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The trouble with travel distribution

It's among the biggest e-commerce markets, and maybe its most turbulent. To compete, players must define their place in travel's next wave.

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A decade after the Internet spurred airlines, hotels, and other travel players to sell directly to customers, the sector's ecosystem is fracturing. Companies are abandoning the systems that are supposed to provide consumers with one-stop shops to book flights, accommodations, and other services. Lawsuits are being filed. And the very people whose interests should be paramount—customers—are being caught in the cross fire. That's giving newcomers a chance to swoop into a sector that today boasts annual online sales of almost \$100 billion, around a third of all global e-commerce activity.

This turbulence isn't a bad thing: the travel sector has reached the next phase in its evolution, and some creative destruction is necessary. In fact, companies are already investing billions of dollars in the next wave of travel e-commerce, from revamping Web sites to changing the technology infrastructure. Consolidation is also creating opportunities that didn't exist before. But the critical question is whether the sector's players can find a sustainable path forward before new rivals blaze the trail for them. To name just two candidates: Google recently paid \$700 million for ITA Software, whose algorithms form the backbone of 65 percent of flight sales by carriers, while Apple has filed a series of patents for a mobile-device application called iTravel.

The bottom line is that travel suppliers, aggregators, and service providers each need to define the sector's next wave quickly. We suggest that industry incumbents move away from a model focused almost exclusively on reducing channel costs and toward one that seeks to maximize returns by best serving customer needs. And the incumbents must understand that the customer experience not only begins before the time of sale—and even before the time of search—but also extends well after purchase and travel. The changes we recommend don't require reinventing the wheel: many solutions already exist, but the sector's myopic focus on costs rather than returns prevents their implementation. Balanced business models that give all value-adding players a seat at the table are what's needed.

A troubled history

For a long time, suppliers in the travel sector regarded themselves as service providers and let distributors handle the technology-intensive process of actually selling airline seats or hotel rooms. The airlines facilitated this approach in the 1960s by creating global distribution systems such as Apollo and Sabre—used by travel agents to search inventory across the world—only to spin them off in the late 1990s, when cash got tight and valuations looked rich.

As with many other sectors, the Internet's arrival changed everything. Online travel booking took off as aggregator sites, such as Expedia, began to give consumers a one-stop shop, in return demanding commissions that forced airlines and hotel operators to rethink

their hands-off strategy. US airlines responded by creating a rival online travel agency, Orbitz, but their return to the distribution business was short lived: as financial pressures on the airlines' core business continued to build, they spun off Orbitz. Recognizing the low-cost direct sales model offered by the Web, the airlines set about redirecting shoppers from aggregators' sites to their own.

American Airlines (AA), for example, withdrew inventory from Orbitz in late 2010; in solidarity with Orbitz, Expedia fired back by removing AA's listings (the airline is now back on both sites). Enterprise Rent-A-Car also left Orbitz, citing high costs, while US Airways piled onto AA's disputes by filing suit against Sabre on antitrust grounds. Such disputes are common whenever industries confront the problem of who owns the content and who owns the customer: cable television companies, for example, regularly battle networks over channel-access issues, and insurers have created their own Internet portals to combat the brokers' entrenched power.

The travel sector's problem, however, is that the underlying model is fracturing. Traditional travel agencies now tend to tailor their services to business travelers, rather than provide options and products for a broad set of customer segments. Suppliers are making huge investments to lure customers to their direct channels, inadvertently reducing return on investment (ROI) by lifting costs with little immediate increase in revenue. Online aggregators are not only pushing suppliers out and undermining their one-stop-shop proposition, but also digging their heels into a format that emphasizes price as the primary product differentiator. Fundamentally, and most damagingly, consumers increasingly find that they don't have what they really want: all travel options at their disposal in one place. If this problem persists, they will become more willing to consider superior alternatives.

The path ahead

So what should be done? We have identified four imperatives for travel companies: making customers the strategic focus, using data to understand them, serving them better through partnerships, and providing the best end-to-end experience to promote both sales and ongoing loyalty.

