

Understanding Cost Drivers and Ways to Optimize Business for Consolidators in the United States



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Index

Abstract	3
Research methodology	3
Activity-based costing	3
Participants overview	4
Introduction.....	5
Market overview.....	5
Industry trends	6
Study results.....	7
Overview of consolidators' average cost and revenues	8
Activity-based costing analysis	11
Profitability and productivity analysis	20
Conclusions and recommendations	24
Conclusions	24
Recommendations.....	26
Appendix	28
Methodology - details.....	28
About Hermes Management Consulting.....	32
About Amadeus	33

Understanding Consolidator Cost Drivers and Ways to Optimize Business in the United States

Abstract

This white paper reviews the results of independent research conducted from May through July 2008 by Hermes Management Consulting (Hermes) in the United States (US). The research was commissioned by Amadeus in order to:

- Give participating consolidators the opportunity to review their cost and revenues and to identify windows of opportunity based on a detailed study performed by consulting professionals.
- Better understand consolidator cost drivers in the US.
- Identify opportunities to add value to consolidators business.

This innovative study of consolidators in the US is the first of its kind and will open windows of opportunity for companies in this market

The purpose of this paper is to communicate the results of the research along with recommendations on how consolidators can more effectively meet the needs of their customers. The sample included five consolidators of different sizes, presenting different levels of automation, but not correlated with their size. This innovative study of consolidators in the US is the first of its kind and will open windows of opportunity for companies in this market.

Research methodology

Activity-based costing

The project included a market overview, a sample selection of consolidators and an activity-based costing (ABC) analysis. Activity-based costing (ABC) is used to identify, describe, and assign costs, and to report on consolidator operations. Since ABC determines the “true” cost of a product or service, it is more effective at identifying opportunities to improve business processes than traditional accounting. ABC principles are used: (1) to focus management attention on the total cost to produce a product or service and (2) as the basis for full-cost recovery. During the project the financial data of the participating consolidators was continually reviewed and their business processes (see Chart 19) were closely examined, thus allowing the main cost drivers to be identified. As mentioned before, the sample was comprised of five consolidators who are involved with other tourism activities such as a tour operator division, however, only their consolidation business was considered relevant for this study.

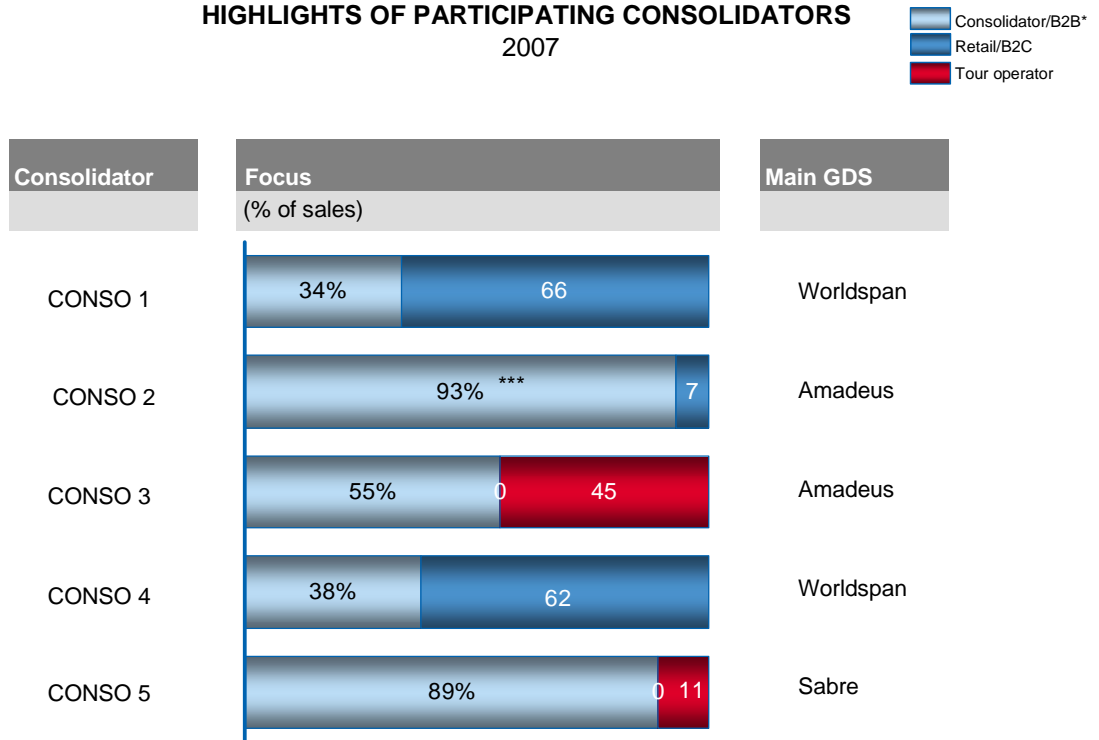
A detailed explanation of the research methodology is provided in the appendix.

Participants' overview

Five consolidators with an average booking volume of approximately 258,000 segments per year participated in this study

Five consolidators with an average booking volume of approximately 258,000 segments per year participated in this study (see Chart 1). Non-homogeneous companies from all over the US were chosen in order to investigate a wider range of business models and to identify differences and common trends in costs and profitability. Most of the participating consolidators mainly operated in a particular market and their transactions corresponded mostly to a specific destination. Moreover, the sample included consolidators that did not all have the same main GDS, in order to add further diversity to the research. The five participants have been working in the business for at least 15 years, giving them a thorough knowledge and understanding of the industry and a credibility which is of particular importance to the project.

Chart 1
HIGHLIGHTS OF PARTICIPATING CONSOLIDATORS
2007



* There was no possible breakdown into leisure and corporate end travelers when analyzing the B2B business

** MIDT information. Includes air segments from all business segments (consolidator, retail, tour division)

*** Includes tour operator sales

Source: MIDT, Participating consolidators; Hermes' analysis

Introduction

Market overview

The US consolidator market is highly concentrated (as seen on Chart 2). Only 14 consolidators comprise 80% of the air segments. Some of the consolidators in the sample belong to the top 14 market leaders, an environment difficult to penetrate especially for new direct competitors. Smaller consolidators usually concentrate on niche markets, making them 'Destination Specialists.'

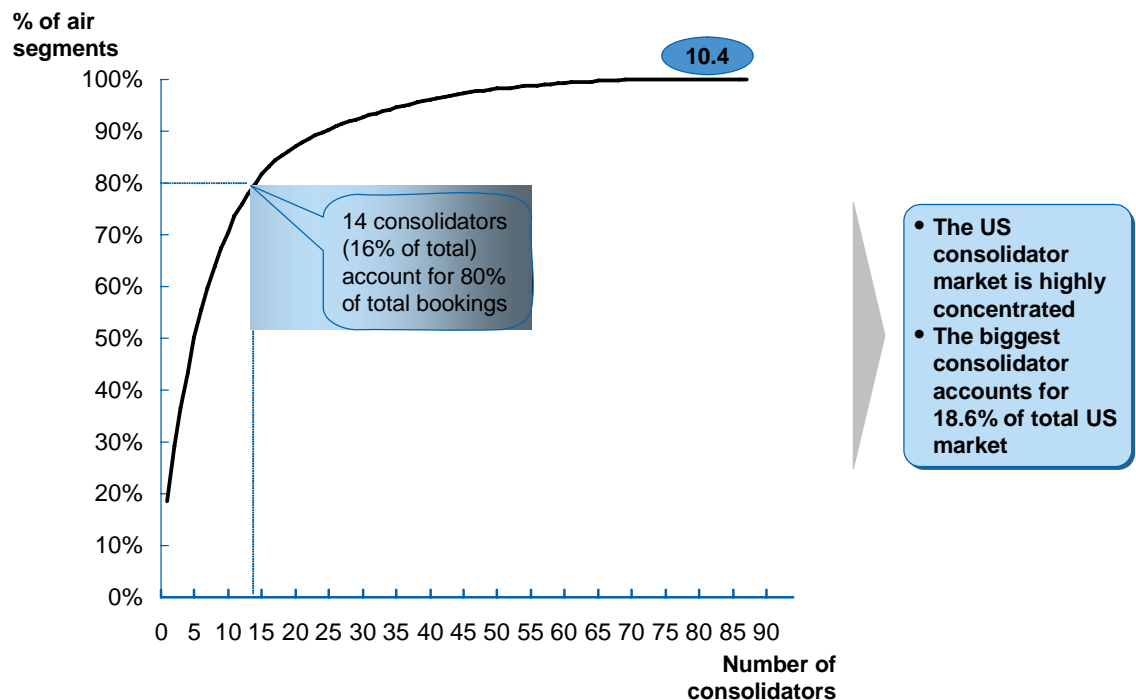
Nowadays, consolidators face competition from:

- Airlines direct distribution. For some years now, market and technology conditions have made airlines shift part of their business towards the direct selling channels. This is a sensitive issue as airlines are consolidators' main suppliers.
- Online Travel Agencies (OLTAs). When consolidators decided to go online, they became OLTAs' direct competition. However, interestingly, OLTAs have expanded their business to B2B and gained clients that used to be consolidator clients, such as small travel agencies.

Amongst US consolidators, the two main GDSs are leaders with a combined market share of 70%

Among US consolidators, Amadeus and Sabre are market leaders with a combined market share of 70%. GDS developers in the US also face strong competition from 3rd party software developers, mainly due to their competitive pricing and more customizable software.

