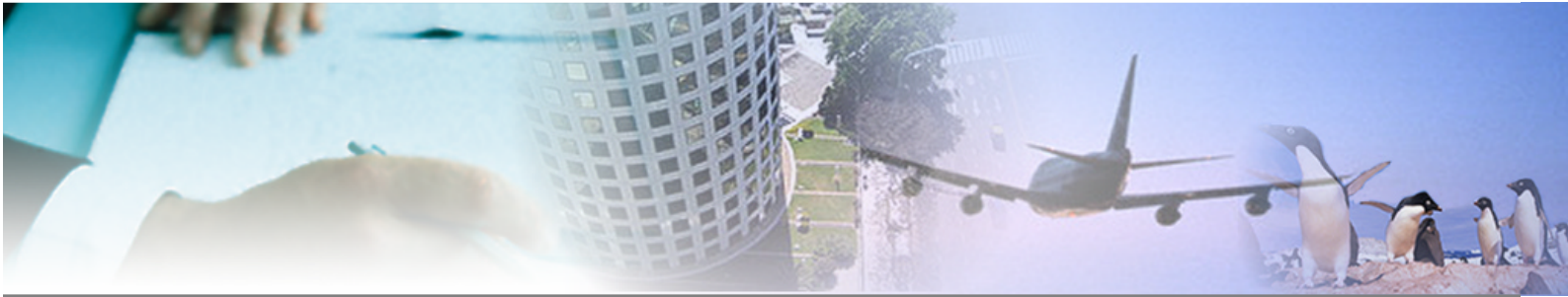


Understanding Travel Agency Cost Drivers and Ways to Optimise Business in Online Travel Agencies



March 2008

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

Abstract



In 2006, Hermes Management Consulting (Hermes) conducted an independent research study in Scandinavia. The complete study included three segments: business, leisure and online travel agencies. In November 2006 a white paper was published based on the research (“Understanding Travel Agency Cost Drivers and Ways to Optimise Business in the Scandinavian countries”). Download at <http://www.amadeus.com/sca/scandinavia.html>.

During the study, it became clear that online travel agency processes are often significantly different from leisure and business travel agency processes. Amadeus is fully committed to the success of the online travel agency industry and therefore commissioned this white paper, which focuses solely on online travel agencies.

For Amadeus the goals of the white paper were to:

- Better understand online travel agency revenues and cost structures
- Analyse online travel agency business models, processes, cost drivers and productivity levels
- Understand online travel agency needs, identifying opportunities to add value and optimise business

Hermes has already conducted similar projects in Argentina, Brazil, Colombia, Greece, Mexico, Italy, UK, Poland, Scandinavia, Malaysia and Saudi Arabia. However, this is the first time this type of study has been conducted involving the online travel agency segment.

Research methodology

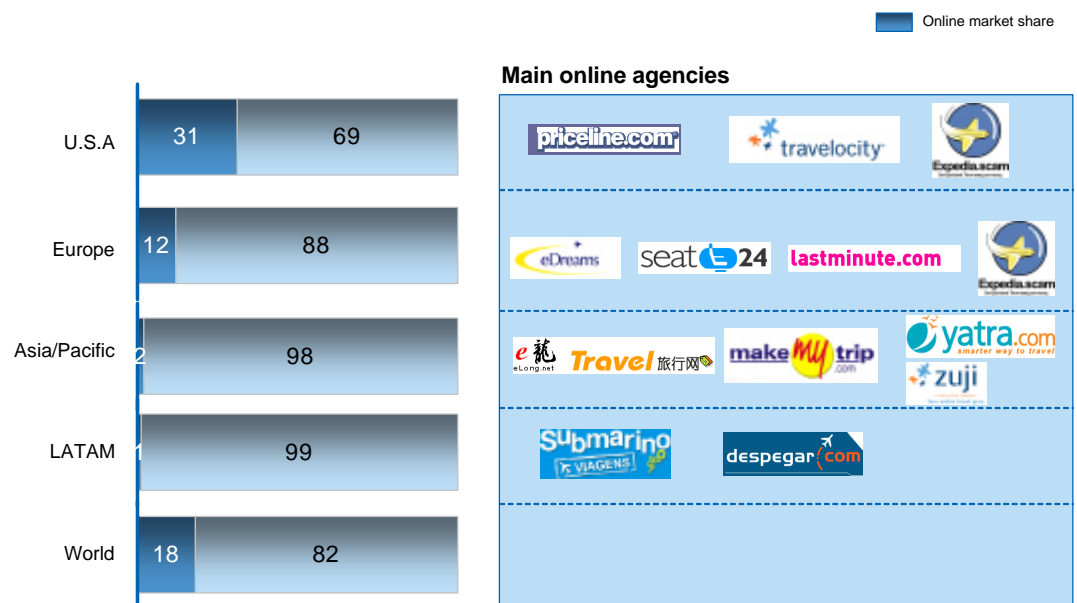
The project included a general market overview, a sample selection of online travel agencies and an Activity-Based Costing (ABC) analysis. Activity-Based Costing (ABC) is used to identify, describe and assign costs, and to report on agency operations. Since ABC costing allows you to determine the “true” 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 travel agencies was exhaustively reviewed and the business processes they followed were closely examined. This allowed the main cost drivers to be identified. A detailed explanation of the research methodology is provided in the appendix.

Introduction

General market overview

The development of online tourism has changed the structure of the travel industry. Online tourism has grown rapidly, and in 2006 it was estimated to represent approximately 18% of total global volume, with the US being far ahead of the trend (Chart 1).

Chart 1
TOURISM ONLINE MARKET PENETRATION RATE PER REGION
in %



The online market penetration is estimated to be 18% globally

Source: MIDT; Hermes Management Consulting analysis

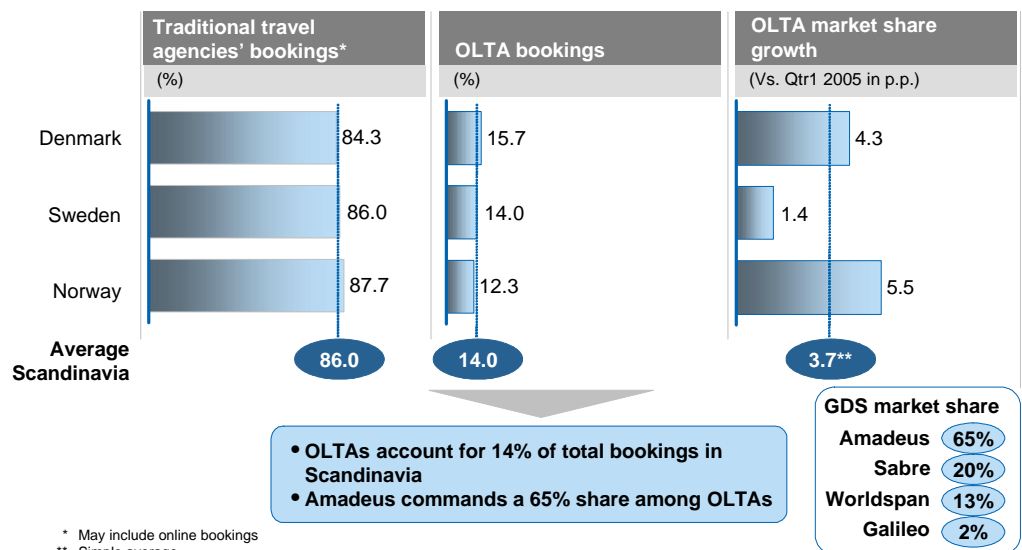
With internet penetration standing at approximately 80%, Scandinavia has been a fertile ground for online travel agency development. In 2006, online travel agencies in Scandinavia represented 14% of total air bookings, a growth of 3.7 percentage points since 2005. According to MIDT data, Amadeus, the leading Global Distribution System (GDS) for online travel agencies in Europe, commanded a 65% share of the Air bookings produced in this segment in Scandinavia at the moment the study was undertaken.

As in the rest of Europe, Low Cost Carriers (LCCs) had grown rapidly and by 2006 represented approximately 15% of the air bookings made in Scandinavia. Nevertheless, LCCs represented only 8% of the air tickets sold by online travel agencies, since these agencies had only limited LCC content to offer.

The evolution of the travel industry is currently forcing online travel agencies to contend with a variety of difficult challenges. In particular, online travel agencies face:

- **Increased competition:** competition has increased not only from new entrants, such as the metasearch engines, the direct channel (whereby airlines, etc. sell their products directly from their own sites) and other pure online travel agencies but also from traditional travel agencies that have developed their own online sales channels.
- **Low customer loyalty:** the commoditisation of the market is making online purchases a price-driven experience. The average online retailer fails to convert 97% of the shoppers on the site into buyers.
- **Correct resource allocation:** managing the marketing budget, which is an online travel agency's key driver, poses several strategic questions. Should the focus be on actions with a short-term impact on sales or long-term brand building? Online travel agencies face the need to balance long-term growth – taking into account relatively low customer loyalty - and short-term profitability - taking into account impatient shareholders.
- **Shrinking margins:** as online travel agencies still rely primarily on selling air tickets, their margins are very low.
- **Fragmented content:** whereas they would prefer to offer comprehensive content that favours cross-selling (selling other related products at the same time) and up-selling (persuading the customer to purchase more expensive items to make a more profitable sale). In this way they could increase margins and simultaneously satisfy customers in an increasingly fragmented environment.
- **Escalating expenses:** resulting in the need to streamline their business processes in order to increase productivity.

Chart 2
SCANDINAVIAN ONLINE TRAVEL AGENCIES (OLTAs) - MARKET SHARE
in % of air net bookings, Qtr1 2006



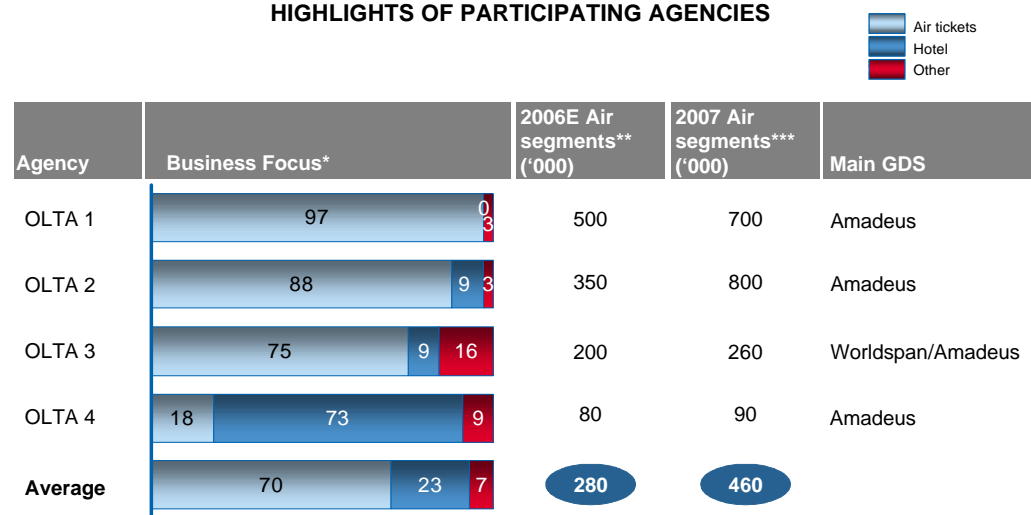
Source: Amadeus; Hermes' analysis



Overview of participants

Four online travel agencies with an average booking volume of 280,000 tickets per year participated in this study (see Chart 3). Non-homogeneous agencies 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 agencies had been founded in 2000 and were in a fast growth cycle. Together, the four agencies represented almost 40% of the Swedish online market. One year after the project's completion their combined air volume had grown by approximately 65%.

Chart 3
HIGHLIGHTS OF PARTICIPATING AGENCIES



- Participants represented approx. 40% of the Scandinavian OLTA market
- One agency focuses mainly on hotels while the rest concentrate mainly on air tickets

* Based on sales
** Includes IATA tickets only
*** July 2007, last 12 months. Includes IATA tickets only

Source: MIDT, Agencies; Hermes' analysis

Two main types of online travel agency **business models** were identified and categorised as:

- **Double low (cost and service):** this type of online travel agency focuses on leisure travellers with low budgets, mostly price-seekers, and operates 100% online. They are dedicated to driving traffic to their websites (most of their investments are focused on online marketing). They mainly sell air tickets with low levels of cross-selling. Their service level is low, with limited call centre hours and reduced staff.
- **Full service:** this type of online travel agency offers an integrated traveller solution and may also serve corporate clients, providing offline bookings and higher service levels. Customer service is a priority for this type of agency. They allow both online and offline bookings and invest in both on- and offline marketing. They develop their own content, instead of outsourcing it, and have 24/7 call centres.

Online travel agencies tend to have the characteristics of one of these two types, although they may not necessarily meet 100% of the criteria of either category. Chart 4 provides more details of the two business models:

**Chart 4
OLTA BUSINESS MODELS**

		1. Double low (Cost and Service)	2. Full service
Commercial value proposition	Target	Leisure	Leisure but may also serve corporate clients
	Products	Focus on air tickets with low cross-sell Little content development	Focus on local content development and providing a complete travel solution
	Customer service	Low priority	High priority
	Distribution Channels	Online bookings only	Online and offline bookings allowed
	Marketing strategy	Focus on driving traffic to the website. Most investments are in online channels (meta-search, affiliate programs, @newsletters and search engines)	Focus on brand building as well as driving traffic to the website. Shows a balanced mix of online and offline marketing (catalogues, print, TV and other)
	Positioning	Lowest fares and fees	Excellent service level, local comprehensive content and complete travel solution
Operating model	Outsourcing	Outsource ground services content and IT	Many activities performed in-house. Initially may outsource its fulfillment activities
	Market customisation	All markets with similar content. Sites are translated into local languages	Every market has its own local content in their website
	Market presence	No local branches or offices. Fulfillment is performed at headquarters	Branches and local employees in each market in which the OLTA has business
	Call centre	Limited hours. Limited languages	24 / 7 service. Local languages spoken
	Staff	Limited amount of resources	Resources recruited to foster future growth
	Managerial processes	Limited planning and control Decisions concentrated at CEO level	Established and formalised processes

Source: Agencies interviews; Hermes' analysis

Results of the study

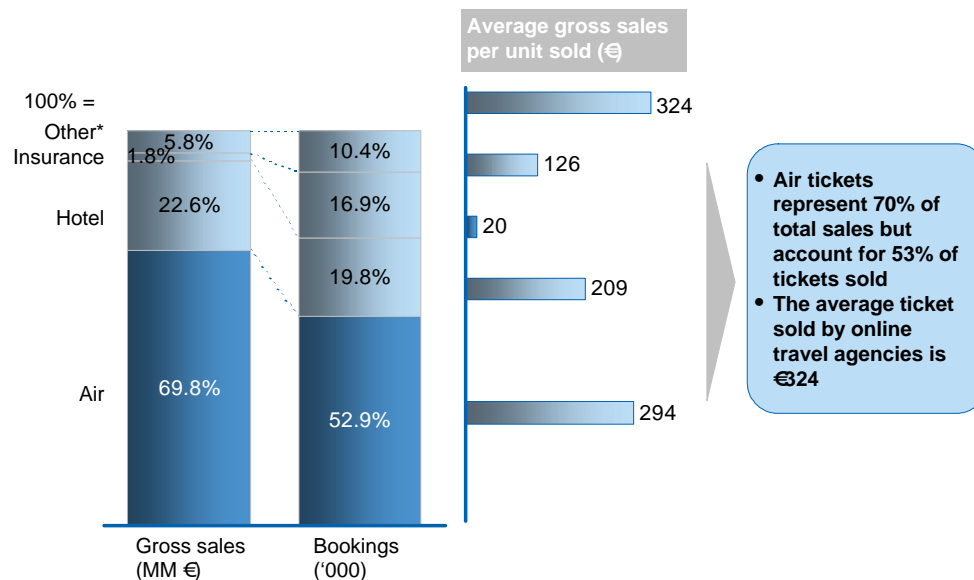
During the project, the financial data of the participating travel agencies was exhaustively reviewed and the business processes they performed were closely examined. Revenues are represented in € (Euros) per ticket. A ticket unit includes a combination of all services provided by the travel agencies and represents the average transaction per customer (including an airline ticket and added products).

The results of the study were broken down as follows:

- Average agency revenue structure: showing where OLTAs' revenues come from.
- Average agency cost structure: studied from both a traditional cost analysis and an Activity Based Costing viewpoint where traditional accounts (personnel, marketing, etc.) are broken down and allocated to an agency's core activities.
- Profitability and productivity analysis: comparing online agencies to business and leisure agencies.

Average agency revenue structure

Chart 5
AVERAGE PRODUCT MIX FOR SCANDINAVIAN ONLINE TRAVEL AGENCIES
2005

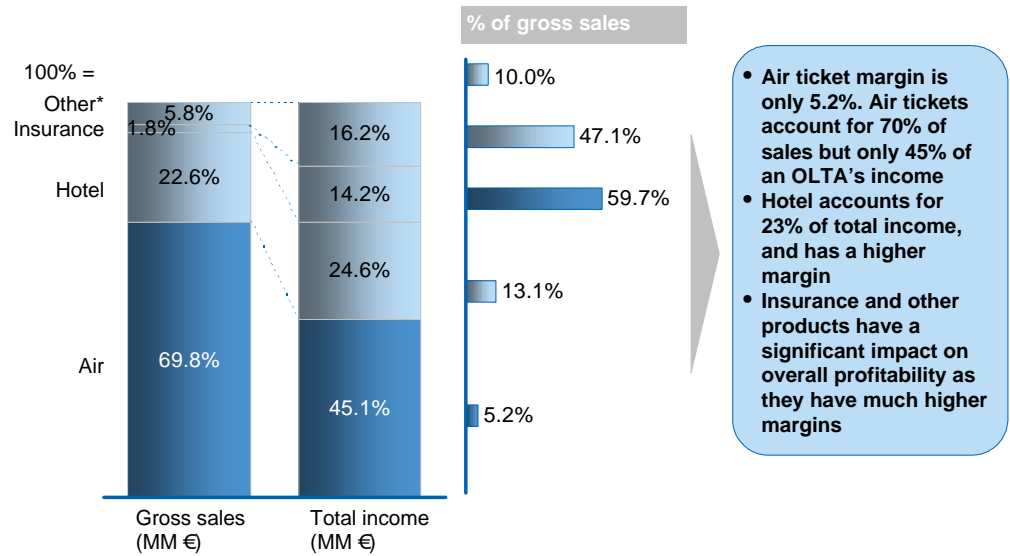


Note: Gross sales per unit sold is calculated for each product assuming that only that product is sold. However, an average ticket really includes a combination of the different products. So, the overall average (€324) is different to the average among individual values

* Includes packages, ferry, group transportation and others, but excludes GDS incentives

Source: Participating agencies; Hermes' analysis

Chart 6
BREAKDOWN OF GROSS SALES AND TOTAL INCOME BY SERVICE TYPE
2005



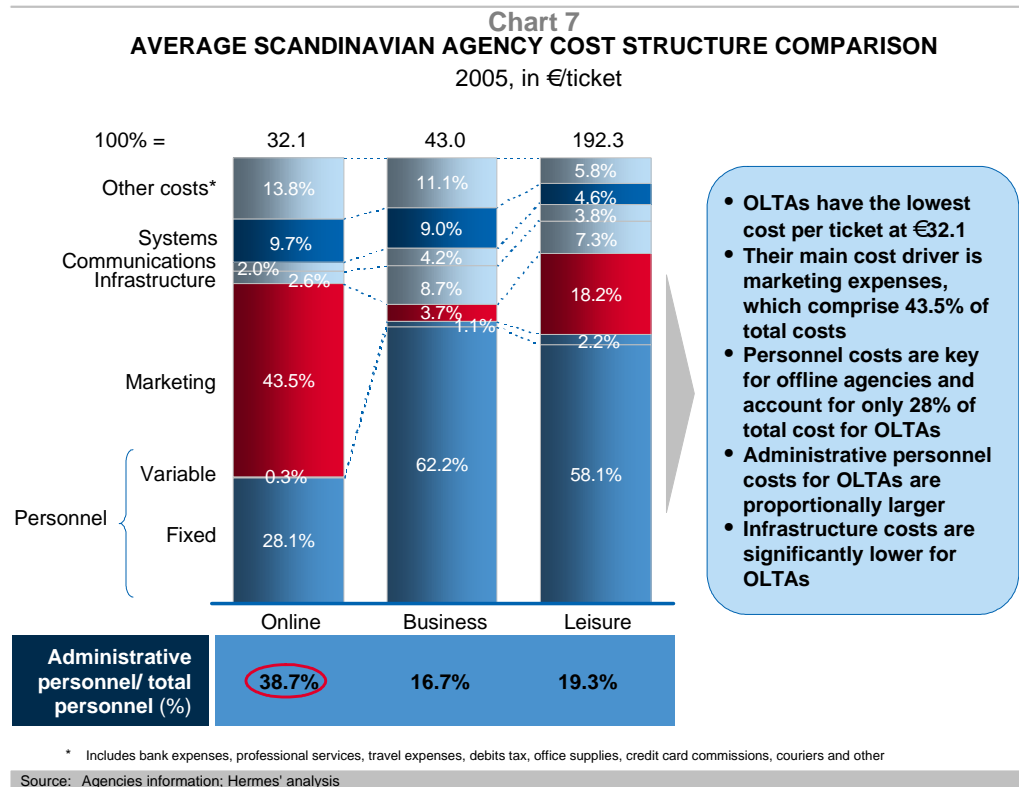
- Air tickets represent 70% of total sales but account for only 53% of tickets sold (Chart 5) and 45% of total income, with a gross margin of 5.2% (Chart 6). If LCCs continue growing as they have in the last few years and supplier direct sites keep trying to drive their online channel, these margins will tend to decline.
- Insurance has the highest margin, at almost 60%. Other products and services, including packages, ferry and group transportation, have an average margin of 47.1% which shows the importance of cross-selling to attain reasonable profitability.
- The average gross sale per ticket issued is €324.
- The gross margin, measured as total income/gross sale, is 10.0%.

The sale of non air products allows Scandinavian online travel agencies to increase their gross margin (measured as total income/gross sale) by an average of 10%

Average agency cost structure

Agencies' cost structures were analysed in two ways:

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



Traditional costing analysis

When analysed from the traditional point of view (Chart 7), cost per ticket results are as follows:

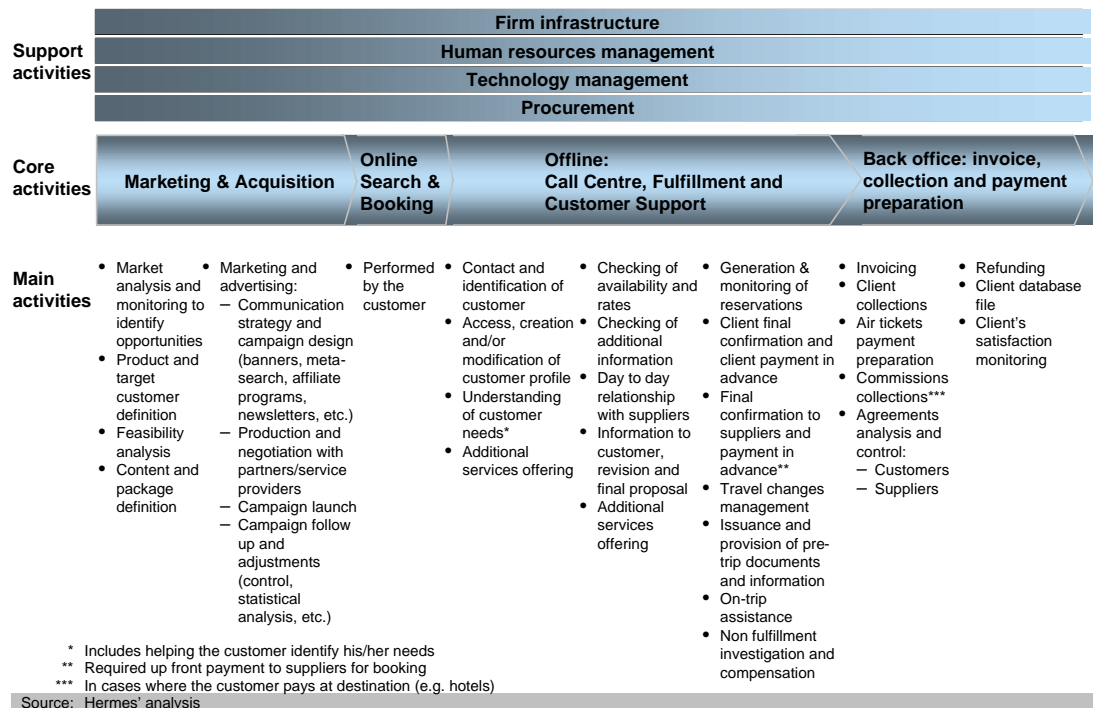
- The average cost per ticket for an online travel agency is €32.1. When compared to traditional Scandinavian travel agencies, the average cost per ticket for online travel agencies is 25% lower than that of business agencies and 83% less than that of leisure agencies. As expected, total cost per ticket is lower in online travel agencies. Nevertheless, the cost gap between business and online travel agencies is not large.
- Online travel agencies have significantly higher marketing costs, (more than double those of Scandinavian leisure agencies). Marketing costs comprise 43.5% of total costs, and are the key core cost driver.

- Although personnel costs are lower for online travel agencies than for traditional travel agencies, they still represent their second highest expense, accounting for more than a quarter of their cost per ticket (28%). The high level of automation in reservation and booking processes allows for fewer operating employees. As a result, the total personnel includes a relatively high proportion of administrative personnel (38.7%) partly for the reasons detailed above but also because of the higher salaries (€77,200) of administrative personnel (which in small companies often includes the CEO) vis-à-vis operating employees (€48,700).
- Scandinavian online travel agencies present a lower share of infrastructure costs as operations are centralised with low space requirements.
- Scandinavian agencies' information technology expenses (systems) are higher than those of other types of Scandinavian agencies, as a result of their high automation levels.

Activity Based Costing (ABC) analysis

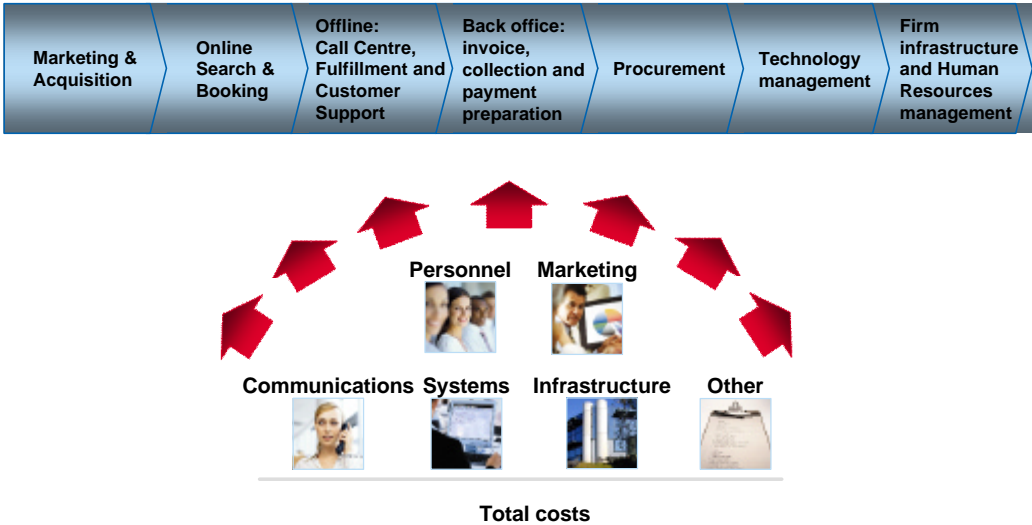
Activity Based Costing is based on the principle of identifying a business's core activities and allocating costs to them. For online travel agencies, the main activities identified are shown in Chart 8.

Chart 8
OVERVIEW OF ACTIVITIES AND PROCESSES
Online travel agencies, level 1 activities



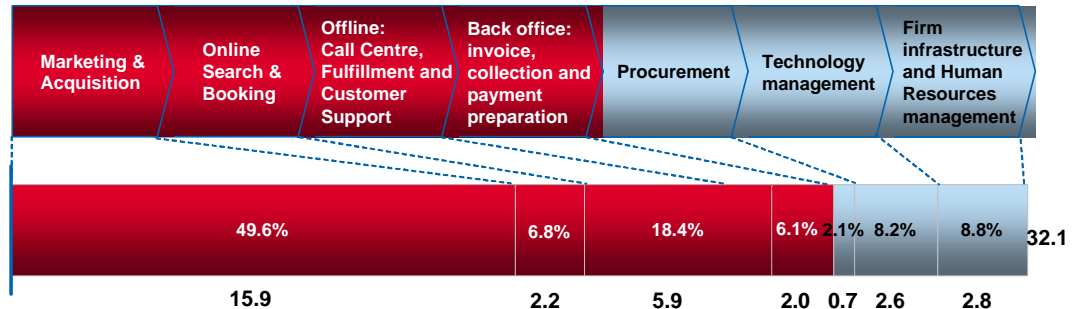
Once processes and activities had been mapped at different levels, traditional accounts were allocated to each of the identified activities, taking into account the amount of resources (cost driver) used for each activity, and then allocated to the tickets issued. Data (revenue, costs, time dedicated 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 agents, etc.) The allocation of traditional accounts to core activities is illustrated in Chart 9 and the results are shown in Chart 10.

Chart 9
OVERVIEW OF ACTIVITIES AND PROCESSES
 Generic level 1 activities



* Support activities includes procurement, human resources, technology management and firm infrastructure
 Source: Hermes' analysis

Chart 10
ACTIVITY COST DISTRIBUTION PER TICKET SOLD
2005, in €/ticket



- Marketing & Acquisition comprises half of OLTAs' total cost per ticket
- Offline activities are the second most costly, accounting for approximately one fifth of total costs

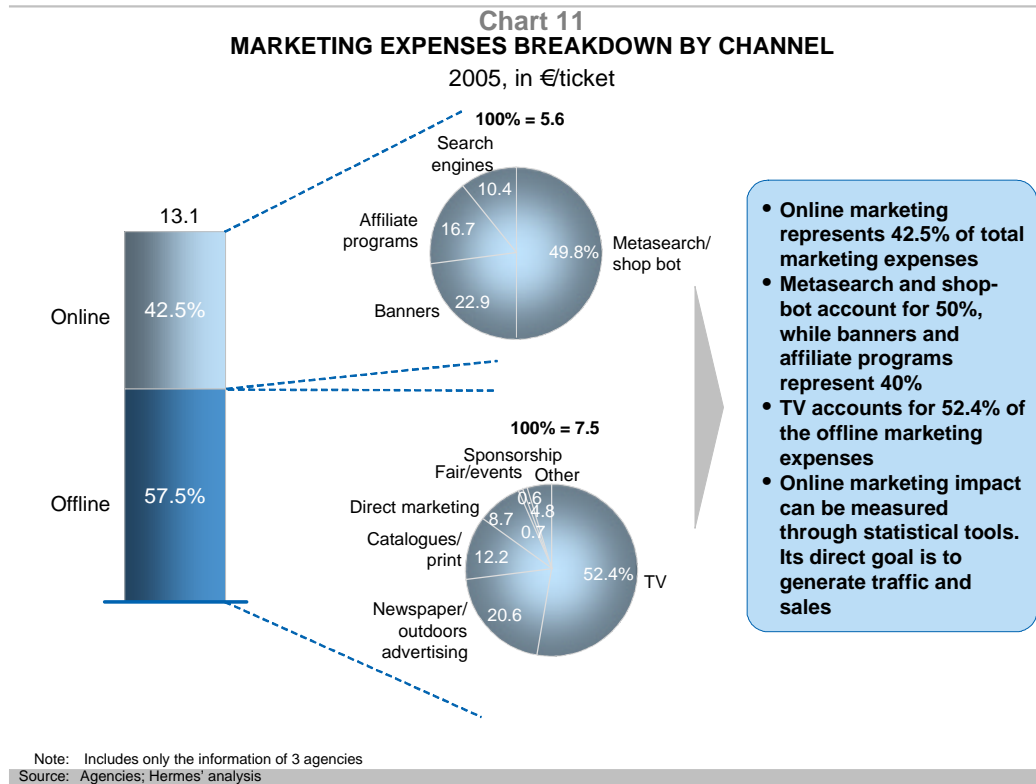
Source: Hermes' analysis

The cost per ticket from the ABC point of view is analysed below for each activity in turn.

Marketing & Acquisition

"Marketing & Acquisition", a key activity, accounts for 49.6% of total costs. It is important to note that in the Activity Based Costing analysis, these costs include all the expenses and costs related to this specific activity (e.g. marketing budget, marketing personnel costs, etc). The traditional costing analysis only includes the marketing budget, which explains why it allocates a lower percentage, 43.5%, to marketing expenses.

As Marketing expenses are an online travel agency's main cost driver, further analyses were conducted. Chart 11 shows the breakdown of the marketing budget into online and offline channels:

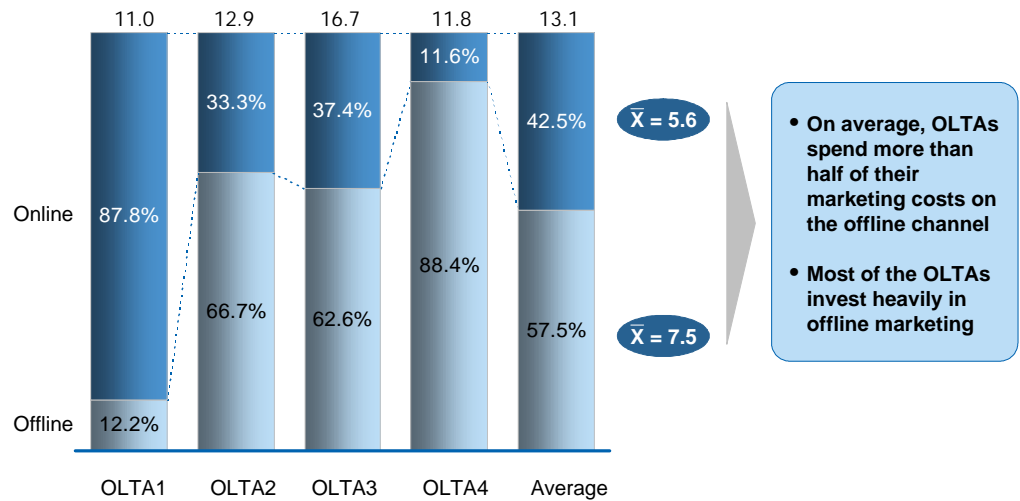


Offline marketing expenses account for 57.5% of the total marketing budget and are mainly allocated to TV, newspapers and outdoor advertising.

Online expenses comprise 42.5% of total marketing costs. These are mainly assigned to metasearch (50% of total online expenses), banners (23%), affiliate programs (17%) and search engines (10%). Due to the importance of the online channel, the most efficient online travel agencies within the sample had implemented tracking tools in order to measure this channel's efficiency through ROI, cost per booking, conversion rates, etc.

Within the sample, marketing expenses by channel varied greatly, demonstrating that at present there is no standard approach to online travel agency marketing. While only one agency concentrated most of its budget on online channels, the other three invested heavily in offline ones accounting for 66.7%, 62.6% and 88.4% of their expenses respectively (see Chart 12). However, for all four agencies, as mentioned before, marketing expenses represent a large percentage of their costs. It is important to note that some online travel agencies focus their efforts on short-term growth while others are focused on long-term brand building activities, which entail different marketing strategies. Online travel agencies have to be careful when trying to balance short-term profitability and long-term brand building as failing to create a strongly-recognised brand could have negative effects in the long-run.

Chart 12
MARKETING MIX
2005, in €/ticket

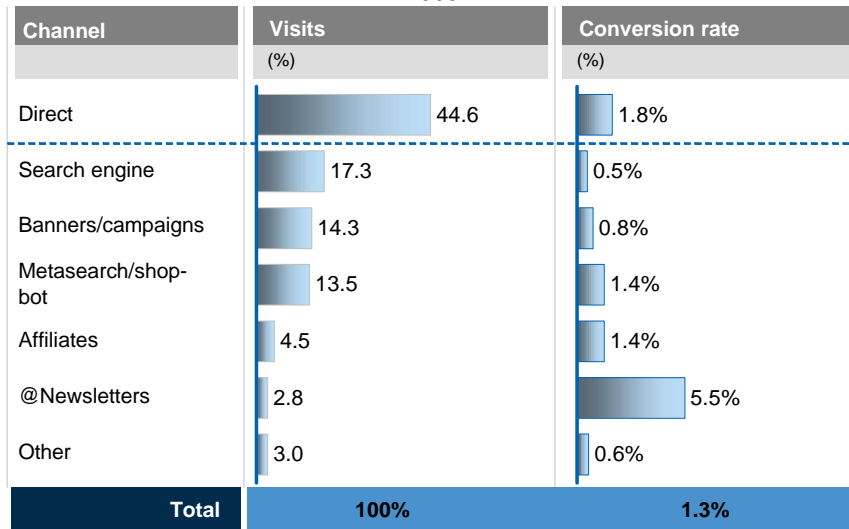


Source: Agencies; Hermes' analysis

Productivity per marketing channel was also analysed (see Chart 13) based on the source of visits (direct, via a search engine, an @newsletter, etc.) and the conversion rate (the percentage of visitors who take a desired action upon visiting a website):

- On average, online travel agencies achieve a conversion rate of 1.3% of total visitors but different channels show conversion rates ranging from 0.5% to 5.5%.
- Direct visitors represent 44.6% of total visits and have an average conversion rate of 1.8%.
- @Newsletters achieve the highest conversion rate (5.5%) but only account for 2.8% of the visits.
- Search engines are the second largest source of visitors but show the lowest conversion rate (0.8%).
- Although online travel agencies dedicate a significant amount of their budget to metasearch channels, the percentage of visitors from this source is only 13.5% and conversion rates are slightly above average.

Chart 13
PRODUCTIVITY PER MARKETING CHANNEL
2005



- On average, per each 100 visitors, only 1.3 book
- The most important source of visitors is direct traffic (45%)
- @Newsletters have the highest booking ratio (5.5%) but only account for 3% of total visits as they are only sent to subscribers
- Conversion rates range from 0.5% to 5.5%

Source: Agencies; Hermes' analysis

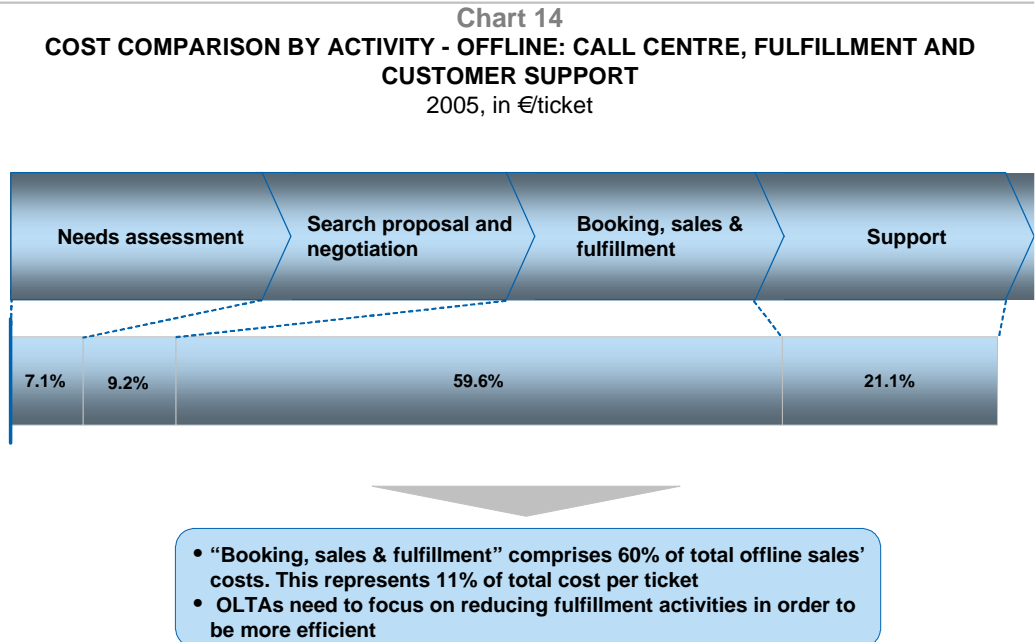
Online Search & Booking

“Online Search & Booking” accounts for 6.8% of total costs. This activity primarily includes the booking engine operational costs. As will be seen later in Chart 15, only 11% of total bookings are made entirely online (touchless transactions). Non-touchless transactions increase the total cost per ticket due to the need for agent intervention in the booking process.

Offline: Call Centre, Fulfillment and Customer Support

This process accounts for 18% of total costs, which makes it second only to marketing. It includes offline bookings, queue management, call centre support and all the fulfillment activities.

This process can be broken down into four activities (see Chart 14).



Source: Hermes’ analysis

Of these activities, “Booking, sales & fulfillment” accounts for almost 60% of the total cost.

At this point, it is interesting to look more closely at the “bookings” element and to observe how far customers are able to book their tickets using a purely online approach and how far they feel the need to resort to offline assistance. Four types of bookings exist (see appendix for the methodology used):

- **Pure online (touchless):** the booking process is done entirely by the customer without any human intervention. In order to make these bookings possible, online travel agencies need a fulfillment engine with scripts, quality checks, etc.
- **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.

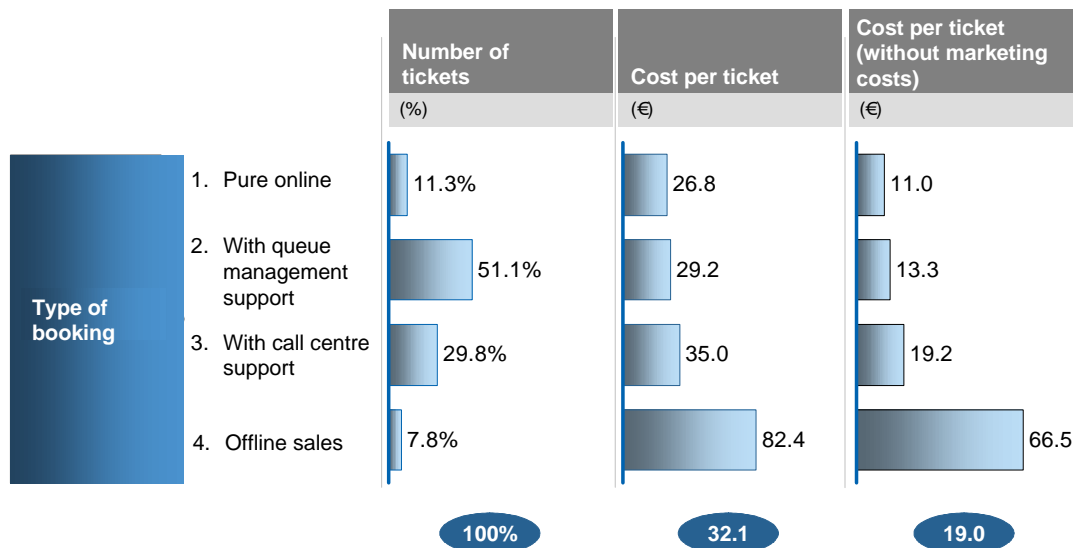
- **With call centre support:** The customer tries to make the booking online but ends up dialling the call centre to solve a problem or ask questions over the phone.
- **Offline:** This booking is done offline through the call centre. Double low online travel agencies may not accept this alternative. Usually, older and less experienced customers prefer to book over the phone.

An estimate of the cost of the different types of bookings was conducted (see Chart 15):

- Touchless bookings are the least costly (€26.8, 17% below the average). As the level of automation decreases, the cost per ticket rises. A 100% offline sale, at €82.4, costs three times as much as a pure online one.
- According to the sample, more than half of the bookings needed queue management support from travel consultants, increasing the cost of the transaction by almost €3.
- In view of the fact that marketing expense is not dependant on the type of booking, the figures in the last column may be more representative of the cost per type of booking.

Chart 15
ESTIMATE OF THE COST PER TICKET BY TYPE OF BOOKING

ESTIMATE



Source: Hermes' analysis

It would appear that low levels of automation and poor booking engines make online travel agencies inefficient. Only 11.3% of tickets are booked purely online, 51.1% need queue management support, 29.8% require call centre assistance and a significant 7.8% are still booked offline.

Back office: Invoice, collection and payment preparation

Back office activities account for 6.1% of total costs. Online travel agency costs differ depending on the level of automation and integration of the front, mid and back office. These costs also depend on airline debit memos (ADMs), fraud levels and credit card merchant commissions.

Support activities

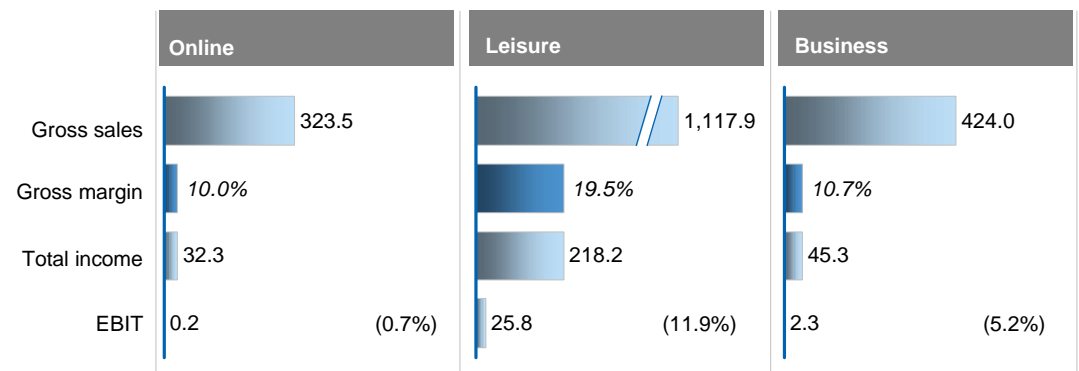
“Technology Management” accounts for 8.2% of total costs per ticket. Booking engine and webpage costs are included in “Online Search” costs due to the fact that they are this activity’s main cost driver. “Technology Management” includes office supporting systems, server maintenance, etc.

“Firm infrastructure and Human Resources Management” account for 8.8% of total costs while “Procurement” comprises 2.1% of total costs.

Profitability and productivity analysis

Online travel agencies are the least profitable agencies in terms of EBIT, when compared to business and leisure travel agencies

Chart 16
PROFITABILITY ANALYSIS
2005, in €/ticket

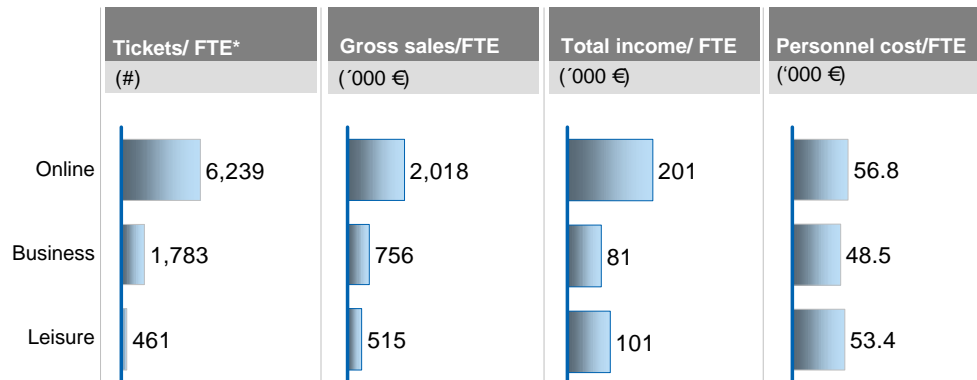


- Leisure agencies are the most profitable due to their higher margins
- OLTAs' total income/gross sales is comparable to business agencies' because both have low levels of cross-sell

Source: Hermes' analysis

- On average, the study shows that online travel agencies are the least profitable agencies in terms of EBIT (Earnings Before Interest and Taxes) when compared to traditional business and leisure travel agencies. Nevertheless, profitability may vary significantly depending on the amount of marketing resources invested and the ROI of the channels used. Furthermore, as most of the online travel agencies at the time of the study were in a high growth phase due to their short lives, their investment in marketing was substantial, their volume still relatively small and many had not yet reached their break-even point. Also it is worth noting that EBIT per ticket should increase once volume grows as online travel agency has high fixed costs they remain fairly stable as booking volume grows, while variable costs should remain relatively small compared to traditional agencies.
- Online travel agencies have the lowest gross sales per ticket (€323.5), mainly due to the fact that they sell mostly air tickets, at a lower margin than a leisure or business travel agency.
- In spite of online travel agencies' relatively high level of income/gross sales (10.0%), the total cost per ticket represents 99.3% of total income, mainly due to higher marketing costs.

Chart 17
ANALYSIS OF PRODUCTIVITY OF TRAVEL AGENCIES IN SCANDINAVIA
2005



- Due to the high level of automation, tickets per FTE in online agencies are more than 13 times higher than in leisure agencies
- Although leisure agencies have the highest gross sales per ticket, online agencies have the highest sales and revenue per FTE

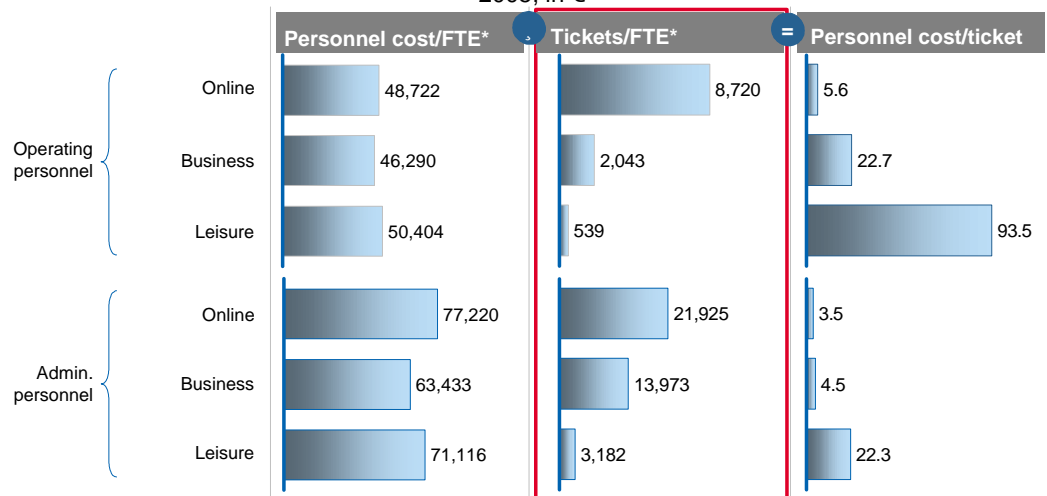
* FTE: Full time equivalent employees

Source: Participating agencies; Hermes' analysis

Online travel agencies show the highest productivity in terms of Tickets per FTE, Gross sales per FTE and Total revenue per FTE

- Online travel agencies are the most productive in terms of tickets per Full Time Equivalent employees (6,239 tickets/FTE) when compared to business and leisure travel agencies (Chart 17), due to the higher level of automation. However, as stated before, these are the cheapest tickets since they are mainly air tickets with low cross-sell.
- Online travel agencies present the highest gross sales per FTE (more than €2m euros). Their sales more than double those of business agencies and are almost four times greater than those of leisure agencies.
- Online travel agencies also show the highest total income per FTE (€201,000), doubling that of leisure travel agencies. The productivity gap between online travel agencies and leisure travel agencies shortens when measured in terms of total income instead of gross sales, because leisure agencies usually sell packages which typically include an air ticket (more rarely a rail ticket), a hotel booking and other added value services, which have higher margins than standalone air tickets sold by online travel agencies.
- Online travel agencies show the highest personnel costs per FTE (€56,800), because of the impact of a higher percentage of more expensive administrative and IT employees.
- In general, personnel costs per FTE account for 50%-60% of the income generated per FTE. In the case of online travel agencies this drops to less than 30%.

Chart 18
ANALYSIS OF PERSONNEL PRODUCTIVITY PER FUNCTION
2005, in €



Online travel agencies are more productive in operating processes than in administrative ones when compared to other Scandinavian segments but show the lowest cost per ticket in both categories

* FTEs for each process (Operating and Administrative respectively)

Source: Agencies information; Hermes' analysis

Online travel agencies present the lowest personnel costs per ticket for both operating and administrative personnel

- Online travel agencies show the highest productivity in terms of tickets per FTE for both operating and administrative personnel, when compared to other European agencies (Chart 18).
- Online travel agencies present the lowest personnel cost per ticket for both operating and administrative processes, reflecting one of the benefits of a higher level of automation.

Chart 19 presents an overall summary for both types of online travel agencies (Double Low and Full Service):

- Full Service online travel agencies have prioritised long-term brand building over short-term profits. At the time of the project they were not profitable while some Double Low online travel agencies that had prioritised short-term marketing investments showed an EBIT/Total income of approximately 25%. This performance gap can be further explained by the fact that:
 - Double Lows are more productive as they do not accept offline bookings.
 - Double Lows have lower merchant credit card commissions because of their method of invoicing clients.
 - Double Lows pay lower salaries, have less costly processes and devote less internal resources to IT by outsourcing.
 - Full service agencies provide a higher service standard but do not charge a premium price to compensate for the extra cost.
 - Double Lows outsource IT solutions resulting in lower costs.

Chart 19
HIGHLIGHTS OF ALTERNATIVE BUSINESS MODELS

ESTIMATES

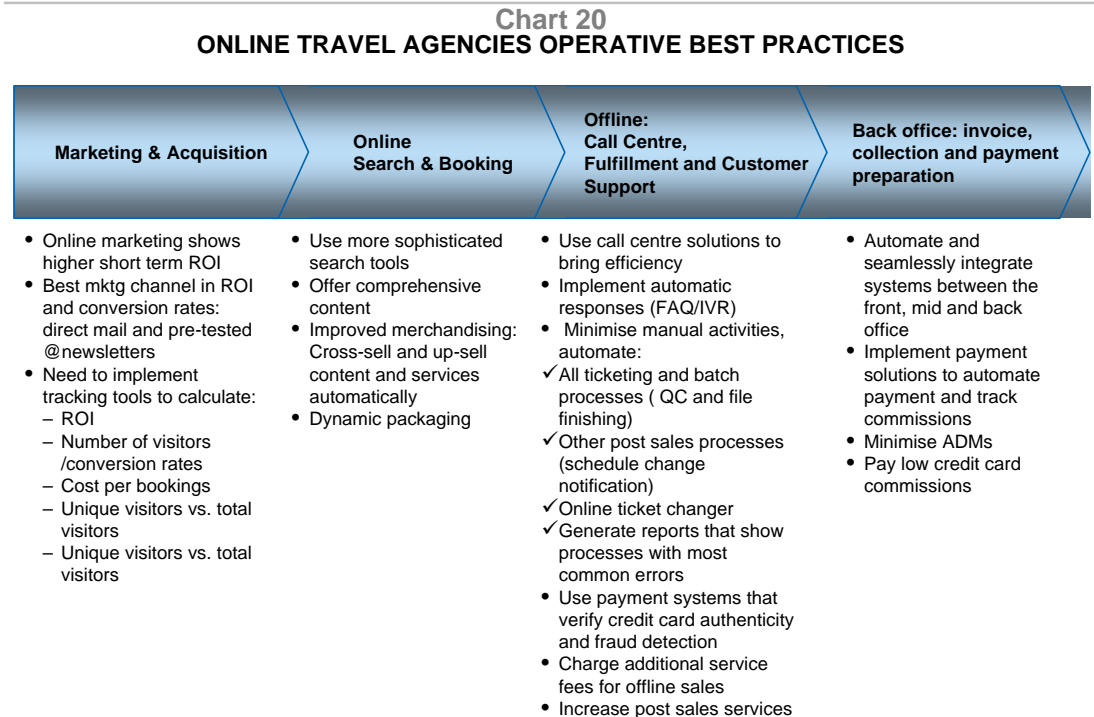
	Double Low	Full Service
• EBIT / total income (%)	Over 25%	Negative
• Gross sales/FTE ('000 €)	3400	2400
• Total income/gross sales (%)	8.5%	10.0%
• Client Collections costs (€/ticket)	1.0	2.5
• Personnel costs/FTE ('000 €)	50	70
• Personnel costs/ticket (€)	6	12
• IT costs per ticket (€)	3	10
• Marketing investment (€/ticket)		
– Total	11.0	13.0
– Offline	Less than 20%	Over 60%
– Online	Over 80%	Less than 40%
• Booking hit ratio	1.5%	1.0%

Source: Agencies' interviews; Hermes Analysis

- When comparing the marketing investment mix: Double Low agencies invest more than 80% of their marketing expenditure in online channels, while for Full Service agencies, which usually have a larger budget, this percentage is less than 40%.

Main conclusions and recommendations

Chart 20 presents a summary of the study's best practice recommendations for online travel agencies.



Source: Hermes' analysis

The study highlighted several opportunities for adding value to travel agencies specifically for the Scandinavian online market, although they could also be applicable to other countries.

As the online travel agencies studied are young startups, high marketing expenses have been necessary this far in order to achieve growth and comprise 43.5% of total costs. However, in the mid-term, these expenses will need to be balanced with profitability.

- Online marketing shows a higher short-term ROI vis-à-vis offline which has long-term brand building objectives, but may not drive sales as rapidly as online.
- Direct mail and pre-tested @newsletters attain the highest conversion rates.
- The use of complex statistical tools allows online travel agencies to measure the efficiency of their marketing investments, measuring total visitors and bookers per marketing channel and campaign, cost per type of booking, etc.

Margins are particularly low for air travel where competition from supplier sites and LCCs is highest.

- Online travel agencies need to focus on other forms of content and increase cross- and up-selling. In the face of content fragmentation, online travel agencies need to be able to integrate reliable and accurate content from different sources using interfaces such as Amadeus API or other substitutes.

Travel consultants dedicate a significant proportion of their time to queue management and fulfillment activities. A high percentage of online travel agencies costs are centred on these activities, and there are many ways in which productivity can be improved.

- Online travel agencies need to implement solutions which automate post-sales processes and queue management, as most bookings require some form of intervention. **Amadeus Touchless Processing's QC & File Finishing and Ticketing** modules are fully customisable to an online travel agency's established processes. This is vital to online travel agency growth, as it reduces the variable costs of processing bookings and therefore increases margins as the online travel agency's booking volumes increase. The automation of booking and ticketing queues could significantly reduce the time spent by consultants on these manual activities and reduce the cost per ticket by up to 2.3 euros.
- Online travel agencies need to automate recurring manual processes, particularly those which generate no revenues, such as schedule change notifications. **Amadeus Touchless Processing's Traveller Alerts** module automates notifications, as it has a customisable template which can be used for any type of communication. Online travel agencies should implement a comprehensive reporting tool that tracks the performance of their automation tools and the status of PNRs to identify which processes could benefit from more automation and to transfer data to the back office.
- Online travel agencies should implement an automatic ticket changer (such as **Amadeus Ticket Changer**) both online and in their call centres to increase service levels, empower the consumer and decrease the time agents spend on changing tickets. Booking and ticketing scripts could help travel agencies to increase the productivity of their agents by automating the systematic quality check of every PNR. Online travel agencies still need to increase their level of automation and make the online booking system faster and easier for the user.

Call centre costs are an important part of an online travel agency's cost structure. Travel agencies often suffer from insufficient monitoring of call centre performance.

- In a Call Centre, the main costs are centred on personnel. Online travel agencies need to implement solutions with customisable scripting and workflows that reduce the need for agent training, help agents deal with calls faster and maximise opportunities for cross-selling.

- Online travel agencies running centralised call centres which serve customers from multiple countries need to implement solutions such as **Amadeus Dynamic Desktop** which automatically identifies the country the customer is calling from and brings up local content.

Online travel agencies dedicate insufficient resources to client databases and profiles.

- Agencies can assess the possibility of developing CRM systems including e-mailing tools that allow one-to-one marketing where the conversion rate is the highest.

Online touchless bookings cost 6 times less than those made offline through a call centre.

- Travel agencies need to improve their content in order to increase their levels of cross-selling and up-selling and to be able to make packages dynamically.
- Through the introduction of a low fare search solution, such as **Amadeus Master Pricer**, and in particular by taking advantage of its customisation possibilities, travel agencies can make their online booking engine more reliable and powerful, increasing the level of automation and, therefore, reducing total costs. **Amadeus Master Pricer** is an accurate and comprehensive low fare search solution that returns up to 200 results per query and significantly improves the speed and efficiency of the online search experience. More sophisticated solutions, such as **Amadeus Master Pricer Calendar**, enable online travel agencies to offer customers an easy way of checking flight availability and fares for a variety of dates through one single search.

Back office costs including invoicing, collection and payment preparation amount to approximately 2 euros per ticket.

- Online travel agencies should integrate their back office with their front and mid office wherever possible. **Amadeus Touchless Processing's QC & File Finishing** module automatically reformats data to match back office requirements.
- Online travel agencies need to be able to access detailed reports about their bookings so that they can reconcile them with their invoice collection, etc. **Amadeus Touchless Processing's Reporting** module generates daily reports on numbers of PNRs processed and ticketed as well as error reports and reports on individual PNRs or PNRs with shared attributes.
- Online travel agencies could implement a payment solution to automate payments and track commissions due to be paid and received such as **Moneydirect**. **Moneydirect** is easy to use, secure and reliable and can be deployed irrespective of booking channel, direction of funds, type or timing of payment or currency.

Fraud is a serious threat to online travel agency profitability. Estimates conclude that fraud can cost up to 0.10 euros per ticket.

- Fraud is costly for online travel agencies, so they need to have a fraud detector. Ideally they should have one integrated in their booking process and another in their post-sales process. **Amadeus Touchless Processing's Fraud Detection** module is easily customisable and can be embedded in the post-sales fulfillment process.

Significant investment goes into technology and IT development. IT costs account for approximately 2.6 euros per ticket.

- The results of the study show that online travel agencies that outsource IT requirements benefit from lower costs and faster results. Online travel agencies could choose to outsource their IT needs and could opt for cost-effective hosting. Amadeus offers state-of-the art hosting and network services for online travel agencies.

Appendix

Methodology

Hermes (a) carried out an overall market study, (b) together with Amadeus Scandinavia, selected travel agencies to take part in the project, and (c) conducted an activity-based costing (ABC) analysis.

How was this done?

Initially, an exhaustive analysis of in the business of four representative travel agencies in Scandinavia was carried out. The sample was selected on the basis of a balanced mix of agencies in terms of size, location, automation level and main GDS provider in order to produce results that faithfully represent conditions in the market place.

Hermes then developed an activity-based costing report that also included the characteristics of each sector, the revenue structure and profitability. This comprehensive analysis of the cost per activity within each travel agency provided important information about the agencies' efficiency in relation to their market segment.

The project was carried out in three steps:

1) Information request

A detailed and thorough questionnaire was sent to each agency, requesting information related to revenue, breakdown of expenses, organisational chart, points of sale as well as IT, software and communications equipment.

2) Process analysis

This step consisted of an in-depth assessment of travel agencies' business processes. Interviews with agency employees were also carried out in order to help understand the main activities performed within each agency and to identify resources used in each activity. One of the findings of this study was that online travel agencies' business systems differed significantly from that of offline agencies (both business and leisure) studied previously.

The processes were documented and analysed at two levels for each agency: Level 1 provided a description of the main processes used by the travel agencies while, at level 2, these main processes were divided into sub processes (Chart 8). For example, "Marketing & Acquisition" (a level 1 activity) included "Market analysis and monitoring to identify opportunities", "Product and target customer definition", "Feasibility analysis", "Content and package final definition" and "Marketing and advertising" (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 8); in the case of "Market analysis and monitoring to identify opportunities" these would be "Analysis of existing offers from competitors", "Identification of attractive destinations", and "Identification of customer segments with unsatisfied needs".

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 the least efficient agencies.

Two cost allocation exercises were performed:

- A traditional costing in which accounts were divided generically (Operating and Marketing Personnel, Administrative Personnel, Communication, Systems, Infrastructure, Marketing and Other).
- An activity-based costing in which traditional accounts were allocated to each activity (Chart 9), 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) were gathered using different sources of information (accounting reports, interviews with managers and agents, etc.).

In the ABC study, costs were presented in € (Euros) per ticket. A ticket unit includes a combination of all services provided by the travel agencies and represents the average transaction per customer (including an airline or a rail ticket and added products). For those agencies with a higher share of ground services as stand-alone products, a voucher per passenger was also considered as a ticket. By using this method, the study provides simple, standardised results and allows for comparison among travel agencies.

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

Hermes has carried out strategy, organisation, operational improvements and valuation projects, in Argentina, Brazil, Colombia, Costa Rica, Chile, Dominican Republic Ecuador, France, 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 <http://www.hermesmc.com.ar>