1. Focus on customers, not channels

The travel sector's approach for two decades has been to push customers toward lower-cost yet more uniform distribution channels. We believe this is the wrong response to a growing mandate for product differentiation: while some customers value price above all else, that attitude is far from universal. Travelers differ in clear ways when it comes to their requirements—both in their traveling needs (which inform product design) and their shopping needs¹ (which inform merchandising design and are relevant for distribution).

¹For more on this topic, see Carmen Nobel, "Clay Christensen's milkshake marketing," *Harvard Business School Working Knowledge*, February 14, 2011.

Suppliers should shift from a business-to-business, channel-centric approach to a decidedly customer-centric one: the overarching goal should be to win customers, not to fight a zero-sum game with intermediaries (for more on how to win customers, see the accompanying interactive exhibit, “Understanding travel’s core customers,” on mckinseyquarterly.com).

In an ideal world, suppliers would tailor services to each individual. Reality makes that goal almost impossible to achieve, but travel companies can and should craft focused solutions for a range of broad customer segments. Price-driven leisure travelers, for instance, are drawn to transparency and comparability above all else, shopping at an average of three to four Web sites before making a purchase. So why don’t airlines, hotels, and car-rental companies bring price comparability to their own sites? This is exactly the model adopted by US insurance companies that quote competitors’ prices alongside their own. While there is some risk of customer defection—especially among price-focused travelers—that’s mitigated by the fact that this approach helps earn customer trust and draws valuable insights (about consumer preferences and behavior) that enable more effective merchandising.

Customers in another segment—unmanaged business travelers—are too small to justify the expensive services of large travel-management companies. However, less costly and more efficient technologies make it easier to service this “long tail” of corporate travelers, and suppliers and travel-management companies alike recognize the potential ROI of moving them to online channels. Unmanaged business travelers seek less expensive versions of the services received by larger accounts, such as expense-management tools, profile management, and company loyalty programs. Meeting this demand will be complicated, but in industries such as banking and telecommunications we see a potential answer by combining a customized product offering with a different sales model. Consortiums and partnerships are likely to be the key to success—for example, imagine deploying a sales force to sell airline product bundles to small- and medium-sized businesses, empowered by the latest external advances in tracking and reporting tools.

A channel-based mind-set limits the willingness of players, particularly suppliers, to make such moves. Instead, they tend to focus on market share targets for channels (and attempt to achieve these targets with initiatives such as Web site overhauls), without considering what it takes to shift preferences by consumer segment. New capabilities, not cosmetic changes, are what are really needed. Focusing on customer-based ROI rather than on channel targets forces executives to ask themselves how much they are going to invest—in which capabilities and targeting which customer shopping needs—to produce which results.

2. Win in the era of 'big data'

Travel companies have access to mind-boggling customer data: everything from basic personal information to preferred airline seats, in-flight-entertainment preferences, meals at hotels, and credit card usage. They have the means to paint detailed pictures to drive marketing initiatives that more deeply engage customers, yet few—if any—of them truly maximize the potential of the data at their disposal. There's no doubt that the synthesis of sales, pricing and revenue management, loyalty, and IT required to deliver on data's promises is daunting. But there's equally no doubt that companies from outside the travel sector specifically tooled to make the most of data are going to figure things out, enter the market, and try to steal customers.

Amazon.com, for example, became the thorn in the side of every bookseller—and, eventually, every retailer—by mining data to craft individualized customer experiences full of conversion-ready streams of recommendations. Amazon is notably absent from travel, at least for now. Google, however, has tens of billions of dollars in cash reserves and hundreds of employees whose job description is data mining. And its acquisition of ITA, a critical airfare search provider, already allows Google to provide users with instant travel itineraries and links to purchase (to see it in action, simply Google “NYC to LAX”).