Chart 2
CONCENTRATION OF US CONSOLIDATORS
2007, in million air segments



Note: MIDT information may have some discrepancies with ARC data
Source: MIDT; Hermes' analysis

Industry trends

Airline margins have diminished due to a number of factors, the primary issues being the rise in gasoline prices and the low-cost carrier (LCCs) competition. As a way to improve their profitability, airlines have cut commissions in order to ensure tighter control of their customers and to target the end-traveler directly through their online channel. LCCs in particular have considerably increased their domestic market share over the past few years with this type of business model. Nevertheless, the large airlines which operate international flights are now focusing their efforts towards this business model as well. As a consequence, airlines have limited the number of consolidators they deal with and raised override targets, thus making it difficult for consolidators to collect the amount of overrides they are used to receiving.

This whole situation has made consolidators rationalize the number of air suppliers they work with. Since it became apparent that overrides were becoming more difficult to achieve due to the new higher targets, consolidators have been forced to sacrifice many contracts while keeping the most profitable ones. As a result, consolidators have had to reduce the number of their other suppliers, creating a significant impact on the technology suppliers.

This contraction of airline margins is then passed on to consolidators. This situation has shaken the consolidators' existing business model where airlines had been their critical partners. Now they are looking for new partners and new lines of business, such as tour operating (TO) or targeting directly the end-travelers with leisure or corporate travel (B2C). However, many try to avoid competing directly with their own clients and suppliers, instead they have created new business units or companies to manage the B2C or TO business.

Some consolidators are expanding geographically either in a neighboring market or on both sides of their specialist destination. As margins are difficult to rise, they aim towards an increase in the volume of operations for better revenues. Exploring beyond their regions of operation has become a trend in the search for improved bottom lines.

By the end of 2007, the US economy has suffered an important slowdown. The 'mortgage crisis' had a significant effect on the economy of the US as a whole (and on the rest of the world). Owing to this fact, consolidators have become even more cost-conscious and cautious with their investments and operational spend. This has led to serious lay-offs on the operational side, as well as a shift towards less-costly investments or even directly canceling investments. In the case of IT investments, consolidators have tried to develop the required tools in-house or have looked for more cost-effective software developers. Furthermore, in order to lower total infrastructure costs, consolidators prefer to close offices instead of opening new ones. The Internet and centralized call centers have provided them the possibility to reach new horizons without incurring major costs. Others have either outsourced or off-shored their operations (i.e. call centers) to low-labor-cost regions such as South America or Asia.

Now consolidators are looking for new partners and new lines of business such as tour operators (TO) or targeting directly the end-traveler with leisure or corporate travel (B2C)

Study results

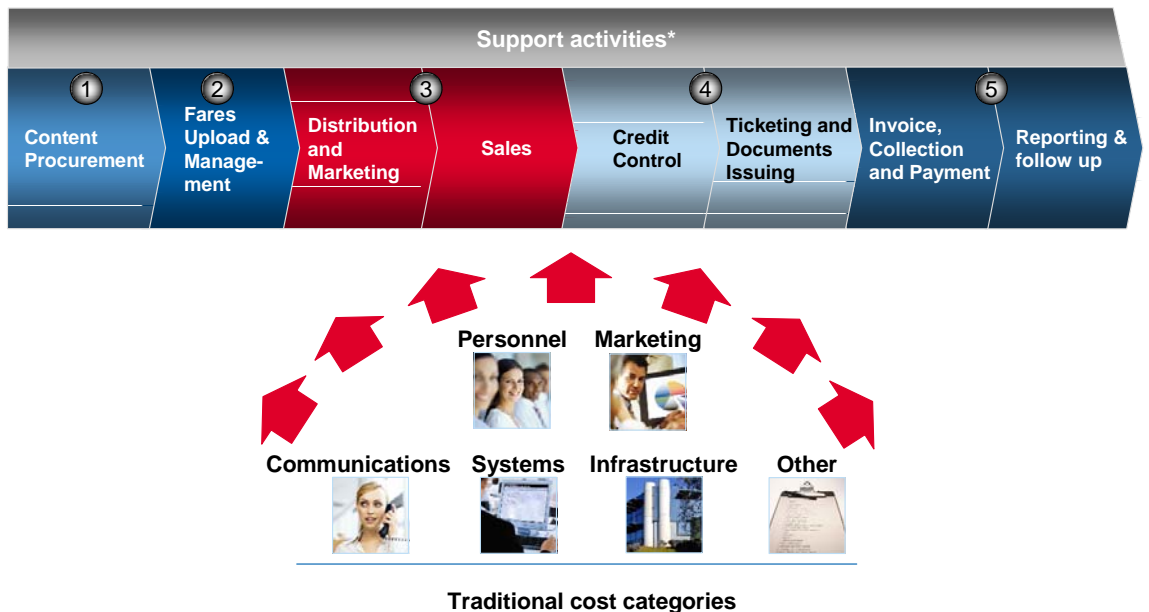
This research project validated consolidators' business process. It includes 11 activities that can be clustered into five business activities and a group of support activities (see Chart 3): These activities were used for the ABC analysis. The difference with cost activities is that traditional cost categories are used widely by companies across any business or market. These traditional cost categories are personnel, communications, systems, infrastructure, marketing and other costs. As mentioned earlier, a further explanation of the methodology of the ABC and the study is given in the appendix.

Figures will be shown in USD per ticket; a ticket unit includes a combination of all services provided by the consolidators and represents the average transaction per customer

The results of the study will be presented by first considering the traditional cost categories division, after which, each activity will be presented and analyzed separately, ending with a productivity and profitability analysis. Figures will be shown in USD per ticket; a ticket unit includes a combination of all services provided by the consolidators and represents the average transaction per customer. Tickets always include an airline ticket and in some cases may also include additional products such as hotel bookings, car rental, insurance, etc.

Chart 3
OVERVIEW OF ACTIVITIES AND CATEGORIES
 Generic level 1 activities and traditional cost categories

● Activities grouping number



* Support activities includes firm infrastructure, human resources and technology management

Source: Hermes' analysis

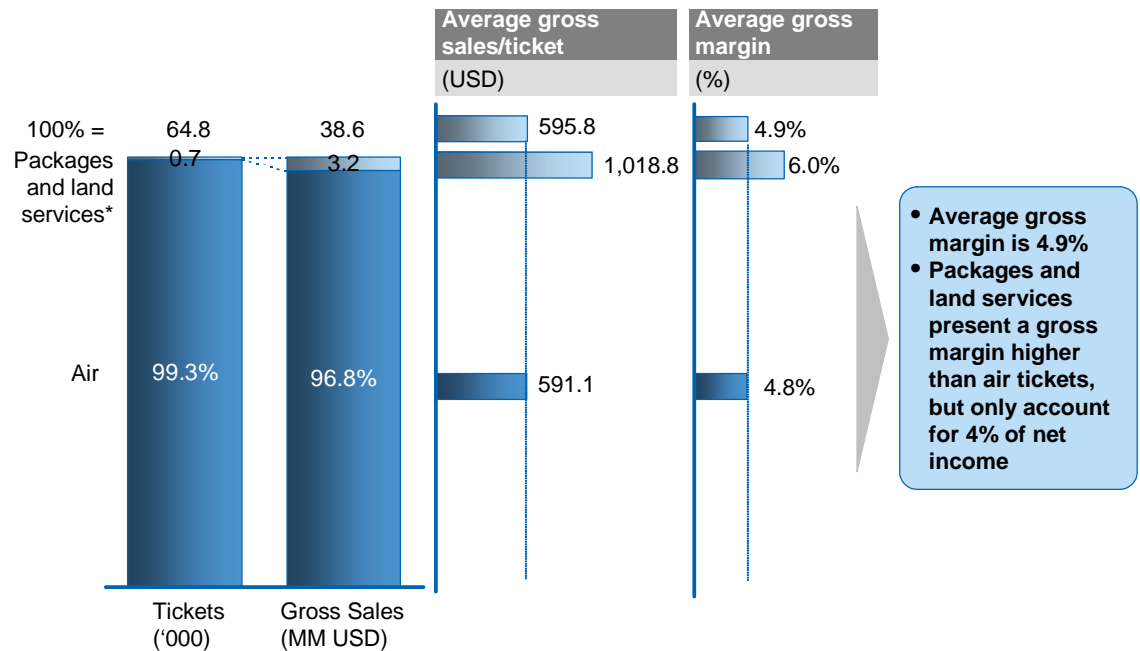
On another topic, it is interesting to compare this study with the study carried out for OLTAs in Europe in 2006. Comparing the two supports the fact that consolidators and OLTAs have turned out to be competitors. Hence, throughout the rest of the document, where it is significant, reference will be made to this study to enrich the analysis of the present one.

