



The Travel Gold Rush 2020

**Pioneering growth and profitability trends
in the travel sector**

Developed by Oxford Economics
in partnership with Amadeus

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About Oxford Economics

Oxford Economics is one of the world's foremost global forecasting and research consultancies. Founded in 1981 as a joint venture with Templeton College, the business college of Oxford University, Oxford Economics has since grown into a major independent provider of global economic, industry and business analysis.

A leader in quantitative analysis, Oxford Economics relies on detailed economic research and cutting-edge analytical tools to help its clients assess the opportunities, challenges and strategic choices they face now and in the future.

By using a suite of time-tested models, the Oxford Economics team of more than 60 professional economists and industry experts provide organisations with the analysis needed to make decisions and develop thought leadership. Oxford Economics helps identify future global economic and business trends and what they will mean for organisations, industries, markets or customers. It presents its insights and foresights in clear business language, backed by a brand organisations can trust.

About Amadeus

Amadeus is the chosen technology partner and transaction processor for the global travel and tourism industry. The company provides distribution and technology solutions to help its 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).

Amadeus operates under a transaction-based business model that offers IT solutions to virtually all players in the travel industry. The Amadeus system processed more than 670 million billable travel transactions in 2009.

Its solutions and services are used by its customer groups in different ways. Over 90,000 travel agency points of sale and more than 55,000 airline sales offices use the Amadeus System to run their business. Many of the industry's other leading travel service providers use Amadeus' modular technology to optimise their distribution and internal operational requirements.

Amadeus began trading on the Spanish Stock Exchanges on 29 April 2010 [AMS].

1 Foreword

The last two years have been tough for the travel sector. But now is the time to think about how the industry will change over the coming years. At Amadeus we remain inquisitive and curious about the future as we believe a desire to shape it is vital to innovation.

A key priority for the sector must be to explore the different routes to growth and to profitability. History shows that the travel sector, more than most others, is at the mercy of the global economic tide, growing slightly faster than the economy in boom periods, falling slightly more than the economy during the downturns.

The challenge for our industry is to better ride the global economic rollercoaster by finding the source of more sustainable revenues. This report explores the question, where are the 'pots of gold' in the next decade?


As an industry, if we can better answer this question, we will be able to build more robust, long-term and sustainable businesses. In this report, the latest in a series which has included *Future Traveller Tribes*, *The Austere Traveller* and *The Amateur Expert Traveller*, we focus on the trends, drivers and tastes most likely to shape the future of our industry.

This study is different to previous reports in that it is not solely focused on the traveller and traveller trends.

We felt that the time was right to focus equally on the industry trends that could stimulate thinking and discussion about how to secure new revenue opportunities and profitability, how to organise our industry to work more effectively across the value chain and how to meet the needs of travellers.

In the *Travel Gold Rush 2020*, we explore new models of co-operation; how a total travel experience can be delivered; and whether or not the future for airlines and agents lies in fundamentally reshaping the services they provide.

This report is not definitive. Instead, the objective is to get us thinking about the future so we are best placed to secure growth and success in the years ahead.



Philippe Chèreque

EVP, Commercial, Amadeus IT Group



2 Executive summary

Amadeus has commissioned a study to explore the trends shaping the future of travel, specifically focused on the challenges and opportunities facing airlines and agents. The report looks at potential new revenue opportunities and drivers of profitability, new models driving future growth and changing traveller tastes and preferences.

The report examines a number of different issues, including:

- Current and future trends within the airline and travel agent segment as they emerge from the recent global recession
- Macroeconomic forecasts of how the travel industry is likely to appear in 2020
- Analysis of how airlines and agents will develop new revenue sources in the future including the role of ancillary revenues and value chain extensions
- The potential for changes in future tastes

A key input to this report is the contribution of expert interviewees. These included participants from major airlines across the world, travel industry experts, online travel agents, tour companies and participants drawn from Amadeus itself. These interviews, combined with macroeconomic forecasts from Oxford Economics, provided insights into how industry participants themselves see the industry developing in future years.

The central thread throughout this report is an investigation into the options available to airlines and agents as they seek growth and profitability. While the travel sector has experienced significant growth in the last decade, profitability remains stubbornly elusive for many airlines and agents.