Meanwhile, suppliers are moving slowly. British Airways recently announced that it would equip flight attendants with iPads rather than paper manifests. This provides a way to capture and use unprecedented levels of customer data, but this capability is only a small step forward—in many ways, incumbents remain squarely on the back foot in the emerging era of big data. It's not too late: suppliers have a wealth of information and resources they could use to test new ideas. But they need to ask themselves which data they could be collecting, which existing data are not being mobilized, and which capabilities they should be building (or partnering to acquire) to compete on the big data battlefield.²

3. Unlock the power of partnerships

Imagine if you could type (or speak) the following instruction into your smartphone: “Book my usual flights from Dallas to New York, out Monday and back Wednesday, usual hotel, rental car”—and quickly receive an itinerary compliant with your corporate travel policies. What would it take to achieve that? We see far too many travel companies seeking to undertake local, discrete tasks well and not simultaneously thinking broadly about the kinds of solutions that really engage and stimulate customers. Considering a customer's mind-set and thinking more creatively about products and services should be a priority, and that may require working with, as well as against, competitors. One good example of this approach is the recently launched hotel search and booking site, RoomKey.com,

²For more on how data, customization, and experimentation will be a new hallmark of competition, see Brad Brown, Michael Chui, and James Manyika, “Are you ready for the era of ‘big data’?”, mckinseyquarterly.com, October 2011.

founded by Marriott International, Hilton Worldwide, Hyatt Corporation, InterContinental Hotels Group, Choice Hotels International, and Wyndham Hotel Group.

In the world of consumer packaged goods, we've seen such partnerships take off: retailers and manufacturers now share unprecedented levels of information across their supply chains, enabling far more effective merchandising decisions and physical-distribution and logistics outcomes. Yet the most public dispute in travel—among AA, Expedia, and Orbitz—is the equivalent of a consumer-packaged-goods company pulling its products from a retailer's shelves: it benefits no one.

Our point here is twofold. First, creating new technologies is not necessarily the answer to all the challenges in travel today; indeed, the technical capacity to deliver what consumers need arguably exists already, dispersed in pockets across a dysfunctional ecosystem. Second, the potential of partnerships—lateral (supplier–supplier), vertical (supplier–aggregator–provider), or with companies beyond the travel sector—remains to be unlocked. Succeeding here may be more about identifying companies with similar interests and synergistic capabilities than about throwing new money and new technology after problems rooted in structural issues of coordination.

4. Master the entire customer experience

Selling a product isn't the beginning of a company's relationship with customers; that starts when they first become aware of its brand. Equally, the relationship doesn't end at the point of sale, because every interaction with customers is an opportunity to foster their loyalty or lose their future business.³ Customer solutions in the travel industry often span multiple players, providing each with an opportunity to showcase its strengths and make a case for becoming a traveler's favorite. Some companies are actively seeking to forge tighter bonds with customers: for example, KLM Royal Dutch Airlines will soon launch a service that allows its passengers use their Facebook or LinkedIn profiles to choose seatmates on upcoming flights. Malaysia Airlines is releasing a Facebook service that lets travelers check if friends are on their same flight or headed to their same destination. Like British Airways' use of the iPad, these innovations deploy technology to shape the customer *experience*, not just to conduct booking and customer service transactions.

A critical prerequisite for influencing the customer experience is the dissolution of organizational barriers—not only budgets and planning processes but also ownership of information—to gain a comprehensive view of the customer journey. There should be a single customer databank, not separate ones for information on loyalty, transactions, and pricing. And to make the customer-centric approach a reality, unprecedented levels of coordination among multiple business units (including those responsible for loyalty

³For more on how consumers make purchasing decisions, see David Court, Dave Elzinga, Susan Mulder, and Ole Jørgen Vetvik, "The consumer decision journey," *mckinseyquarterly.com*, June 2009.

programs, pricing, sales, marketing, and information technology) are also required. Far too few companies in the travel sector have taken the steps needed to achieve this level of unification.



The digital revolution has upended business as usual in almost all industries, and travel is no exception. Consumers are empowered by information: they have near-instant access to their flight, hotel, and car-rental options; virtual price transparency; and the ability to play suppliers off against one another. The game is now about delivering a superior customer experience. If players can do that, the investment returns will follow. ○

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