Consolidators have an average ticket of USD 595.8, composed of 97% air products

Overview of consolidators' average cost and revenues

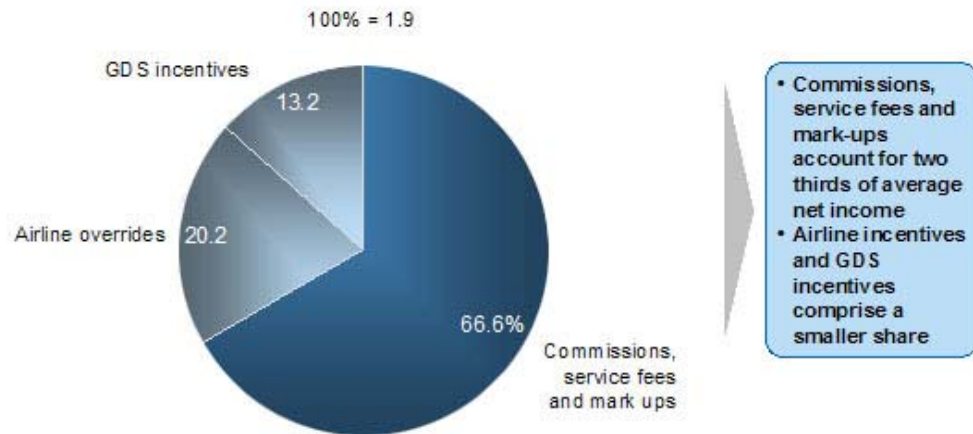
On the revenue side, consolidators have an average ticket of USD 595.8 (see Chart 4). This average ticket is composed of 96.8% air products and the remaining 3.2% represents non-air products, such as packages, hotels and other ground products. The average gross margin for US Consolidators is 4.9%, mostly because air products have a 4.8% gross margin. Land services have a 6.0% gross margin but only account for 3% of consolidators' gross sales.

Chart 4
BREAKDOWN OF TICKETS AND GROSS SALES BY TYPE OF SERVICE
2007, average consolidator



* Includes packages, ferry, hotels, cars, rail, insurance, visa application, group transportation and other
Source: Participating consolidators; Hermes' analysis

Chart 5
BREAKDOWN OF REVENUES BY TYPE OF SERVICE
2007, million USD



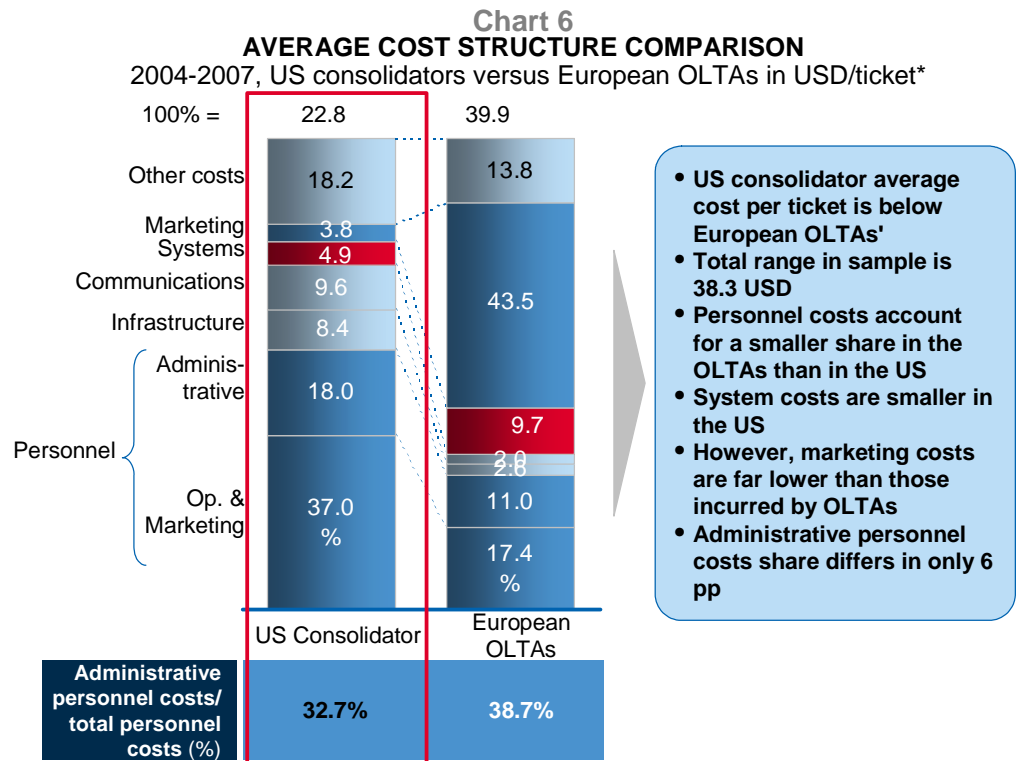
Two thirds of consolidator revenue is due to commissions, service fees and mark-ups; the rest of their revenue is due to overrides (20.2%) and GDS incentives (13.2%)

After paying the suppliers, which are mostly airlines, the consolidators' revenue per ticket is USD 29.0. This revenue is split among three different sources: two thirds of revenue is due to commissions, service fees and mark-ups; the rest of their revenue is due to overrides (20.2%) and GDS incentives (13.2%, see Chart 5).

On the cost side, consolidators show an average cost per ticket of USD 22.8. Considering the traditional cost structure, more than half of this cost (55.0%) is due to personnel (see Chart 6). The weight of personnel costs shows that many operations are still carried out manually. Other costs including credit card fees and donations; commission loss has the second highest amount of 18.2%. Communications and systems¹ together account for 14.5% of total costs. The former is mostly comprised of call center costs (this high usage of the phone still justifies consolidators' manual practices) and the latter represents the Internet Booking Engine's (IBE) costs. Approximately 8% of the total cost is allocated to infrastructure while just 3.8% is spent on marketing, mainly due to the fact that consolidators do not target end travelers.

Compared to OLTAs, consolidators show higher relative costs in the personnel and communication categories. OLTA costs are significantly lower due to higher levels of online sales and automation in their business processes. OLTA personnel costs represent just 28.4% and communication costs 2.0%, compared to 55.0% and 9.6% from consolidators respectively.

¹ GDS expenses are not included in system costs, as they are discounted from GDS incentives.



* Figures from the OLTAs project conducted in Europe (2006) were converted from Euros to US Dollars with the exchange rate of 2005. Although this update does not include inflation, it is an approximation of current costs
Euro exchange rate for 2005 was 1.24 USD/EUR

Source: ABC studies; Hermes' analysis

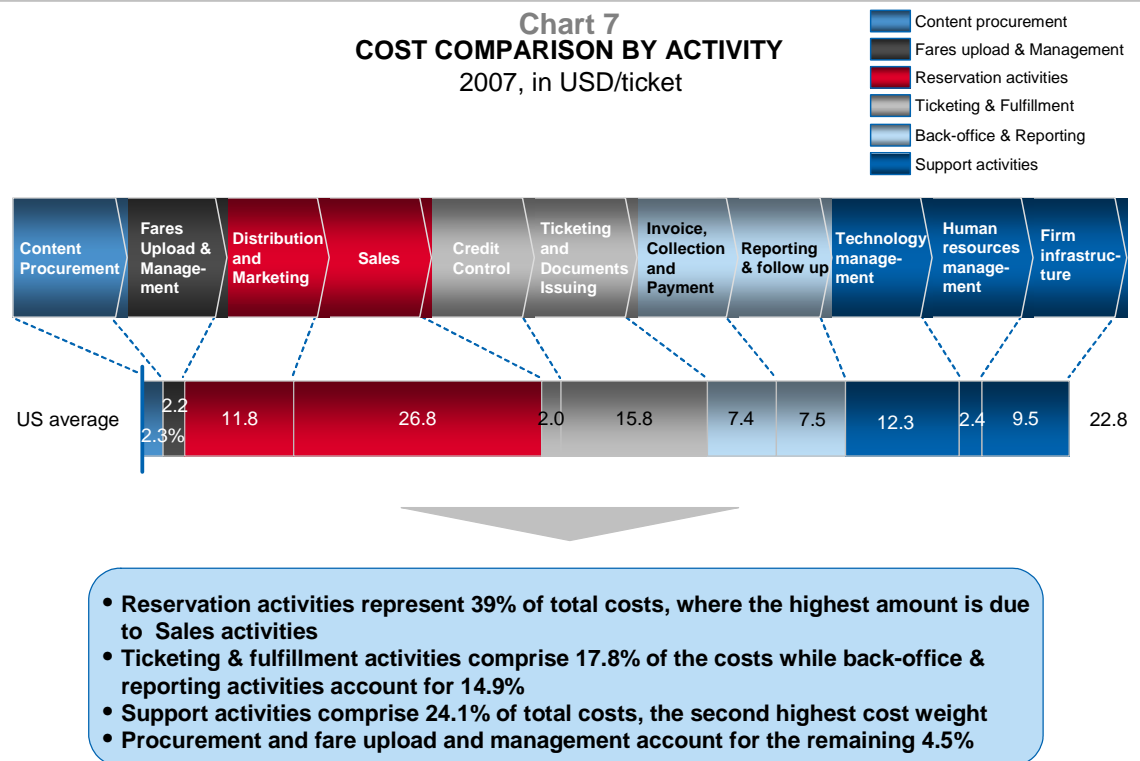
In regard to marketing expenses, OLTAs' spend is 11 times greater than consolidators' spend (43.5% vs. 3.8%). This is primarily due to the fact that consolidators have travel agencies as customers and OLTAs work directly with end travelers. Consolidators base their sales on long-term relationships and word-of-mouth as a key driver for new customers, whilst OLTAs need to promote themselves through different marketing channels. Over the past few years, consolidators have cut and reallocated marketing expenses in areas such as businesses development. This has caused a reduction in marketing expenditure with most of the marketing activities being developed at a lower cost in-house, i.e. e-newsletters.

US consolidators have average Earnings Before Interests and Taxes of USD 6.2 per ticket

Finally, US consolidators have an average Earnings Before Interests and Taxes (EBIT) of USD 6.2 per ticket. This EBIT corresponds to 1.0% of gross sales. Consolidators now find themselves in a mature market with shrinking margins, although they are still profitable.

Activity-based costing analysis

As mentioned before, consolidators' business processes were analyzed in depth during the study (see Chart 7). This section explains the cost per activity or per group of activities in order to understand what consolidators' main costs are in each activity, and also how they can be more cost-efficient. In the appendix there is an in-depth explanation of the activities.



Source: Participating consolidators; Hermes' analysis

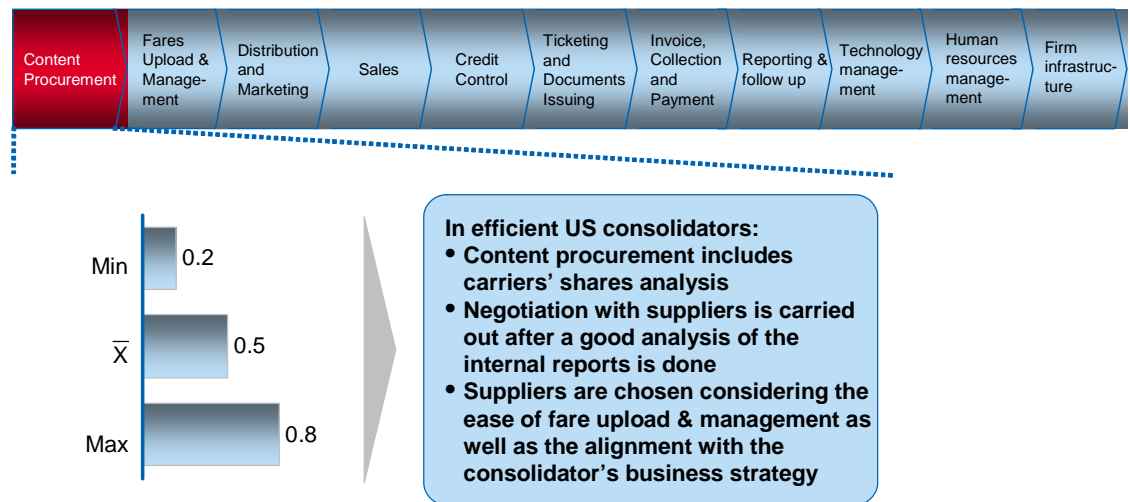
The groups analyzed in the following section are:

1. Content procurement
2. Fare upload and management
3. Distribution, marketing and sales
4. Ticketing and fulfillment
5. Back-office and reporting
6. Support activities: technology management, human resources and firm infrastructure

Content procurement

Consolidators have identified that content procurement is the first activity in their business processes (see Chart 8). Basically, this activity involves all the negotiations with content providers, mainly airlines. On average this activity accounts for 2.3% of total costs, or USD 0.5 per ticket. However, this figure ranges from 0.2 to 0.8, depending on the number of meetings and time consolidators spend on each airline.

Chart 8
COST COMPARISON BY ACTIVITY
2007, in USD/ticket, average consolidator



Source: Participating consolidators; Hermes' analysis

Airlines have become tougher with their contracts with consolidators by lowering basic commissions and raising volumes, which are needed to achieve overrides

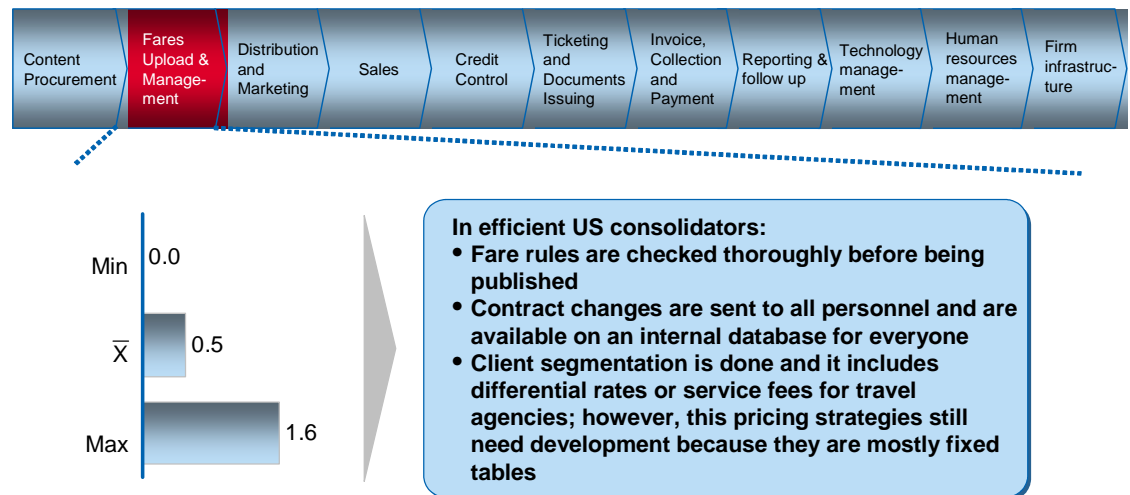
Of late, air content negotiations have proven to be particularly difficult for all parties. Airlines have become tougher with their consolidator contracts by lowering basic commissions and raising volumes, which are needed to achieve overrides. Consolidator CEOs negotiate contracts directly with airlines on a regular basis, although, consolidator bargaining power is beginning to weaken. In this new scenario, consolidators have been forced to focus on fewer airline contracts in order to reach their projected targets. They also choose their airline suppliers based on their travel agency customers' preferences. In addition, airlines' terms and conditions impact consolidators' need for fare management tools to upload and show non-ATPCO fares to their clients.

Fares upload and management is a major challenge for consolidators, as it is the starting point of all their quality control requirements

Fares upload and management

Fares upload and management is a major challenge for consolidators (see Chart 9). It is time consuming and critical as it is the starting point of all their quality control checks. This activity stands for 2.2% of total costs (USD 0.5 per ticket). An important caveat to note is that this figure is an average of a sample that sold mostly ATPCO² fares and should be considered as a best case scenario for consolidators. The uploading and management of non-ATPCO fares increases the cost of fare filing activities. This was made evident by the participating consolidators who sold these fares. This explains the variability in the minimum and maximum figure of this activity, as shown in Chart 9.

Chart 9
COST COMPARISON BY ACTIVITY
2007, in USD/ticket, average consolidator



Source: Participating consolidators; Hermes' analysis

Despite the issue regarding non-ATPCO fares, consolidators still worry about contract changes and quality control, as well as upload of non-ATPCO fares into each GDS. They also need to keep their reservations personnel and their travel agencies informed and updated on all contract changes. These measures have to be taken to prevent receiving Airline Debit Memos (ADMs).

Consolidators are looking for real-time, multi-GDS and mass uploading tools. The decision to use a fare filing tool is driven by the following factors:

1. Rules accuracy
2. Cost
3. Multi-GDS distribution³

² ATPCO stands for Airline Tariff Publishing Company. Most airlines deliver the negotiated rates with consolidators to this organization so that agencies can book on all GDS fares. Non-ATPCO airlines are mostly ethnic or non-US based.

³ Generally, consolidators work heavily in one or two GDSs. Therefore, multi-GDS distribution is a priority for them.

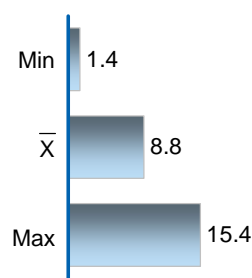
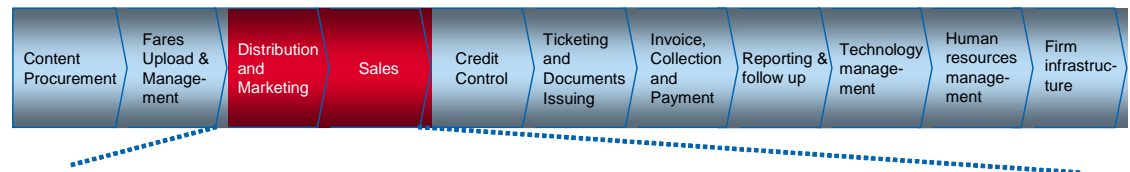
Concerning mark-up management, consolidators make a manual decision based on several factors: benchmarking against other consolidators and grouping of their clients by payment patterns

Consolidators often opt for 3rd party software vendors for fare filing tools. Alternatively, they would choose to develop their tools in-house. In this case, they would have internal databases which are available for all the reservations and ticketing staff.

Concerning mark-up management, consolidators make a manual decision based on several factors: benchmarking against other consolidators and grouping of their clients by payment patterns. However, there is an opportunity for consolidators to automate their pricing strategy with yield management tools.

Distribution, marketing and sales

Chart 10
COST COMPARISON BY ACTIVITY
2007, in USD/ticket, average consolidator



In efficient US consolidators:

- The IBE is the main booking engine
- Call center solutions are located in countries with lower personnel and infrastructure costs than in the US (eg: Central or South America)
- Call center operators are not allowed to issue tickets; this is done by another department
- Sub-agents are not allowed to make partial releases and the consolidator is always responsible for the record, lowering the probability of being charged with debit memos

Source: Participating consolidators; Hermes' analysis

The call center is still the main distribution channel for most US consolidators

The average cost of distribution, marketing and sales is USD 8.8 per ticket, 38.6% of total costs (see Chart 10). These two groups together are responsible for the largest expenditure, total personnel costs, of which 36% is assigned to these activities. As a result, the level of manual intervention involved in a reservation activity is still high. This is due to the fact that the call center is still the main distribution channel for most US consolidators. In order to reduce call center costs, two out of the five consolidators that participated in the study have relocated their call center to another country with lower personnel costs.