This report explores some of the scenarios that shed light on where the industry may find new revenue opportunities or 'pots of gold'. It focuses on issues such as greater collaboration across the industry, shifting business models, the opportunities presented by the 'total travel experience' and changing demographics. Key findings and insights include:

The Big Picture

1. The global travel industry is making an uneven recovery from the recession.

2010 has seen a return to growth with global arrivals increasing 5.6% in the first six months of the year. However,

Europe remains sluggish and there are lingering economic concerns. Hotspots remain Latin America and Asia-Pacific.

2. Asia will represent one third of travel spending by 2020 – up from 21% today.

Macroeconomic modelling by Oxford Economics has suggested a dramatic realignment of travel spend over the next decade. Asia will account for nearly 22% of global arrivals by 2020 (up from 18% in 2008) and the region's residents will account for 32% of travel spending by 2020.

Options For Growth

3. Ancillary services offer new opportunities but they may not be the silver bullet to revenue growth that many expect.

Ancillary revenue generation has spread from LCCs to major carriers and become an increasingly important source of revenues; however, it may not be the answer to revenue growth many would like. Considerable uncertainty remains about how important ancillary revenues will be in the long term, especially to major carriers. Nonetheless, with estimates suggesting that ancillary revenues may contribute anything up to 35% of airline revenue in the future the industry needs to fully understand where the opportunities lie.

4. Airlines and agents must explore new models that take a more comprehensive view of the total travel experience.

Airlines may adopt a broader (or generic) approach to travel and integrate activities more closely with the rest of the travel value chain. There may be potential to derive yield from alliances with high speed rail providers, from customers who are willing to pay for seamless travel (e.g. improved ground transfers/transport), and by taking closer account of customer preferences beyond the airline trip itself. In general, there are significant opportunities for airlines (and agents) which could arise from the weak points in the current value chain, such as the disconnect between ground transportation and the flight. Passenger willingness to pay for a smooth travel experience seems to be a significant opportunity, with a variety of sources of value but one which has so far gone largely unexploited. New technologies offer the potential to access these sources of value by allowing airlines and agents to more closely tailor their products to match traveller preferences.

The Future Revealed

5. Traditional cabin classes to be replaced by “virtual classes” as individual traveller preferences create a personalised experience.

The future of the aircraft cabin is set to go through significant changes as customers are able to share their preferences with airlines and airlines will be expected to meet their individual needs leading to the decline of traditional cabin classes.

6. Face-to-face (F2F) travel agents set to become more highly valued.

F2F agents may evolve to provide more services across the entire travel experience, particularly at its weak points. As travellers increasingly try out new experiences and destinations, it is likely that F2F agents may be able to play to their strengths of being there. They are likely to focus on industry niches/deep expert advice in the future. Their customer proposition will focus on ensuring that their clients are assisted across the entirety of the travel experience.

8. Business travel will recover from the recent recession but business class may face changes.

Videoconferencing is likely to supplement rather than supplant business travel due to industry growth and the continuing advantages of F2F contact, particularly for initial meetings. Analysis in the US suggests that for every dollar invested in business travel companies realise \$12.50 in incremental revenue. Business class is most likely to survive and thrive but classes in general are likely to become increasingly fragmented.

9. Emerging nations’ travel habits remain the great unknown.

Despite their importance (and macroeconomic forecasts indicating broad trends) there is some uncertainty about where citizens from emerging nations may travel to or how their tastes may differ from Western travellers. The demographic trends associated with Western travellers may be less relevant when applied to the emerging markets.

Exploring The New Frontiers

7. Richer, older and going somewhere - demographic changes will alter Western travel.

Demographic changes and health advances will mean more travellers with more free time, who travel for longer periods and who are still able to incorporate a variety of travel experience. These new travellers will present new opportunities for airlines and agents.



3 Trends within the travel industry

Key points

- Whilst the global travel industry has steadily grown since 1995, the recent recession was a setback with global tourist arrivals down to 880 million in 2009 from 920 million in 2008.
- 2010 has seen a return to global growth, but Europe remains sluggish and there are lingering economic concerns.
- The global aviation industry mirrors these trends. Whilst it is forecast to return to profitability in 2010, its forecast annual net profit margin is only 0.5%. Questions over industry viability and the need for new revenue sources remain.
- Agents face the additional challenges of the demise of commission-based travel and increasing use of the internet in place of traditional F2F contact.
- Agents are likely to reinvent their role as bespoke travel advisors and as a trusted source of information.
- Macroeconomic modelling by Oxford Economics suggests that Asia will account for nearly 22% of global arrivals by 2020 (up from 18% in 2008). The region's residents will account for 32% of travel spending by 2020 - up from 21% today.

3.1 General trends affecting the travel industry

Before the future of airlines and agents is considered, it is important to understand the current state of play of the travel sector as it emerges from the global recession of 2008-09.

Emergence from recession

The United Nations World Travel Organisation (UNWTO) recorded 880 million tourist arrivals in 2009 – up from 536 million in 1995 but well below the 920 million of 2008. Until 2008 the pattern was one of steady growth, with the exception of a plateau between 2000-2003 as a result of events such as September 11, SARS and global economic stagnation.





Source: IATA

However, global tourism arrivals fell by 4.2% in 2009 to 880 million as the effects of recession hit. Tourism receipts (\$852 billion) were 5.7% below the levels of 2008 – suggesting that people were also spending less per trip if they did travel.

Early 2010 has seen a tentative and uneven recovery. The UNWTO estimated arrivals growth of 7% for the period January-April 2010. More recent data, compiled by Oxford Economics, suggest global arrivals growth of 5.6% for the year to June 2010, with a slightly larger downturn (4.8% decline) in 2009.

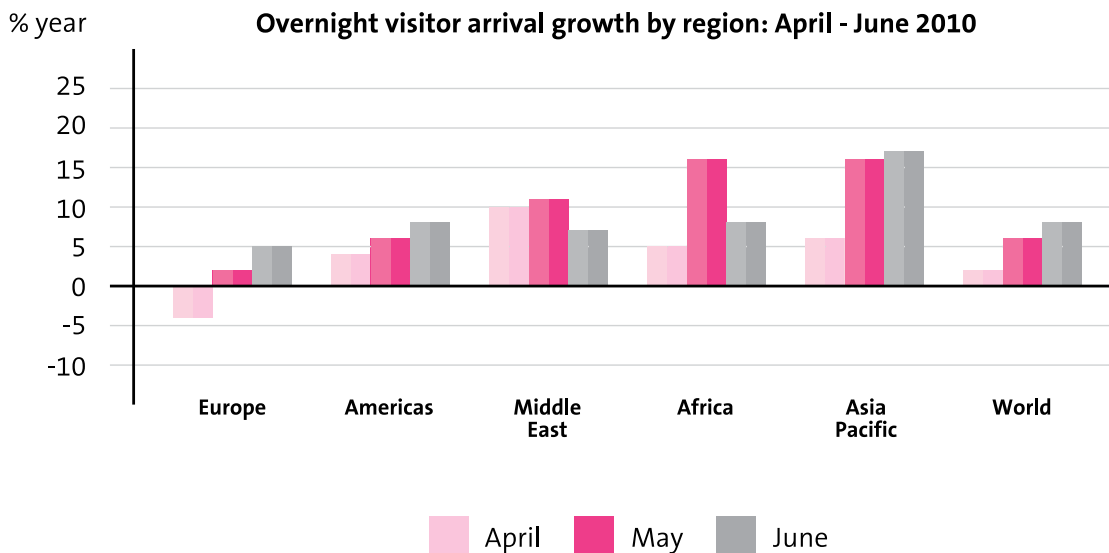
Global arrivals fell by over 4% in the 2008-09 recession

European growth has been slower than the global average

A slow recovery poses challenges



Recent months have seen a return to visitor arrivals growth in all regions, however, European visitor arrivals growth has been slower than the global average.



It is likely that the phasing out of stimulus measures in Western economies may constrain demand during the remainder of 2010.

The relationship between GDP growth and travel demand has historically been a robust one. Accordingly, despite a strong start to the year, instability in the Eurozone, a sluggish recovery in the US and lingering doubts about China's ability to sustain its current pace of growth, all point to the need for caution for the remainder of 2010 and into 2011.

Will the recession have lasting impacts?

Typically travel demand tends to have an income elasticity above 1.0 (Oxford Economics 2009b). This means that travel growth tends to be faster than GDP growth – but correspondingly drops by more than falls in GDP during recessions. Euromonitor International (2009) points to this effect by noting that global international arrivals generally exceeded global GDP growth of around 4% p.a. between 2004-2007 (inclusive). Conversely, recessions may be especially pronounced in some sections of the travel industry.

In general, the recovery from the recession of 2008-09 is likely to be lengthy and halting (Economist 2009a). This means that consumer demand for leisure travel may take some time to re-establish itself.

Nonetheless, the current recession should not obscure long term trends. Current expectations are that consumers will resume their previous travel spending as the upturn takes hold – i.e. there will be no major long term shift to lower cost leisure travel as a result of the recent recession (Oxford Economics 2009b). What is of more specific concern to airlines and agents is how to tap into passenger needs so as to ensure revenue growth in the future.



Airlines are recovering but profitability is still an issue

3.2 Trends within the aviation industry

The 2008-09 recession: a hammer blow but not a death blow

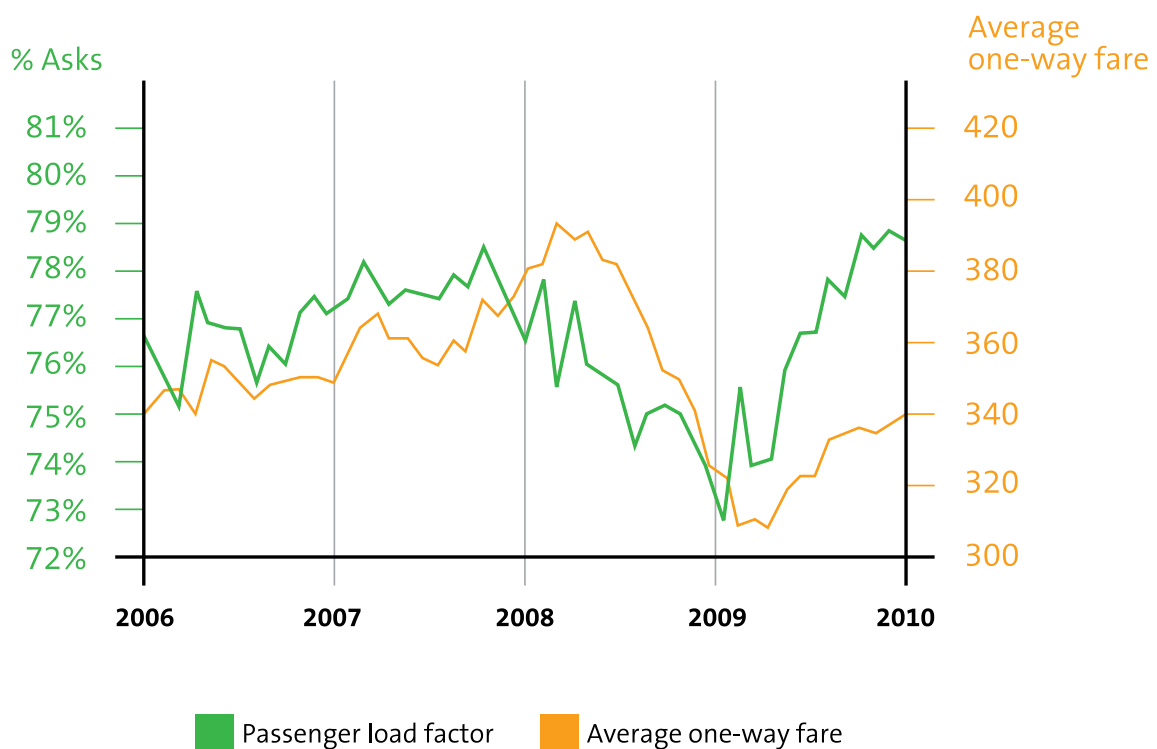
After an estimated \$9.9 billion loss in 2009, IATA figures released in June 2010 suggest that the global aviation industry will return \$2.5 billion in net profits during 2010. Pre-recession levels of passenger traffic were already regained by May 2010. However, even this profitability figure represents a net profit margin of only 0.5%. IATA estimates a return on capital of 2.8% for 2010 – half that of peak levels and well below the cost of capital (IATA Financial Forecast June 2010).

Further, these overall profit figures obscure the fact that losses in Europe are expected to be some \$2.8 billion in 2010, with better results in North America, Latin America and Asia serving to offset this and produce a net profit result.

This low profitability implies that, in the longer term, there is likely to be downsizing within the industry, reducing capacity and pushing up prices, until profitability is restored. IATA data suggests that there are already signs of this with passenger load factors reaching 79% in early 2010 - slightly above pre-financial crisis levels.

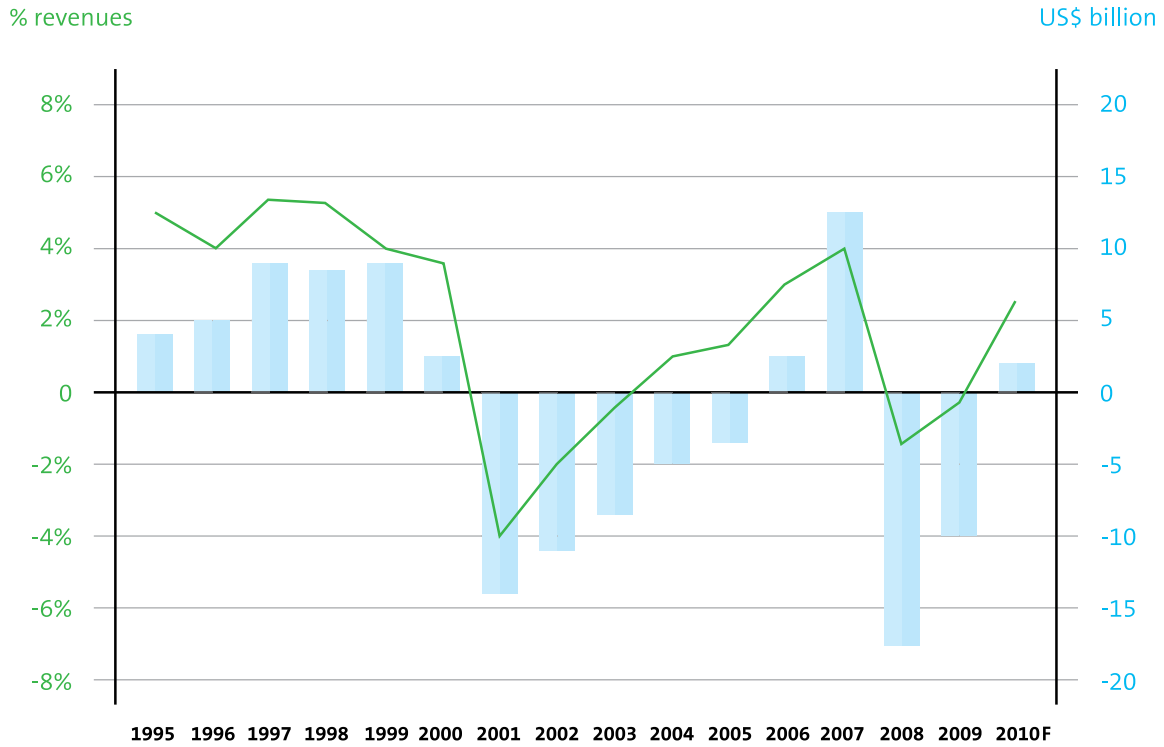
If returns on investment continue to be below the cost of capital, those companies making losses will eventually exit the market. In Europe, this capacity cutback by network airlines may provide more opportunities for Low Cost Carriers (LCCs) who have generally reported higher levels of profitability.

Load factors and fares



Source: IATA

Global commercial airline profitability: 1995 - 2010



Source: IATA

■ EBIT margin (left scale) ■ Net losses (right scale)

International air passenger growth and revenue per passenger kilometre (RPK) data provides support to the argument that the fundamentals behind air travel have not changed significantly. They suggest that swings in GDP drive much of the airline industry's performance. By this logic there is no reason to think that the recent recession has had permanent effects on air travel. However, low profit margins, an inability to recoup the cost of capital and repeated airline failures all raise long term questions around industry performance and revenue generation capacity. The industry's fortunes may well rest on whether it can find new (and/or more reliable) sources of revenue in the future and how it adapts to potential changes in tastes and travel patterns.

These questions, along with broader issues in the global travel market and in the nature and composition of air travel, are vital issues to consider.



3.3 Trends within the travel agency segment

Agents have been affected by the recent recession in much the same way as the global travel industry – as indicated by the decline in global arrivals during 2009, discussed above. In addition, there are also longer term questions about their future. Concerns about the role of face to face (F2F) agents, in particular, have been rising for many years, especially given the growth of the internet as an alternative source of travel bookings¹.

For example, by 2008, 41% of Europeans booked holiday travel online compared to 32% in 2006. In terms of overall European travel, 39% of outbound trips were booked using the internet versus 24% using F2F agents (ITB 2009). Fast Future reports that 64% of people believe it is very likely that they will be booking the bulk of their travel online by 2015 (Fast Future 2009).

Against this, a number of analysts have argued that agents will continue to play an important role in the future. Apart from the fact that the internet simply provides another business portal for many agents (particularly larger ones), F2F agents may be advantaged by factors such as professionalism, trust, bespoke advice and the need to deal with complex and demanding travel arrangements in the context of consumer time poverty.

¹This report refers to travel agents as a whole and F2F agents as that component of the industry representing actual face to face contact. Naturally, many travel agents (particularly major ones) offer both F2F and online services, whilst some agents are purely online and others are essentially pure F2F. Key issues however are whether the role of agents as a whole is changing regardless of the medium of contact, whether F2F will now disappear or whether it has a role in the future.



3.4 Macroeconomic forecasts for future travel

The discussion above has focused on the immediate recovery from recession and some of the trends which emerged in the period preceding it. However, it is also instructive to look forward. Oxford Economics (OE) undertakes regular forecasts of travel and tourism activity on behalf of the World Travel & Tourism Council (WTTC) and are calibrated using data and forecasts from OE's global macroeconomic model on a group of core variables, including income growth and demographic changes.

The figures below compare estimated foreign visitor arrivals and resident departures in 2010 with forecasted arrivals in 2020 for major global travel markets, disaggregated by geographical region. (Note that China and India are a subset of Asia Pacific in these tables.) In terms of visitor arrivals, average 10 year growth rates range from 3.3% per annum (Europe) to 5.8% per annum (Asia Pacific) with China in isolation accounting for 6.7%. The most significant trend is obviously a shift in arrivals to the Asia-Pacific region which will account for nearly 22% of arrivals by 2020.

Inbound visitor traffic: 2010 and 2020

Foreign Visitor Arrivals (mns)					
	2010 Estimate	2020 Forecast	10 year growth rate (%pa)	Global share in 2010 (%)	Global share in 2020 (%)
Europe	996	1383	3.3	59.5	55.9
N. America	172	258	4.1	10.3	10.4
L. America	36	56	4.5	2.2	2.3
Asia Pacific*	306	535	5.8	18.3	21.7
Middle East	57	86	4.2	3.4	3.5
China	133	255	6.7	7.9	10.3
India	5	11	7.8	0.3	0.4

*Including China and India

Source: Oxford Economics

By 2020 the Asia-Pacific region will account for 22% of global arrivals

Outbound visitor traffic

Resident Trips Abroad (mns)					
	2010 Estimate	2020 Forecast	10 year growth rate (%pa)	Global share in 2010 (%)	Global share in 2020 (%)
Europe	571	855	4.1	54.2	51.5
N. America	101	149	4.0	9.6	9.0
L. America	27	43	4.7	2.6	2.6
Asia Pacific*	250	447	6.0	23.7	27.0
Middle East	62	102	5.1	5.9	6.1
China	49	95	6.9	4.6	5.7
India	10	17	5.6	0.9	1.0

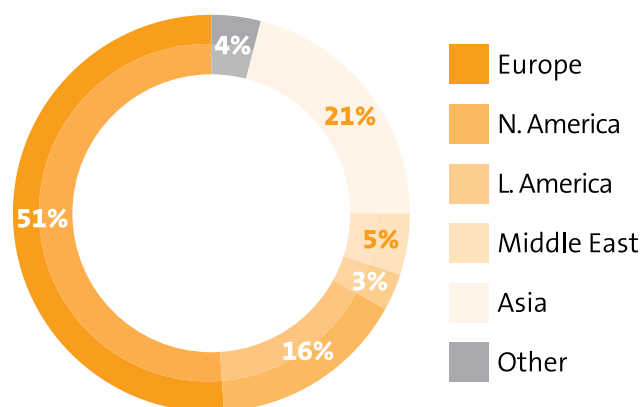
*Including China and India

Source: Oxford Economics

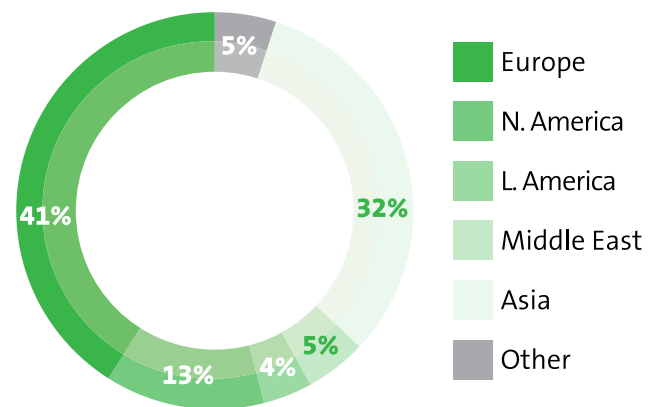
In the case of both foreign visitor arrivals and resident trips abroad, the fall in Europe's share of the global totals by 2020 is effectively counterbalanced by the increase in the Asia-Pacific share. Similar trends appear in spending patterns. The charts below indicate the trends in outward bound spending by region in 2008 and 2020 (i.e. travel spending by residents of given geographical regions). Spending by Asia-Pacific residents is forecast to account for 32% of the total in 2020 – much larger than the 2008 level of 21%.

The increasing importance of Asia-Pacific raises questions about how travellers from these emerging markets might travel. Will they travel within their region or to the more traditional markets of Europe and North America? Will their travel habits be similar to travellers from Western countries or distinctly different? What can travel providers and sellers do to adapt to meet the opportunities and challenges associated with these global trends?

Outbound spending by region: 2008



Outbound spending by region: 2020



Source: Oxford Economics

4 Changes in revenue drivers



Key points

Ancillary services

- Ancillary revenue generation has spread from LCCs to major carriers and become an increasingly important source of revenue.
- Unbundling fares can result in win-win situations (e.g. passengers willing to pay for improved food/seating/privileges) and identifying these is key to maximising the potential of ancillary services.
- Though there are concerns that some ancillary revenue generation would displace agents (e.g. car and hotel bookings), it is more likely that the relationship will be one of co-operation. Agents themselves are exploring ancillary revenue sources such as advertising.
- Considerable uncertainty exists about how relevant ancillary revenues will be in the long term, especially to major carriers.

Extending across the complete traveller experience

- Airlines may adopt a more comprehensive (or generic) approach to travel and integrate activities more closely with the rest of the travel value chain. There may be potential to derive yield from alliances with high speed rail providers, from customers who are willing to pay for seamless travel and by taking closer account of customer preferences beyond the airline trip itself.
- However, there is also some scepticism about the potential for such opportunities. Emerging market carriers may be more active in these areas than established carriers.
- Incorporating the potential of new technologies (such as smartphones) to the in-flight experience offers another source of revenue and a win-win situation, where customer preferences for food, ground transport and accommodation could be met in a much more efficient manner.
- The traditional cabin classes may start to break down as electronic transmission of preferences allows for the formation of “virtual cabins” along with increased differentiation of physical ones.
- