticket in Europe and 50% or €17.4 in Scandinavia. **Offline** activities are the next largest, accounting for 18% of total costs.

Technology Management is the third cost driver, representing 12.7% of total costs – €5.2 per ticket. European OTAs spend more on Technology Management activities than Scandinavian (12.7% vs. 8.2%).

Online Search & Booking only represents 4.8% of all costs, as this cost pool only represents web-page maintenance and development. All costs for server maintenance and technology support for the IT department are under Technology, while the online marketing costs are under Marketing, as described above.

Procurement is a minor cost which represents 1.8% of total costs given that the majority of OTAs do not file fares as they rely on carriers' fare management to sell airline content. Thus this activity includes mainly personnel.

Finally, **Firm Infrastructure and Human Resources Management** represents 7.8% of total costs, or €3.2 per ticket.

When compared with the 2006 Scandinavia study, Marketing, Offline and Technology Management costs have gone up. However, Back Office costs have shrunk to €0.4 from €2.1. Increased automation and efficiency, together with better integration, could explain this reduction.

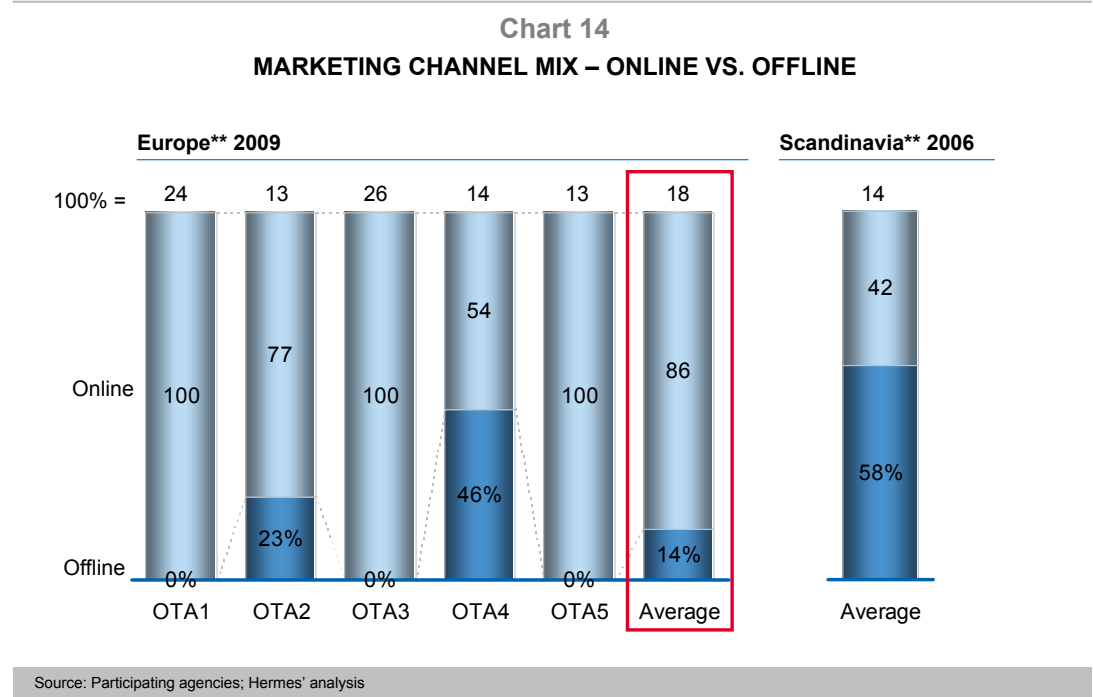
The study will now take an in-depth look at the ABC activities:

Marketing & Acquisition

Reported as the biggest cost driver for an Online Travel Agency, marketing activities account for 54% of total costs: the average marketing cost for the participating agencies is €6.5 million which represents an average cost per ticket of €22.1. This includes marketing budget, personnel, office space, communication costs etc. related to this department). The pure Marketing budget represents €17.9 per ticket (€5.5 million in absolute terms). It is important to make this distinction as we will be using both numbers during the analysis. The average number of marketing employees is 3.7 per Online Travel Agency.

86% of pure Marketing budget (€15.5 per ticket) is spent online with 14% allocated to offline channels (€2.5 per ticket) (Chart 14). Online is the major marketing channel, a significant change from the 2006 Scandinavian study.

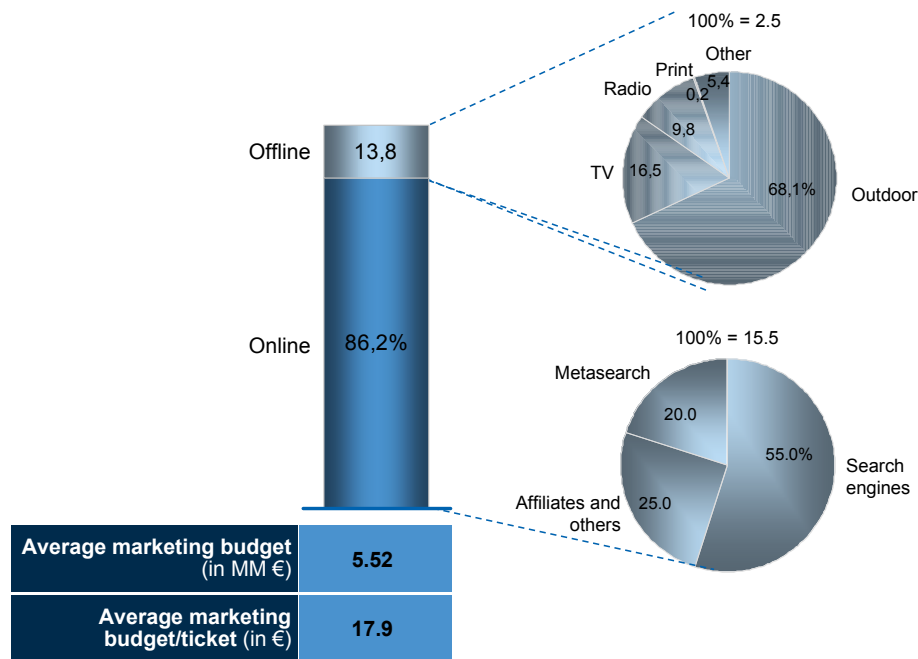
Chart 14 shows some of the differences the five participating Online Travel Agencies on how they spend their marketing budget: as mentioned previously the largest marketing expenditure is allocated to online.



The trend moving forward might see Online Travel Agencies adjusting their marketing budget as they try to find the right balance and a competitive return on marketing investment.

Online marketing is key in driving traffic to websites. But in markets where the Internet penetration is lower, Online Travel Agencies should spend more on offline marketing. This will enable OTAs to reach travellers who do not spend much time on the web and to alert offline travellers to their online presence. A mix of online and offline marketing might be healthier in the long run as it could enable Online Travel Agencies to increase their brand equity.

Chart 15
MARKETING EXPENSES BREAKDOWN BY CHANNEL



Source: Participating agencies; Hermes' analysis

If we look at **Chart 15, which shows the marketing mix of the participating OTAs** in more detail, search engines such as Google, Yahoo! and MSN account for more than half of total online marketing expenses. On average, each OTA spends €2.6 million a year, or €8 per ticket, on search engine marketing. This is the primary area where OTAs need to gain more efficiency as the impact of this cost is major. Ways of bringing down costs would include improving Search Engine Optimization (SEO) and promoting more effective channels.

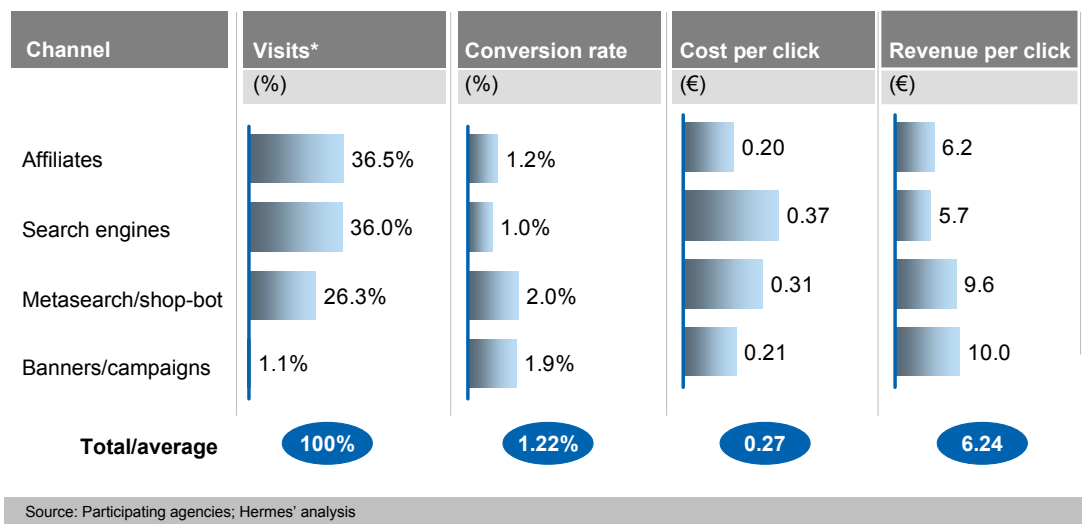
The second biggest marketing vehicles are affiliates (25%) followed by Metasearch (20%). The penetration of Metasearch varies between European markets. However, it is a vehicle which is on an upward trend and will continue to grow in Europe. In Germany, Metasearch is widely used and therefore its relative weight in the marketing budget is higher. Other channels, such as direct mail and social media, are not shown as both activities are done in-house with negligible time allocation from marketing personnel. Two of the five Online Travel Agencies were using Facebook and Twitter to promote their brands. However, in the next few years social media will also become a more prominent channel in the overall marketing mix.



Online marketing can be more easily measured than offline. OTAs can implement tracking tools in order to measure this channel efficiency in terms of return on investment (ROI), conversion rates, cost per booking etc. However, some smaller agencies are still learning how to use the many tools available. Big OTAs, though more experienced, can still continue to improve their monitoring and reporting in order to truly understand marketing channel effectiveness.

For example, in order to measure effectively conversion rates OTAs must eliminate duplication, or double counting. If a customer enters a website via a banner and exits before booking, but then books a flight via a Metasearch website, he or she will only make one booking, which must be assigned to only one marketing channel. In this case, even though OTAs pay for both the banner and Metasearch traffic, they have to allocate the booking to only one channel. Generally, OTAs use the 'last click wins' rule. In the example above, it would be assigned to the Metasearch channel.

Chart 16
PRODUCTIVITY PER MARKETING CHANNEL



Only three out of five agencies were capable of providing conversion rates broken down by different originating channels, but were unable to identify if they were new or repeat customers.

If we take the four online marketing channels, the channel that generates the highest number of visits is affiliates (36.5%) followed closely by Search Engines (36%), followed by Metasearch (26.3%) and lastly Banners/Campaign (1.1%).

If we consider conversion rates, all four channels have an average conversion rate of 1.22%, which means that for every 100 visitors who enter an Online Travel Agency only 1.22 book. However, the channel with the highest conversion rate is Metasearch (2%). The lead/visit obtained via the Metasearch channel is more qualified than the visit generated via Google, hence the higher conversion rate. The channels with the second highest conversion rate are Banners/Campaign (1.9%), followed by Affiliates (1.2%) and lastly Search engines (1%).

If we look at other indicators such as cost per click we see that Affiliates and Banners/Campaign have the lowest cost per click. However, Metasearch and Banners/Campaigns are by far the most efficient channels in terms of revenue per click.

It would be more effective and profitable for Online Travel Agencies to push for Metasearch and banners, if appropriate to the market. Banner technology has improved substantially over the last few years and several online advertising companies are offering technology to place real-time pricing on banner advertisements.

Marketing & Acquisition: Key Challenges for OTAs

Improve marketing efficiency:

- *Improve reporting and tracking tools to measure the effectiveness of marketing channels*

Improve efficiency of online marketing channels:

- *Reduce SEM costs with improved SEO*
- *Focus on higher conversion channels such as Metasearch and Banners*
- *Increase use of social media such as Facebook and Twitter*

Implement CRM and use of personalized offers to customers:

- *Implement customer loyalty programs and focus on increasing customer retention*

Move to offline channels in markets with lower online penetration in order to target new consumers.

The key challenge OTAs are facing today is **profitability**, an issue which will be covered in more details later in the paper. While marketing is the highest cost driver at €22.1 per ticket, there are numerous ways for OTAs to improve:

Reporting & Tracking Tools: Firstly, OTAs **can improve their reporting and tracking tools** to measure the effectiveness of their channels. All participating agencies were doing this to a certain extent but there is definitely room for improvement. Automation is a must, and new types of reports need to be produced which can improve control over marketing expenditure.

Online Marketing Channel Efficiency: Next, OTAs should focus on the efficiency of their online marketing channels. Search engine marketing is the highest cost at €8 per booking. While search engines generate a very high number of visitors, conversion rates are not as high as other channels. Improving SEO (Search Engine Optimisation) and focusing on channels with higher conversion rates such as Metasearch and banner advertising are ways in which OTAs can improve efficiency in this area.

Social Media is still in its infancy. In 2009, some of the participating agencies were using Facebook and Twitter to promote their offers and as this channel matures increasing use is expected.

Customer Relationship Management: Personalisation is still an area of potential improvement for European OTAs, and effective customer relationship management (CRM) tools will be vital to achieve this.

Customer loyalty programs are another area where OTAs will be able to profit from in the future.

Online Search & Booking

Online Search & Booking is a key activity for an OTA as it is the main point of interaction a customer has with a brand. Improving the shopping experience for customers is critical.

On average, OTAs allocate 4.8% of their total costs to this activity (€2.0 per ticket, see chart 12), around €600,000 a year. Under the ABC analysis, this only represents the cost of maintaining and developing the website. It does not include the costs related to server maintenance and technology support, which are under Technology; nor does it include online marketing costs, allocated to Marketing activities.

One of the main costs included in this activity is the Internet Booking Engine (IBE). Three OTAs have developed an in-house IBE, while the remaining two used a third-party solution. On average, the total cost for the IBE development and maintenance – either done in-house or outsourced – is €1.7 per ticket.

Use of Advanced Search Tool

Low fare search functionality is highly valued by customers. All participating OTAs have third-party solutions, and some complement it with internally developed add-ons.



Online Search & Booking: Key challenges

Use of **advanced search tools**, such as calendar search or affinity shopping to enrich the experience of customers and increase conversion rates.

- **Enhance product steering** for non-air products, where there are opportunities to increase margins, higher conversion rates
- **Offer better content.** Both in air (via LCCs) and non-air (especially hotels but also insurance, cruise, cars and packaging)
- **Boost cross-selling** of products with high margins such as insurance by implementing tools and processes to cross-sell and up-sell content and services automatically

Search technology has improved considerably. Up to a few years ago consumers were only able to conduct an origin and destination search with specific dates and the results were listed by price generally on the results page. More advanced search tools are available today, such as calendar search which allows a traveller with flexibility to search +/- 3 days from the desired travel date.

Using advanced search tools not only improves the shopping experience for customers and ultimately customer loyalty but also improves conversion rates - two out of the five participating OTAs using calendar display reported an increase of 50% in conversion rates. Other types of advanced search tools include search by budget, geography etc. Participating OTAs using advanced search tools agreed that they would focus even more effort on these tools in the future.

Some OTAs even started to include on their home page a direct link to thematic destinations such as 'beach', 'ski' or 'scuba diving'. Known as affinity shopping, some OTAs believe this will help them to compete with specialist package holidays operators. Affinity and destination sales are seen as seasonal sales boosters and as being helpful to dig into some niche markets such as customers seeking to attend sports events.

Use of steering tools

These tools sort search results according to certain variables such as price or supplier. Enhanced steering tools in both air and non-air are vital for Online Travel Agencies: not only as a means of better controlling their margins (by steering higher margin content to their consumers), but also to improve the shopping experience and ultimately customer loyalty as they can give relevant content to their consumers.

In general, most European OTAs sort their air product by price. However, an Online Travel Agency should be able to steer the right content to the traveller based on their profile and needs. For example if a traveller conducts a search for his wife and two children, one could assume that he could be more concerned with convenience rather than price and should therefore return relevant results ; students, on the other hand, would lean more towards the cheapest fare. For non-air products such as hotels and packages, OTAs could sort search results according to preferred suppliers (according to the level of commissions paid) price, average user ratings and other variables, but currently only the most efficient OTAs are able to do this. One of the challenges in this area is to build the right logic and algorithm to make relevant recommendations. This is more difficult in travel than for other products such as books as in the Amazon model. As the use of CRM tools becomes more commonplace, this will get easier in the future.

Some of the participating OTAs mentioned they used basic biasing or steering tools but claimed that there is room for improvement.

As we have mentioned the importance of focusing on non-air products in the previous section, improvements that can be made in this specific area are:

Offering better content in both air via LCCs and non-air – hotels, insurance, cruise, cars and packaging. Sales of packages are very low in volume and value and OTAs need to push this more. All OTAs confirmed they needed to improve their hotel and package content. Most of them rely on one hotel consolidator and are seeking to include either a second consolidator or add merchant hotels. OTA executives claim that most consolidators have a good content offer but is limited to large cities.

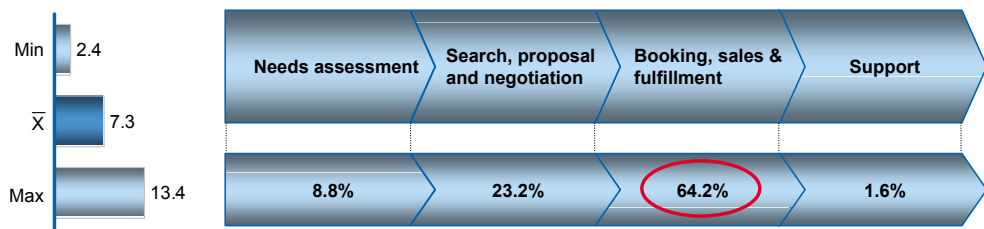
Air fare management from traditional airlines is not yet an issue for OTAs as the majority seems to use airlines' fare filing and access them through their GDS. However, OTAs believe that the volumes of fares not available through the GDS will increase in the future. Low Cost Carriers' content comes, most of the time, from API as opposed to screen scrapping solutions more used in the past. For non-air products, some OTAs outsource content to another larger OTA or work with car or hotel consolidators.

Offline: Call centre, Fulfillment and Customer support

This activity accounted for 18% of the cost of a ticket, equivalent to €7.3 per ticket and is the second biggest cost driver. On average, the OTAs spent €2.2 million per year on this function.

Nearly two-thirds of total offline costs came from booking, sales and fulfillment activities. Search, proposal and negotiation are the second most important activity performed by the offline staff, accounting for 23.2% of total offline costs. Needs assessment and Support complete the remaining 10%.

Chart 17
BREAKDOWN OF OFFLINE COSTS
In €/ticket, average OTA



Source: Participating agencies; Hermes' analysis

Four out of five OTAs' call centres were multi-market, meaning that the same call centre answered calls for more than one country. However, customers prefer operators who can speak in their native language with no particular accents. Four out of five OTAs had an in-house call-centre solution while the remaining OTA had an outsourced solution in their own country.



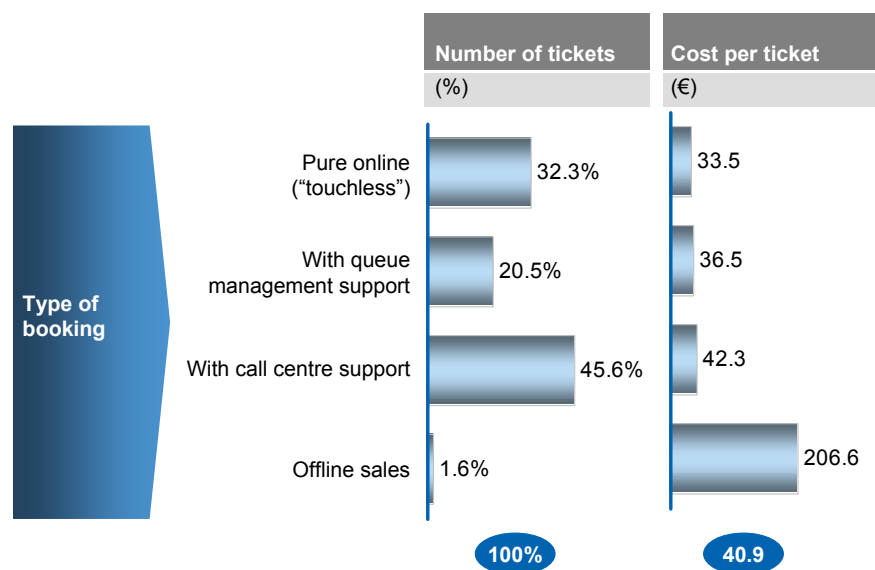
Touchless bookings only represent one third of total bookings

In order to minimize the work of fulfillment staff, mid-office products are used in all OTAs. But despite internet booking engines becoming more sophisticated, many bookings still need an offline input. The study identified four types of bookings and the cost implications of each of them (Chart 18):

- **Pure online/touchless:** the booking is made entirely online by the customer without any human intervention. It is the most economical, at a cost of €33.5. Nearly one-third of travellers book this way.
- **With queue management support:** the booking is done online but a travel consultant needs to manually change priorities or handle some issues that are not automatically checked. Tickets issued this way are 9% or €3 more expensive than touchless. Around 20% of the bookings needed queue management support from travel consultants.
- **With call centre support:** The customer tries to book online but ends up contacting the call centre to solve a problem or ask questions. Nearly half of all bookings need call centre support. These bookings cost €42 each, 26% more than touchless. OTAs handle on average 7,500 calls per month, but only one of them is able to identify the reasons for the calls.
- **Offline:** This booking is done entirely via the call centre. Older and less experienced customers prefer to book this way. A 100% offline sale costs six times as much as a pure online booking at €206.6. Luckily, only 1.6% of the bookings use this channel.

Chart 18

COST AND WEIGHT OF THE MAIN BOOKING TYPES



Source: Participating agencies; Hermes' analysis



Schedule changes cost OTAs €3.6 per booking

OTAs are trying to implement various methods to reduce the workload and cost of their call centre, such as instructing operators to talk the customer through the online booking process. Some OTAs are driving this by simply not taking bookings over the phone; some do charge an additional fee to offset the cost. Interactive Voice Response (IVR) technology and emails are also used to help reduce call volumes and limit call centre hours.

Most of the participating OTAs complained that the highest cost was allocated to schedule changes. They state that 5.5% bookings were subject to changes: 3.2% due to airlines' fault and 2.3% due to passengers. Schedule changes cost OTAs €3.6 per booking.

As mentioned, many OTAs do not analyse why customers contact the call centre. More efforts should be made in this area.

Offline: Call centre, fulfillment and customer support - Key Challenges

- *Increase share of 'touchless' bookings by:*
 - Automating all ticketing and batch processes
 - Implementing online ticket changers and automating email responses to customers
- *Decrease offline work load by:*
 - Implementing automatic response solutions and reducing working hours
 - Charging additional service fees for offline sales
 - Limiting call centre hours
- *Use call centres to push more lucrative products such as non-air*
- *Improve reporting to monitor call centre performance and reasons for calls and take corrective actions*

Back Office: Invoice, Collection and Payment Preparation

The last process which is identified as a main activity within the ABC analysis comes under the banner of back office. It only accounts for 1% of the total costs - €0.4 a ticket - as most back-office systems are now fully integrated with front and mid office. Further integration can help reduce this cost further.

Standardized processes can also help reduce fraud. Fraud seems to have increased since the study conducted in 2006 on Scandinavian OTAs. In 2006, fraud incidence was €0.03 per ticket and in this study the incidence increased to €0.88 per ticket.

Lastly, minimizing Airlines Debit Memos (ADMs) is a key area of improvement for OTAs. The participating OTAs mentioned that they generated 15 ADMs on average per week.

Support Activities

Procurement

Procurement activities account for 1.8% of total costs, or €0.7 per ticket. Generally, negotiation is done by the OTAs' CEO or procurement manager once a year. OTAs are willing to extend contracts length from one year to two.

With most OTAs, all the fare filing is done by the airlines, reducing resources required and consequently total costs.

In terms of air bookings sold by OTAs, 94% are with traditional airlines, whereas 6% come from LCC. Most OTAs have at least one strong national LCC carrier.



Technology Management

IT activities account for 12.8% of total costs or €5.2 per ticket. Due to the importance of technology for OTAs, a breakdown of the activity was conducted in five different categories (see Chart 18).

- **Business Process Design:** includes all the tasks regarding idea generation, process design and project management. Generally, when an IT process starts, all the planning and the outline performed at the beginning is included in this activity.
- **Web application development:** this was reassigned to Online Search & Booking activities because has to do entirely with the IBE.
- **Web application supporting systems:** includes the cost of systems that are supporting the IBE such as the GDS, APIs with LCCs or packages software.
- **Office supporting systems:** covers all support systems such as the back-office mid-office system or an accounting system.
- **Server maintenance:** covers hosting, server updates and other costs.

Chart 19
BREAKDOWN OF TECHNOLOGY MANAGEMENT COSTS
In €/ticket

Activity	Business process design	Web application development	Web application supporting systems	Office supporting systems	Server maintenance	Total
Average (€)	2.2	1.4	1.2	1.2	1.1	7.2
Performance gap (range in €)	4.6	1.7	1.0	1.6	1.7	

Source: Participating agencies; Hermes' analysis

The most demanding activity in terms of costs is 'Business Process Design' because project management is normally performed by senior staff. OTAs are constantly improving their websites: some have standardized processes to make their web page enhancements or to improve internal processes from a technology standpoint.

System outage – meaning the amount of time the website is not working – is measured in some OTAs but the impact on costs and revenues is not correctly assessed. On average, overall downtime for OTAs represents 16 hours a year and this could have a negative impact of approximately €0.06 per ticket.

Firm Infrastructure and Human Resources Management

These two support activities account for 7.8% of total costs, €3.2 per ticket. The main driver for these activities is office rental costs; as most OTAs are located in large cities, infrastructure represent a significant cost. However, some OTAs are located in smaller cities, with lower rent costs, demonstrating efficiencies in the cost of these activities.

Human resources management costs are mainly around training call centre operators, where the highest staff turnover occurs.



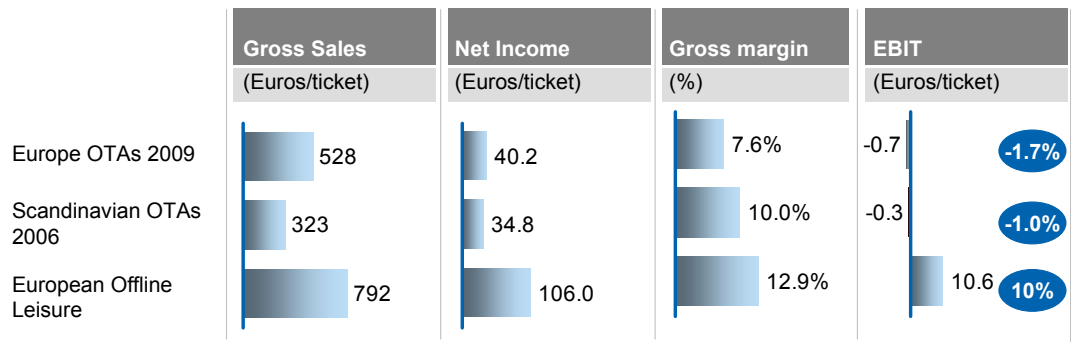
OTAs have a negative EBIT per ticket of €0.7

Profitability and Productivity Analysis

Profitability Analysis

Profitability is an issue across the segment but seems to have a greater impact on medium-small size OTAs. From all participants, two out of the five European OTAs were profitable, although their margins were quite low. On average, these OTAs receive a net income of €40.2 per ticket (see Chart 20). As their average cost per ticket is of €40.9, they have a negative EBIT per ticket of €0.7. This loss of €0.7 translates to -1.7% in percentage EBIT/net income.

Chart 20
ONLINE AND OFFLINE TRAVEL AGENT PROFITABILITY



Source: Participating agencies; Hermes' analysis

When comparing these figures with the same study carried out in 2006, the Scandinavian OTAs were also losing €0.3 per ticket, which translated to -1% in percentage EBIT/net income.

European OTAs show an average cost per ticket 15% higher than Scandinavian OTAs. If these costs are divided by their corresponding gross sales, the break-even point is obtained. This percentage of gross sales is the minimum amount OTAs should charge their customers (or suppliers) in order to break-even. Scandinavian OTAs show a break-even point of 10.1% while European OTAs have a break-even point of 7.7%. Europe has a lower value due to a combination of selling an average ticket 51% more expensive with costs higher only by 15%.

Traditional offline leisure travel agencies have an EBIT of €10.6 per ticket booked (10%), which is healthier and possibly shows that OTAs could increase their margins by replicating some of the traditional offline travel agencies' model.

On the other hand, traditional offline European travel agents sell more expensive tickets, achieving around €792 gross sales per ticket. They sell a much higher volume of non-air bookings which have higher prices per ticket. People normally book long duration family tours through this channel. At the same time break-even for offline agencies is not so high, despite more manual involvement - selling tickets of higher value compensates for higher costs.

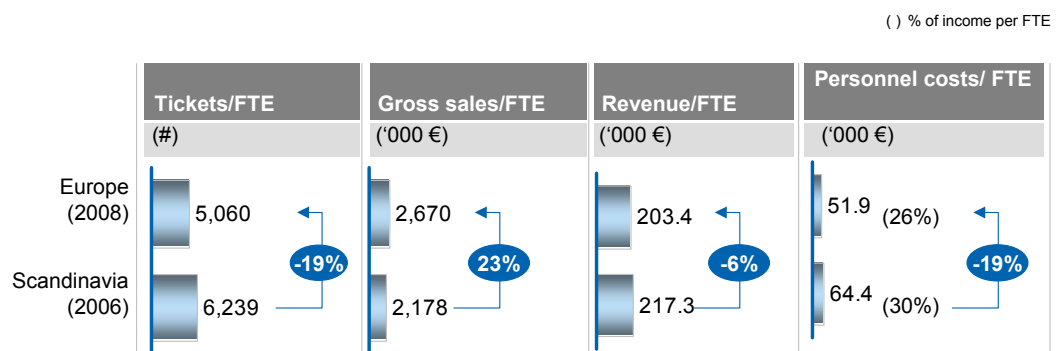
Productivity Analysis

A useful indicator to measure productivity is the total amount of tickets sold per full time employee (FTE). Participating European OTAs produce on average 5,060 tickets per FTE, 19% less than their Scandinavian counterparts who averaged 6,239 tickets in the 2006 study.

However due to the higher price of tickets sold in Europe compared with Scandinavia, the studied OTAs obtained a higher income. Gross sales of €2.7 million generated per FTE for European OTAs is then much higher (+23%) than Scandinavian OTAs' €2.2 million gross sales per FTE.

When combined, these two dynamics result in similar net income figures for the two sets of OTAs. In Europe net income per FTE is €203,000 compared with €217,000 for Scandinavian OTAs. A reasonable explanation for this is the average ticket price - European OTAs have an average gross sales per ticket of €528 while Scandinavia averages €349 (see Chart 20). Therefore, as the average ticket is more expensive, it is more 'challenging' for European FTEs to sell these tickets and this reduces the productivity expressed as number of tickets sold per FTE.

Chart 21
ANALYSIS OF PRODUCTIVITY OF OTAS



Source: Participating agencies; Hermes' analysis

Personnel costs per FTE for European OTAs of €52,000 is 19% less than Scandinavia (€64,000). This is probably due to the fact that salaries are higher in Scandinavia. The cost for European OTAs is equivalent to 26% of the revenue each FTE generates per year. It is worth mentioning that for traditional offline travel agencies, this percentage ranges between 50% and 60%.

Conclusions and Recommendations

The main challenge for OTAs is to re-engineer their business by finding new sources of revenue and control costs more efficiently in order to improve their profitability. The study reveals that, overall, the studied European OTAs were not on average as profitable as they could be.

There are many opportunities for OTAs to continue to improve if they consider the following recommendations.

Revenue Diversification

(i) More focus on non-air products

Air constitutes a very high part of OTAs sales at 86%, generating an average gross margin of 6.6%. Non-air represents 14% of OTA sales, but with a gross margin of 12.8% almost doubles that of air.

In the same way that traditional agencies have diversified their business and are selling more non-air, mid-sized OTAs also need to improve their non-air sales because of the superior margins non air business generates. Insurance is the product with the highest margin at 51.4% and even though it is fairly mature (31% of all air bookings have an insurance booking attached to it) there is still an opportunity to grow.

Hotels and packages are probably the biggest opportunity for Online Travel Agencies, as their cross-sell rate is lower at 21% and 4% respectively. Hotels can offer a margin of 13% and even though currently the average ticket price of hotel is fairly low, in absolute terms the margins are higher than air (€31.6 per ticket against €22.1 for air). Most of the Online Travel Agencies participating in the study were using third-party hotel aggregators which also granted lower margins. Partnering with the right provider for access to relevant merchant hotel content will be key to this strategy. Packaging is another big opportunity which is currently not being exploited, it only represents 1.1% of the average mix but also offers double-digit margins, 12.8%.

The extent to which mid-sized European Online Travel Agencies are exploiting the opportunity that non-air represents is limited. This is especially apparent when a comparison is made to traditional leisure agencies, who are generating 76% of their sales from non-air and to OTAs in the US, who according to PhoCusWright generate nearly half their sales from non-air products.

By increasing the level of cross-selling across non-air offerings, OTAs can protect their average margins, position themselves not only on price but also build loyalty at the same time by adding value to the traveller as a one-stop-shop for travel arrangements.

The implementation of tools that automatically cross-sell would facilitate this strategy.

In order to maximize revenue and margins from non-air, **biasing tools** should be used to steer the most profitable product for OTAs to travellers, which in turn satisfies travellers' need for the best fare on the market.

(ii) Diversifying into new areas

Service fees and mark-ups are the main source of income, accounting for more than half of net income at 52.4%, with non-air commissions, air commissions, airline overrides and GDS incentives making up the rest.

In some markets such as Scandinavia, airline fees have been replaced by markups and **OTAs have had to evolve their business model accordingly**. Eventually European OTAs will see non-air commissions and related service fees and mark-ups becoming more sizeable contributors to their revenues. Apart from the obvious diversification into non-air and packages mentioned before, other actions could be considered by mid-sized OTAs:

Time should be spent now on analysing how **advertising** could be converted into a revenue generator. Online travel agencies receive huge amounts of traffic to their website and monetizing this traffic would be highly beneficial to them, especially since advertising products are generally high margin products. Profiling website visitors better should allow mid-sized OTAs to segment their market better and offer superior advertising packages to other interested parties. The more data they can provide, the better the proposition will be for the potential advertiser.

Cost control in the marketing area

Marketing is the main cost driver for an OTAs (around 54% of total costs) while personnel is the main cost driver for traditional agencies (around 60%).

With tight margins, mid-sized European OTAs need to invest in **marketing consultancy** upfront to allow them to get the best advice on how to contain costs and get better return on their marketing spend allowing them to focus on their day-to-day business.

Search Engine Marketing (SEM) represents the highest cost at €8 per booking. Although this activity generates visits, conversion rates are not as high as other channels. Focusing on channels that show higher conversion rates such as Metasearch (in relevant markets) and banner advertising (using latest technology) should allow the sampled OTAs to improve efficiency.

Costs associated with search engines account for more than half of online marketing costs, with Google as the main player among all studied OTAs. Permanent focus should be given to Search Engine Optimisation (SEO) in order to improve efficiency in this area.

The study reveals that none of the sampled OTAs at the time of conducting the study had a **formal CRM system** in place (although some were planning on implementing one in the near future), and not one had a defined **loyalty strategy**. CRM could help OTAs to customize information and offers that are being pushed to the market and help to gain customer loyalty. Generally, price-led consumers are brand agnostic, but OTAs should build loyalty campaigns to encourage repeat usage, in turn generating brand loyalty. Enhanced content and superior user experience can also help repeat visits and custom.

Given the tight margins and speed at which things change, OTAs should be stringent in their **tracking and reporting methodology**. This will give them access to the data they need to plan their tactical marketing effectively.

Affiliate marketing should be developed along the lines of amazon.com and other examples of online marketing excellence from outside the travel sector.

Travellers use **social media** before, during and after booking their trips, which could suggest that OTAs should be active in this space. Only two of the OTAs surveyed use **social media** for their marketing activities. While there isn't a proven correlation between increased social media activity and increased conversion rates, OTA should be more agile than most, as they operate exclusively in the online space. Being first in this arena could give OTAs the brand awareness they need to differentiate themselves and create loyalty.

Cost control through automation and outsourcing

Taking a critical look at the opportunities for cost control through automation and outsourcing could be time very well spent for mid-sized OTAs.

Outsourcing certain functions should be considered, the advantage being that OTAs can then concentrate on their core business, while their technology provider can help with the technology management of their processes.

Even though OTAs have improved considerably in automating their processes over the last few years there is still room for improvement in most areas of the business.

One of the key areas of focus is **Offline, Call Centre & Fulfillment** which is the second highest cost driver representing 17.8% (€7.3 per ticket) and a lot can be done in this area to improve efficiency.

***Touchless booking is the most cost-effective method of booking at €33.5.** Some manual intervention such as queue management increases the cost to €36.5. **The highest cost in this area is ticket changes** (€3.6 per ticket). Bookings with some call centre support – 46% of the cases, climb to €42.3. An offline booking is the most expensive (€206) but only 1.6% of bookings are fully conducted via the call centre.*

With the objective to increase touchless bookings, OTAs should identify specific areas for automation such as ticket and schedule change, automation of queue processes and automated email responses.

To get a higher percentage of touchless bookings, OTAs could analyse and monitor at what stage of the booking process the traveller uses the phone. Implementation of pay lines for calling the Helpdesk could also be considered. OTAs need to balance service with reaching their touchless targets.

- Time freed up at call centre level could be used to sell more lucrative non-air content.

Automation does reap rewards and further improvements can be made in terms of front to back office integration. OTAs should also concentrate on minimising Airlines Debit Memos (ADMs) where possible.

Standardized processes can also help reduce fraud. Fraud seems to have increased since the study was conducted in 2006, when fraud incidence was €0.03 per ticket. In this study the incidence increased to €0.88 per ticket. While most OTAs have taken some measures against it, continued attention should be paid to this issue.

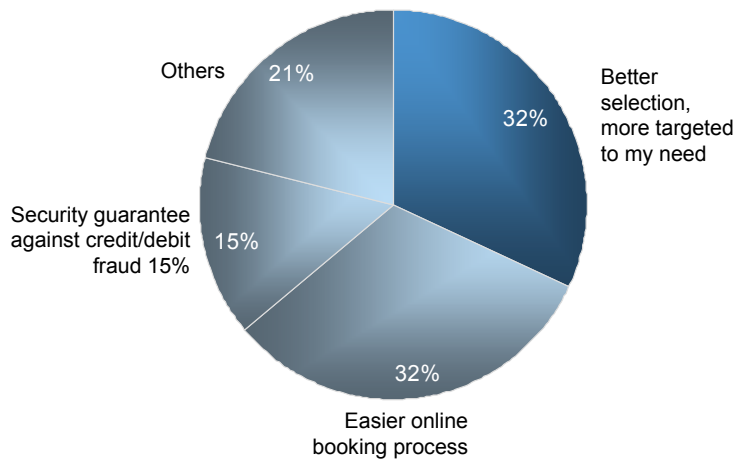
Customer experience enhancement

Conversion rates for OTAs are very low. While pushing up conversion rates is challenging and travellers are literally 'spoilt for choice', OTAs need to stand out in terms of offering savvy travellers an experience that will make them want to book and come back.

Overall mid-sized OTAs should make sure their technology can respond quickly to trends, such as travellers seeking inspiration when searching for holidays rather than booking with a pre-defined trip in mind. OTAs should also remember the importance that travellers place on the ease of use of a website.

Chart 22 highlights the reasons why a consumer will book online or decide to go offline if wishes aren't fulfilled.

Chart 22
REASONS TO BOOK ONLINE



Source: PhocusWright Europe Online Travel Overview 5th Edition (November 2009)

When **looking at easier online booking processes**, better shopping technology, calendar options and facilities to create packages easily and quickly will help set mid-sized OTAs apart from their competition. The use of advanced search tools can generate better results for the traveller, leading to conversion rates which can be up to 50% higher. A lot of innovation is expected in this field with advanced search technologies like activity based search, map search and budget search.

Additionally, integration with tools that allow users to access relevant and recent user generated feedback will make customers more loyal in the long run.

Travellers want a better selection more targeted to their needs. OTAs need to look at what other online players, such as Amazon, are doing to perfect customer tracking and to insert algorithms or fuzzy logic into searches that prompts travellers to see options and reviews that reflect their profiles. Solutions that will help mid-sized OTAs customise the shopping window, while at the same time push more profitable content, should be considered.

The travellers' overall shopping experience could be enhanced by more relevant content, so that the travellers' visit to a mid-sized OTA website can provide all the elements of the trip, including non-air elements, insurance and relevant destination information. Overall, OTAs need to differentiate themselves using innovative solutions and strengthen their value proposition beyond price.

Provider negotiation

OTAs should review relationships with providers with a view to getting better deals on relevant content. In recessionary times, the business reality of some of these providers has changed, which could make them approach potential relationships with OTAs in a different way. These relationships should be regularly revisited and depending on traveller trends, mid-sized OTAs need to secure the best deals and become known for that in their target market.

Better mechanisms for tracking trends and competitive positioning

Tracking perception of travellers of deals available and own positioning is something that OTAs need to be always aware of as it is constantly changing in such a dynamic and fast changing environment. OTAs need to devise measures to stay ahead in terms of being a first mover with the best offer, for the trendiest destination, which will also help in terms of brand awareness.

Appendix

Methodology - Details

Hermes carried out an overall market study, selected OTAs to participate in the project, and conducted an activity-based costing (ABC) analysis. The study was commissioned by Amadeus.

How was this done?

Initially, an exhaustive analysis of activities of five representative OTAs in Europe was carried out. The sample was selected on the basis of a balanced mix of OTAs in terms of size, location and automation levels, in order to produce results that truly represent the current conditions in the market place. The OTAs in this study were involved in other tourism activities, but only the online business was considered.

Hermes then prepared an activity-based costing report that also included the characteristics of each sector, revenue structure and profitability. The comprehensive analysis of cost per activity within each OTA provided important information on their efficiency in relation to their market segment.

The project included three steps:

1. Information request and financial documents

A detailed and thorough questionnaire was sent to each OTA, requesting information related to revenue, breakdown of expenses, P&L statement (as the study required covering an entire fiscal year, 2008 data was used), the company's organisational chart in detail, IT, software and communications equipment.

2. Process analysis

This step consisted of an in-depth assessment of OTAs business processes. Additionally, interviews with OTA employees were carried out in order to help understand the main activities performed within each OTA and to identify resources used in each activity.

The processes were documented and analysed at two levels for each OTA: Level 1 provided a description of the main activities carried out by the OTAs whilst, at level 2, the main activities were divided into sub activities (Chart 23). For example, 'Marketing and Acquisition' (a level 1 activity) included 'Product and package development' and 'Marketing and Sales Origination' (all level 2 activities); and each level 2 activity has a level 3 description with all the sub-sub-activities involved (not illustrated in Chart 23); in the case of 'Product and package development' these would be 'Market analysis and monitoring to identify opportunities', 'Product and target customer definition', 'Feasibility analysis' and 'Package final definition'.

3. Cost allocation

An activity-based costing methodology was used to determine the cost of each activity during the process, to identify cost reduction opportunities and, finally, to establish the differences between the most and least efficient OTAs.

Two cost allocation exercises were performed:

- A traditional costing in which categories were divided generically (Operating and Marketing Personnel, Administrative Personnel, Communications, Systems, Infrastructure, Marketing and Other).
- An activity-based costing in which traditional categories were allocated to each activity, taking into account the amount of resources (cost driver) used for each and then allocated to tickets generated (issued). Data (revenue, costs, time dedicated to each activity, space occupied by each department and systems costs - IT, phone, etc) was gathered using different sources of information (accounting reports, interviews with managers and other employees, etc).

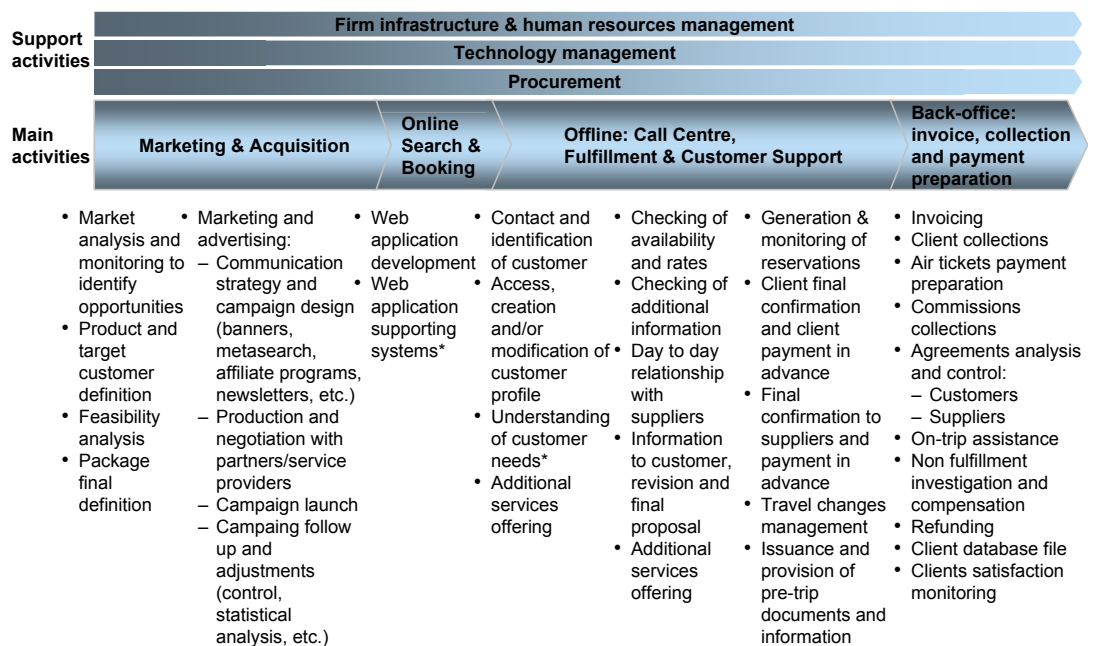
Hermes selected five OTAs to participate in the project. It conducted an exhaustive analysis of the participating OTAs using traditional and activity-based costing (ABC) methods. This approach covered revenue structure and profitability.

The ABC analysis reviews OTAs business processes, split into two clusters (see Chart 23):

- **Main activities** refer to Marketing & Acquisition, Online Search & Booking, Offline and Back-Office activities, broken down further into twelve functions.
- **Support activities** refer to Procurement, Technology Management and Firm Infrastructure & HR Management activities, covering seven functions.

Chart 23

ABC ANALYSIS – AN OVERVIEW OF PROCESS BREAKDOWN



In the ABC study, costs were presented in € (euros) per ticket. A ticket unit includes a combination of all services provided by the OTAs and represents the average transaction per customer (including an airline ticket and added products). By using this method, the study provides simple, standardized results and allows a comparison between OTAs.

The study carried out in Europe was based on OTAs. However, the same analysis was replicated for other business models such as business travel agencies, leisure travel agencies, consolidators and tour operators all around the world. A summary of the studies carried out by Hermes is shown in Chart 24.

Chart 24
ABC PROJECTS CARRIED OUT BY HERMES

		# of agencies analyzed by segment				
	Country/Region	Leisure	Business	Tour Op.	Consol.	OLTAs
America	Argentina	2	6	-	-	-
	Mexico	2	5	-	-	-
	Brazil	3	4	4	4	-
	Colombia	3	4	-	-	-
	USA	-	-	-	5	-
Europe	United Kingdom	-	4	-	4	-
	Italy	4**	4**	-	-	-
	Poland	-	4	4	-	-
	United Kingdom	4	2	-	1	-
	Scandinavia	4	4	-	-	4
	Greece	-	8	4	-	-
	France	6	-	-	-	-
	Europe*	-	-	-	-	5
Asia	Malaysia	4	4	-	-	-
Middle East	Saudi Arabia	6***	4***	-	-	-
		14	38	53	12	14
				12		9

* Agencies located in France, Germany, The Netherlands and Scandinavia

** One agency was analyzed in both segments

*** Four agencies were analyzed in both segments

About Hermes Management Consulting



Hermes Management Consulting (Hermes) is a Latin American consulting firm specialising in strategy, organisation, 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 analysis, 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, organisation, 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.

**To learn more about Hermes Management Consulting please visit their website at:
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