Consolidators put low levels of investment into call center technology. Nearly all have voice over IP (VoIP) phones and do not use any additional functionality that is available such as caller ID filtering or call center performance measurement. These tools would give consolidators the possibility to optimize their working practices and improve their control over their activities.

Consolidators are developing Internet Booking Engines (IBE) as an alternative distribution channel. However, not all consolidators that participated in the study had a fully-operating B2B IBE. In fact, one of the participating consolidators did not even have an IBE and does not plan on utilizing one for the consolidator business. Another consolidator has an online presence but its agencies use it just as a quoting tool and then they book through the GDS or over the phone. Those who have an IBE dedicate most of their IT investments to it.

Consolidators are looking for IBEs to be fully customizable, have advance search options, especially low-fare search, with the ability to integrate with database and mid- to back-office systems

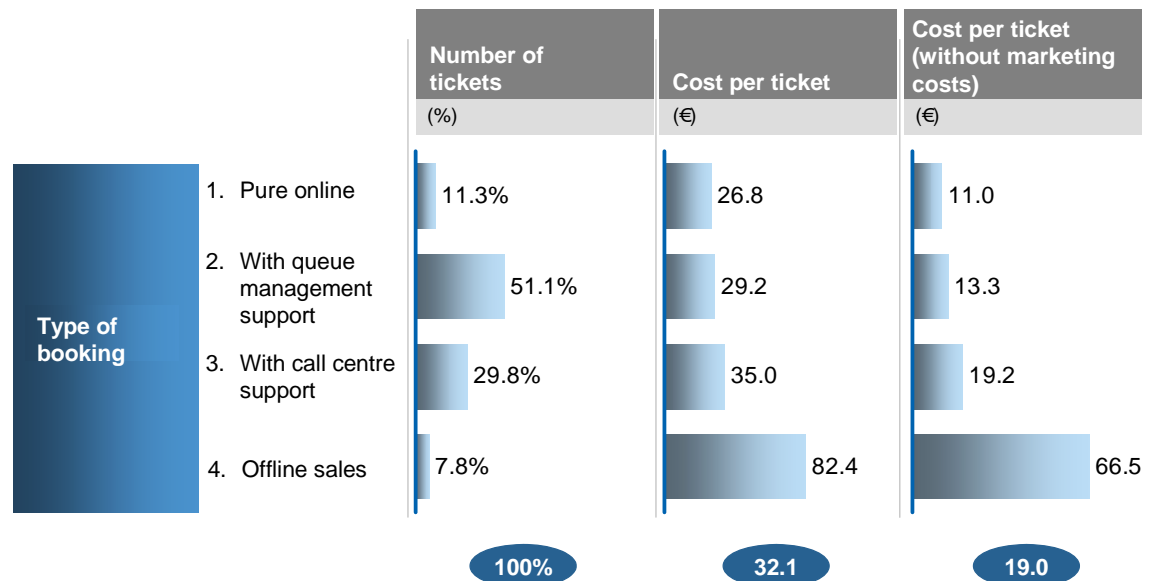
In most cases, consolidators outsource the development of the IBE to third parties. Some may develop the IBE in-house because existing solutions do not fully address their requirements. Consolidators are looking for IBEs to:

1. Be fully customizable
2. Have advanced search options, especially low-fare search
3. Integrate with fare database and mid- to back-office systems

The OLTA study has highlighted the benefits of using “touchless” sales channels. The cost per ticket varies per booking channel for OLTAs (see chart 11). Considering this comparison, the IBE is also better in absolute values. Although this same breakdown is not available for US consolidators, they should be able to achieve lower cost levels if they move towards online sales.

Many customers still prefer the traditional operational methods and consolidators know they cannot afford to lose any of their customers in today’s competitive market.

Chart 11
ESTIMATE OF THE COST PER TICKET BY TYPE OF BOOKING IN THE EUROPEAN OLTA STUDY *ESTIMATE*



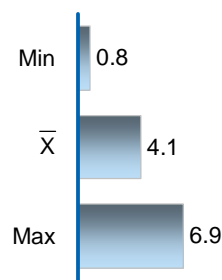
Source: Hermes' analysis

Ticketing and fulfillment

This activity is comprised of 17.8% of consolidators' total cost, USD 4.1 (see Chart 12). This activity grouping is comprised of the end-to-end process of ticketing and quality control. The main objective of these activities is to correctly issue the tickets booked by the reservations staff and reduce the Airlines Debit Memos (ADMs). Some consolidators force the GDS to include the travel agency mark-up through a process called "Phase 4". However, if they make a mistake doing this, the airline issues an ADM. So, in order to avoid further mistakes, the most efficient consolidators use GDSs' auto-price function with the objective of transferring the responsibility of the ADM to the GDS provider. When they use this function, they issue the ticket using its original price, leaving aside any potential changes made during a "Phase 4" process.

The main objective of these activities is to correctly issue the tickets booked by the reservations staff and reduce the Airlines Debit Memos (ADMs)

Chart 12
COST COMPARISON BY ACTIVITY
2007, in USD/ticket, average consolidator



In efficient US consolidators:

- Customers have specific credit limits assigned
- Ticketing queues are managed with specific priorities with no need of a queue manager
- Tickets are done with the Autoprice function from the GDS, in order to be able to transfer the responsibility to the system, in case of a debit memo
- E-tickets are sent directly to the travel agency by the system

Source: Participating consolidators; Hermes' analysis

Most consolidators carry out manual operations to assess the quality control throughout their whole business process from fares uploading down to ticketing. Few have automated tools for this activity. There is a great opportunity to reduce costs in this operation through automation. Consolidators are still reluctant to move from their current manual processes to a non-tested automated one.

Ticketing queue management is also included in this activity. These queues are generated when the reservations department makes a booking and leaves it on a ticketing queue. Currently, consolidators' reservation staff does not ticket, as the ticketing procedure is done separately. Also, in order to increase the level of quality control consolidators are still handling these ticketing queues manually and according to the urgency of each particular ticket. In the case of OLTAs, the study revealed that more than half of the bookings need queue management support, increasing the cost of the

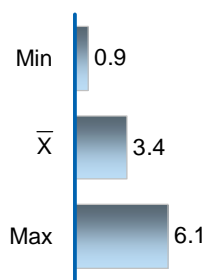
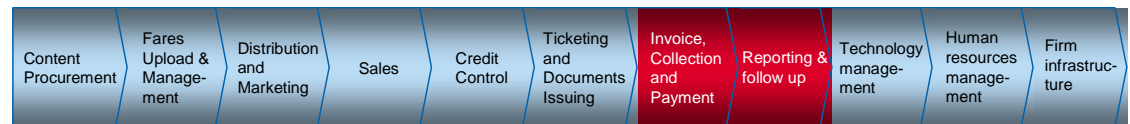
transaction considerably by almost 3 Euros. Once again this is a great opportunity for automation in order to be more cost-efficient.

Back-office and reporting

These activities cost USD 3.4 per ticket on average for a US consolidator as shown in Chart 13 (14.9% of total costs). Usually, the interface between the front- and back-office is manual. Consolidators have to manually connect the operations between the GDS and the accounting system at least once a day. The mid- to back-office integration is also still performed manually. Evidently there is a low level of integration among the differing software providers at each stage. Again, there is an opportunity to automate and reduce total costs.

In most cases, the interface between the front- and back-office is manual

Chart 13
COST COMPARISON BY ACTIVITY
2007, in USD/ticket, average consolidator



In efficient US consolidators:

- Credit card sales are tested by macros and, if risky, transferred to a specific department that handles risky operations
- Frauds are practically zero
- ARC reports are checked regularly in order to have all figures from the back-office matching the weekly report
- Reporting includes airlines and travel agencies analysis

Source: Participating consolidators; Hermes' analysis

Regarding the payment process, there are some challenges that need to be faced and solved. On the credit card side, consolidators are concerned about fraud and they work hard to prevent it. This issue obliges them to have further quality checks when a customer pays with credit card and even more thoroughly when the agency pays with the end traveler's card. Although it can reduce their competitiveness, many consolidators do not even accept credit cards from end travelers. Consolidators have managed to control the threat of fraud by various manual processes and in-house software development. In the case of European OLTAs, it was found that fraud is a threat to their profitability. Estimates concluded that fraud can cost up to 0.10 Euros per ticket. The difference here is that OLTAs operate in a B2C environment and they must accept end traveler cards, which exposes OLTAs more to fraud than consolidators. Yet, consolidators should be ready to implement the correct technology checks to avoid bearing this cost or to reduce manual checks. In order to reduce manual tasks they require their customers to pay through an Automated Clearing House (ACH, a wholesale electronic payment and collection system).

Although it can reduce their competitiveness, many consolidators do not even accept credit cards from end-travelers

The level of reporting is low and it is still performed manually.

Additionally, consolidators need to know how well they are performing with the various airlines with which they have contracts. They should be well aware of the volume of seats sold by all their agencies in order to be better positioned to negotiate future discounted fares' contracts.

Many consolidators receive the information manually out of their back-office system and those with automation only perform a partial tracking. Consolidators look for precise, easy-to-use reporting tools. Automated reporting tools would not only reduce their costs significantly but would also provide consolidators with better information, thus increasing their bargaining power.

Another issue that consolidators face is travel agency mark-ups. Airlines do not allow travel agencies to charge the customer more than 25% of the price of the ticket. The consolidators' ticketing departments must check mark-ups before issuing the ticket which adds to their manpower strain, impacting even more their personal cost.

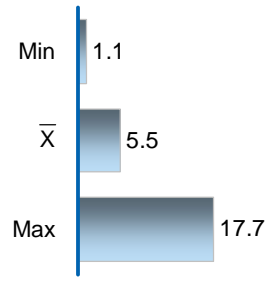
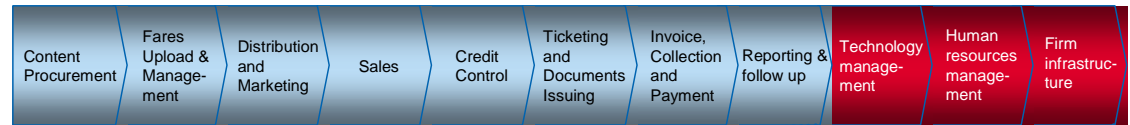
Support activities

The cost of all support activities is USD 5.5 per ticket, almost a quarter of total costs (24.1%, seen in Chart 14). These activities include human resources, firm infrastructure and technology. Human resources and firm infrastructure are mostly connected to employees in a management position who dedicate much of their time on strategy planning, recruiting activities, etc., accounting for an important share of the total costs.

Technology development includes process design, tools development and most importantly, support and maintenance of current/incumbent applications (both hardware and software). Over the past few years, consolidators have devoted the largest chunk of this budget to upgrading their phone systems to voice over IP (VoIP) phones. No other improvements affecting their call centers have been performed. However, very recent investments show an interest for the IBE systems.

The consolidators' top management dedicates much of their time to these activities, revealing an important share of total costs

Chart 14
COST COMPARISON BY ACTIVITY
2007, in USD/ticket, average consolidator



In US consolidators:

- Where available, the IBE demands most of the IT investment which is sometimes inefficient
- Business process design activities require management time that make the activity more expensive
- Call center solutions are not developed as in other industries (e.g: caller ID routing, lost calls reports, etc)

In the future, US consolidators should:

- Promote their online booking channel, supported by a strong IBE
- Implement advanced call center solutions

Source: Participating consolidators; Hermes' analysis

Before incurring costs in IT investments, consolidators base their decision on the following factors:

1. Cost
2. Reliability
3. Benchmarking: if they know that the market is investing in certain technology, they tend to invest. In such a competitive environment, they can not afford to lag behind.
4. Customization: this is a key factor when it comes to selecting the technology they choose to invest in. Less important, but still influencing their decision, is for the technology to be flexible enough so it allows integration with 3rd party software.
5. Business impact of automation: consolidators seem to only invest in technology with proven efficiency in the marketplace.

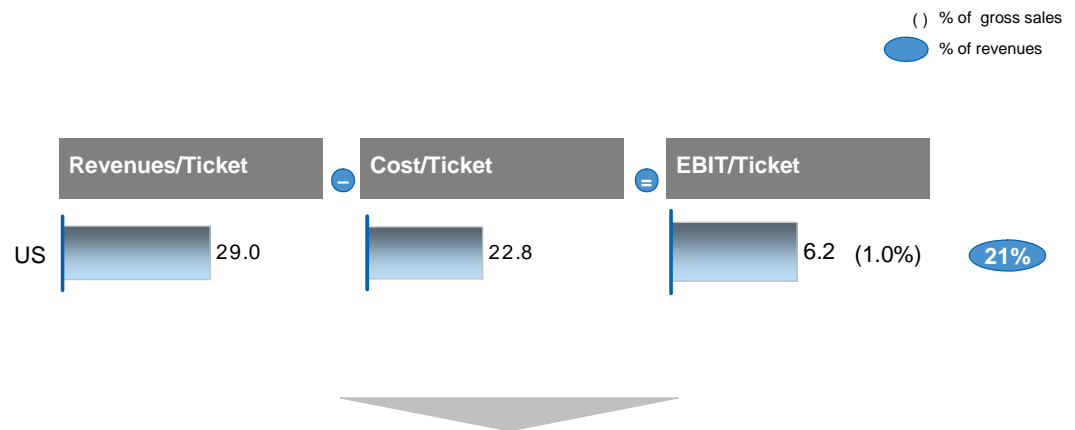
In conclusion, consolidators are technology-savvy and are extremely demanding in regard to technology investments.

Profitability and productivity analysis

Profitability analysis

On average, after paying suppliers (mostly airlines), consolidators receive a gross revenue of USD 56.7 per ticket. Out of this amount, USD 27.7 per ticket is given to sub-agents as a discount, resulting in a revenue per ticket of USD 29.0. Airline overrides and GDS incentives represent 17% of gross revenue, showing that most of consolidators' revenue comes from commissions, fees and mark-ups. The average consolidator earns USD 6.2 per ticket, or 1% of gross sales. This puts pressure on consolidators who are constantly chasing efficiencies to maintain profitability (see Chart 15).

Chart 15
ANALYSIS OF PROFITABILITY OF US CONSOLIDATORS
 2005-2007, in USD/ticket



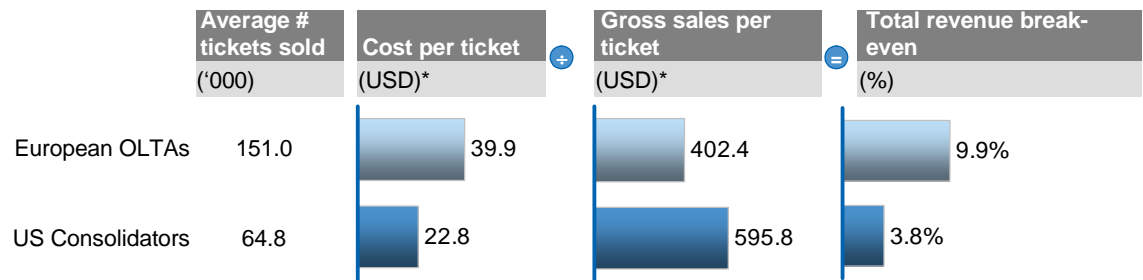
- US consolidators have an EBIT per ticket of 6.2 USD
- When analyzed in terms of revenues per ticket, US consolidators present an EBIT of 21%

Source: Participating consolidators; Hermes' analysis

Consolidators show a break-even point of 3.8%, while OLTAs have a break-even point of 9.9%

Consolidators in the US show an average gross sales per ticket of USD 595.8 (see Chart 16) whilst European OLTAs have a lower average ticket of USD 402.4. In the same chart, costs for each study can be appreciated and again consolidators are better off than OLTAs, with a lower cost per ticket of 43%. 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 consolidators or OLTAs should charge their customers in order to break-even. Consolidators show a break-even point of 3.8% while OLTAs have a break-even point of 9.9%. However, as mentioned before, the fact that both businesses are at different stages of maturity plays a significant role in the result.

Chart 16
TOTAL REVENUE BREAK-EVEN COMPARISON
2005-2007, average US consolidator and European OLTA



- When compared to the European OLTAs study, the US break even is far lower. This is mainly because:
 - US consolidators sell more expensive tickets than OLTAs' average (about 48%) and US costs are about 44% lower, which makes the break even point 6.1 pp lower
 - US consolidators market is on a different stage of maturity than were European OLTAs are (eg: OLTAs are investing heavily in advertising and growing rates of 50% per year)

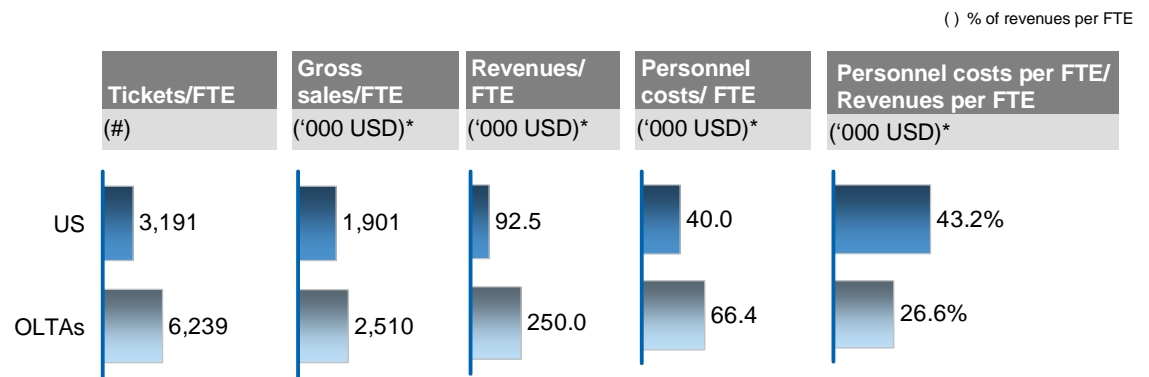
* Average exchange rate of 2005 (1.24 USD/EUR)
Source: ABC studies; Hermes' analysis

US consolidators generate 3,191 tickets per full-time equivalent employee per year

Productivity analysis

Productivity-wise, US consolidators generate 3,191 tickets per full-time equivalent employee (FTE, see chart 17). Instead, OLTAs almost double that amount with 6,239 tickets, showing how their higher level of automation increases their productivity. Each consolidator FTE generates on average USD 1.9 MM of gross sales that represent USD 92,500 in revenue. In the case of OLTAs, FTEs produce USD 2.5 MM of gross sales, 30% more than consolidators. OLTAs FTEs are more efficient in terms of tickets, gross sales and revenues.

Chart 17
ANALYSIS OF PRODUCTIVITY OF US CONSOLIDATORS VERSUS EUROPEAN OLTAs
2005-2007

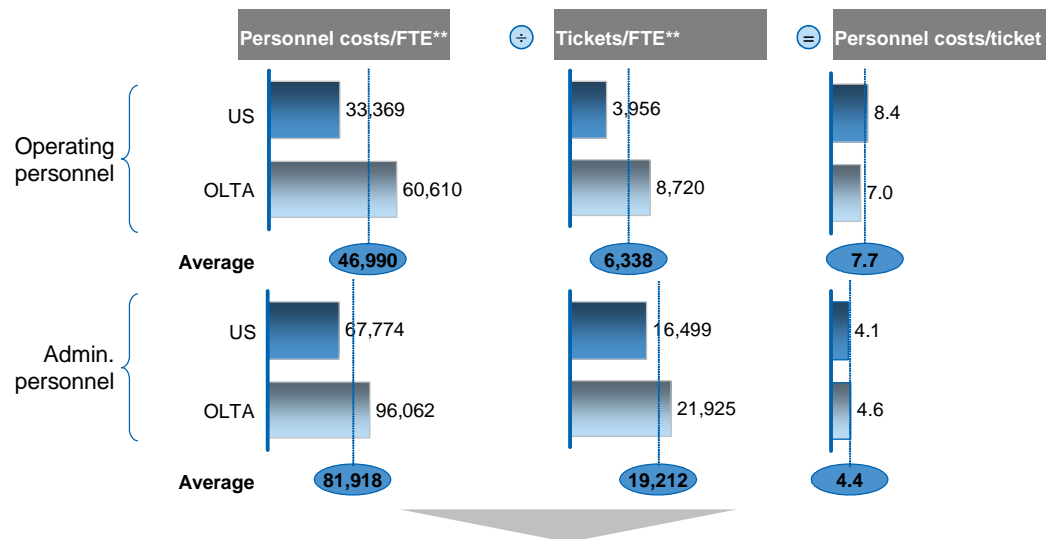


- US consolidators' FTEs sell 3,191 tickets a year while European OLTAs almost double them (1.96 times)
- This represents USD 1.9 MM per FTE in gross sales for Consolidators and USD 2.5 MM per FTE for OLTAs, that is 30% more
- However, in terms of costs, OLTAs' are more efficient, having personnel costs per FTE that represent 27% of the revenues per FTE while for Consolidators' they represent 43%

* Average exchange rate of 2005 (1.24 USD/EUR)
Source: Participating consolidators; Hermes' analysis

Chart 17 shows that personnel costs per FTE are USD 40,000 for consolidators, equivalent to revenue of 43% of the income they generate. This productivity is even greater in OLTAs, where this figure is 27%. Chart 18 shows a deeper analysis of personnel productivity for both studies, broken down by two types of personnel, operating (sales) and administrative, both studies show that consolidators have the lowest costs per FTE. Even though personnel costs are higher for OLTAs, in both personnel categories they present higher productivities in terms of tickets per FTE. This combination of factors within OLTAs helps explain why both types of personnel categories end up with similar personnel costs per ticket.

Chart 18
ANALYSIS OF PERSONNEL PRODUCTIVITY PER FUNCTION
2005-2007, average US consolidator and European OLTA, in USD*



- US consolidators have lower expenses per FTE than European OLTAs' on both types of personnel: Administrative and Operating
- US productivity is lower on both types of personnel, nevertheless their Administrative personnel cost per ticket is lower than OLTAs' (but higher in Operating personnel)

* Adjusted by average exchange rate of 2005 (1.24 USD/EUR)
** FTEs for each process (Operating and Administrative respectively)
Source: ABC studies; Hermes' analysis

Conclusions and recommendations

Conclusions

The study provided the following key learnings:

Latest market trends and commission cuts are forcing consolidators to streamline their processes in order to increase profitability and reduce costs

Many consolidator tasks are currently being performed manually. These tasks are:

- Fare uploading and management: when working with non-ATPCo airlines, consolidators have to manually upload these fares and the corresponding rules to the system
- Mark-up management: consolidators decide upon service fees and mark-ups considering market benchmarks and the loyalty of the client
- Sales: most consolidator sales come through the call center channel
- Quality control: to avoid debit memos and other problems, consolidators employ personnel to be fully dedicated to this activity
- Ticketing queue management: consolidators designate an employee in charge of arranging tickets in queues according to the urgency regarding the travel date
- Interface between systems: the integration between front- and back-office, as well as mid- to back-office, can only be completed when an employee performs this manually
- Reporting: consolidators do not possess automatic reporting tools and generally build reports manually by collating information from the back-office system

These processes are performed by the following areas: distribution, marketing and sales and back-office. These areas account for the most manual work and have higher personnel costs assigned. Distribution, marketing and sales comprise 36% of total personnel costs, while back-office comprises of 37% of total personnel costs. Also, communication costs which are assigned in high amounts to this processes (40% and 36% respectively) give clarity on the manuality of consolidators. Communications and personnel costs together account for 68% of sales costs, which can be directly associated to the importance of the call center and outlining how much manual work is performed by consolidators.

Quality control is a particular task that is extremely manually orientated, yet highly reliable. Consolidators have managed to reduce problems related to quality control to a minimum through an exhaustive manual quality control check, that in some cases is redundant (i.e. double checking every quality control step). Although reliable, it is highly costly for consolidators. The activity of ticketing and issuing, which comprises quality control, is the second most expensive activity of the 11 designated in the consolidators' business processes. This activity costs consolidators an average of USD 3.6 per ticket (16% of total costs). Of this amount, almost 60% is due to personnel costs.

Consolidators see an opportunity in moving into multi-channel distribution. By enhancing their online channels, they are able to reduce the impact of their manual operations and thus reduce the cost-per-ticket, which nowadays is USD 22.8. They are aware that by automating they can save money. As it was identified in the European OLTAs study, the cost-per-ticket per distribution channel is cheaper and more automated (see Chart 11), nevertheless, off-line sales are still predominant. These sales still represent a considerable cost in terms of personnel. Some have even tried to lower costs by outsourcing their call center operations to low-labor-cost markets, however, communications costs are significant.

All consolidators who participated in this study differentiate themselves from their competitors by diversifying their business and exploring new opportunities

Consolidators are required to expand their sales to higher margin products such as hotel, car rental, cruise or packages. This expansion can enhance their current tight margins on air products, which have a margin of 4.9% on average, while the other products all together present an average margin of 6.0%. However, air products on average still account for 97% of a consolidators' gross sales. The transition towards offering more diversified products is still at an early stage.

Many consolidators which are diversifying their product offering are also expanding their business portfolios. They are evolving their activities into new business lines, especially TO and B2C sales. These businesses present much higher margins than the consolidation business. The TO business is a high margin product itself, while the B2C sales can give them a better margin from the very same products they already sell.

Furthermore, consolidators are looking to specialize in niche markets such as ethnic travel and/or specific destinations (e.g Greek Islands, Australia, Latin America). Although nowadays many end-customers plan their trips by themselves using the Internet, and only contact travel agencies if specific advice is required. It is important to note that many travelers still prefer to use this traditional way of booking a trip, seeking a TA with experience in their chosen destination and as a result TAs become destination specialists. Thus have the consolidators as TAs required negotiated fares for specific destinations.

Recommendations

The study highlighted several opportunities for adding value to US consolidators.

Consolidators need to keep a competitive position and increase their productivity by reducing their costs

Personnel costs in 'fare upload and management,' 'distribution,' 'sales and marketing' and 'ticketing and fulfillment' activities show that the level of automation of US consolidators is low. There is a clear need to automate some processes involved in these activities using batch processing technology in order to reduce total costs.

Consolidators need to concentrate their efforts on their core processes: the negotiation of fares and their distribution to the travel agency network. They should focus on their core processes instead of spreading their efforts on less relevant operational activities. In order to do this, consolidators should consider outsourcing and partnering with experts for the support activities. By doing this, they would free up time for planning and executing key activities. The OLTAs study identified that those online travel agencies that outsourced IT requirements benefited from lower costs and faster results. Employing consultative services and partnering with companies who specialize in other operational work, (e.g. communications or marketing) would free up time and save money.

Exploring multi-channel distribution can help consolidators increase their revenues

Distribution is the key, yet multi-channel distribution is under-exploited. Regarding online distribution, most consolidators are looking essentially for B2B Internet Booking Engines. The concept of B2C IBEs is generally not on the mind of the consolidator, because it could potentially bring more complications than benefits. By going direct to the end-customer they would be competing with airlines, their main supplier, and as a result jeopardize their relationship with their own customers. The alternative for targeting the end-traveler is to have a separate business unit; this has been achieved by some consolidators. As far as the off-line distribution channel is concerned, there is technology available that improves call center operations and boosts performance. It is highly recommended to analyze available tools to understand the investment they represent and the improvements they could generate.

Focusing on customers and on a specific target segment or market is a path towards greater competitiveness and a more efficient business

The actual industry trend has shown the emergence of "ethnic specialists" or "destination and tour specialists." This trend has reduced the vision of business for many consolidators, but has given them a competitive advantage to compete. There is a great potential for win-win business partnerships between the consolidator and its suppliers, and between the consolidator and its clients (the TAs). It has made consolidators negotiate fares with fewer key airlines, making it easier for them to achieve their selling

targets, obtain airline overrides, and thus later negotiate for better contracts. Moreover, consolidators can even seek partnerships with suppliers of all types of products and offer additional services, such as packages, car rentals, hotel, etc., that have higher margins than air products. It is highly advisable for medium- to small-sized consolidators to become known for specializing in certain destinations, which gives them leverage over their competitors.

Profitability can be positively impacted by developing new lines of business

As long as it does not jeopardize current business, consolidators should consider exploring new lines of business, such as tour operation (TO) or B2C sales. Some consolidators are developing these new businesses based on their key strengths. The TO business comprises a high product margin. B2C sales gives consolidators the opportunity to sell the products they already offer but with higher margins.

Having adequate information can help in the negotiations with airlines and manage better the company, leading to increasing the profitability

In such a challenging economic environment, consolidators have to be better equipped in terms of information to negotiate with suppliers, especially with airlines. As pointed out before, the investment in reporting technology is extremely advisable. Retrieving booking data per supplier or per customer automatically can give consolidators a better insight into how their sales are doing and improve negotiations with their suppliers. Besides, keeping track of key performance indicators can give consolidators a deeper insight into managing their business.

Appendix

Methodology—Details

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

How was this performed?

Initially, an exhaustive analysis of activities of five representative consolidators in the United States was carried out. The sample was selected on the basis of a balanced mix of consolidators in terms of size, location, automation levels and the main GDS provider in order to produce results that truly represent the current conditions in the marketplace. The consolidators in this study were involved in other tourism activities, but only the consolidation business was considered.

Hermes then prepared an activity-based costing report that also included the characteristics of each sector, revenue structure and profitability. This comprehensive analysis of the cost-per-activity within each consolidator 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 consolidator, requesting information related to revenue, breakdown of expenses, P&L statement (as the study required covering an entire fiscal year, 2007 data was used), the company's organizational chart in detail, IT, software and communications equipment.
- 2) Process analysis
This step consisted of an in-depth assessment of consolidators' business processes. Additionally, interviews with consolidator employees were carried out in order to help understand the main activities performed within each consolidator and to identify resources used in each activity.

Chart 19
CONSOLIDATORS' BUSINESS PROCESS

Support activities	Firm infrastructure							
	Human resources management							
	Technology development							
Level 1 activities	Content Procurement	Fares Upload & Management	Distribution and Marketing	Reservations	Credit Control	Ticketing and Documents Issuing	Invoice, Collection and Payment	Reporting & follow up
Level 2 activities	<ul style="list-style-type: none"> Public air fares analysis Negotiation of air fares and volumes with suppliers Negotiation of access and rates with 3rd parties (Inc. aggregators) 	<ul style="list-style-type: none"> Mark-up management Upload of fares (systems and processes) 	<ul style="list-style-type: none"> Selection of distribution channels Customer Relationship Management Marketing and advertising 	<ul style="list-style-type: none"> Needs assessment Search, proposal and negotiation Booking and sales 	<ul style="list-style-type: none"> Credit limit and credit record Management of delinquency/fraud and uncollectibles 	<ul style="list-style-type: none"> Quality control Ticketing/e-ticketing fulfillment Document issuing/delivery 	<ul style="list-style-type: none"> Invoicing Client collections Air tickets payment preparation Agreement analysis and control 	<ul style="list-style-type: none"> Non fulfillment investigation/compensation Refunding Commission tracking Reporting on volume per airline and volume by TA

Source: Interviews, Amadeus; Hermes' analysis

The processes were documented and analyzed at two levels for each type of consolidator: Level 1 provided a description of the main activities carried out by the consolidators while, at Level 2, the main activities were divided into sub activities (Chart 19). For example, "content procurement" (a Level 1 activity) included "public air fares analysis," "negotiation of air fares and volumes with suppliers" and "negotiation of access and rates with 3rd parties (including aggregators)" (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 19); in the case of "public air fares analysis" these would be "analysis of historical sales evolution by airline," and "definition of sales objectives by airline."

3) Cost allocation

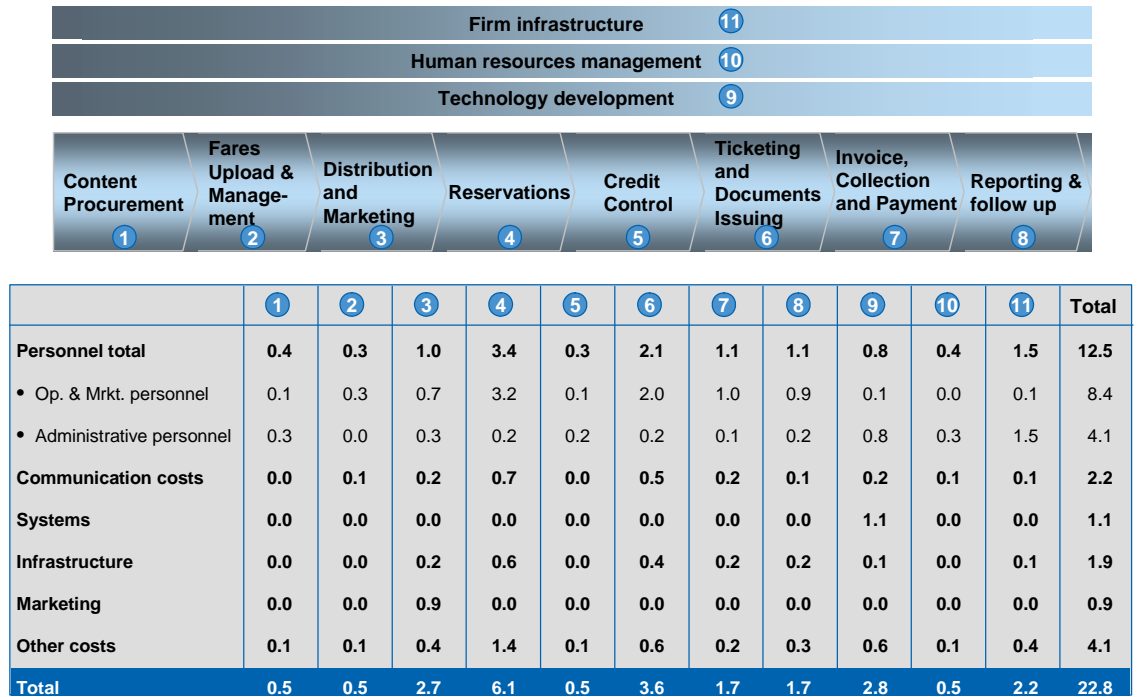
An activity-based costing methodology was used to determine the cost of each activity during the process, to identify cost reduction opportunities and, finally, to establish the differences between the most and least efficient consolidators.

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 (Chart 20), 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).

Chart 20
STRUCTURE FOR THE ABC ANALYSIS RESULTS
Consolidator, in US\$ per ticket



Source: Hermes Management Consulting analysis

In the ABC study, costs were presented in USD (US Dollars) per ticket. A ticket unit includes a combination of all services provided by the consolidators 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 to be drawn between consolidators.

The study carried out in the United States was based on consolidators. However, the same analysis has been replicated for other business models such as business travel agencies, leisure travel agencies, online travel agencies (OLTAs) and Tour Operators all around the world. A summary of the studies carried out by Hermes is shown in Chart 21:

Chart 21
ABC PROJECTS CARRIED OUT BY HERMES

		# of agencies analyzed by segment					
	Country	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	-	-	-	-	
Asia	Malaysia	4	4	-	-	-	
Middle East	Saudi Arabia	6**	4**	-	-	-	
		13	38	53	12	14	4

* 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 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 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, 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.

To learn more about Hermes Management Consulting please visit their Web site at <http://www.hermesmc.com.ar>

About Amadeus IT Group



The leading provider of IT solutions to the travel and tourism industry

Amadeus is the chosen technology partner for providers, sellers and buyers of travel. The company provides distribution, IT and point-of-sale solutions to help customers adapt, grow and succeed in the fast changing travel industry. Customer groups include travel providers (airlines, hotels, car rental companies, railway companies, ferry lines, cruise lines, insurance companies and tour operators), **travel sellers** (travel agencies) and **travel buyers** (corporations and travellers). Solutions are grouped in four categories—**Distribution & Content, Sales & e-Commerce, Business Management and Services & Consulting.**

Amadeus has central locations in Madrid (corporate headquarters & marketing), Nice (development) and Erding (operations and data processing center) and regional offices in Miami, Buenos Aires and Bangkok. Amadeus Canada, with its head office located near Toronto and regional office in Vancouver, distributes Amadeus products and services to the Canadian market.

Amadeus provides localized solutions through 65 local Amadeus Commercial Organizations (ACOs) covering more than 217 markets worldwide. Jointly owned by BC Partners, Cinven, Air France, Iberia and Lufthansa, the company has more than 8,500 employees, representing 95 nationalities.

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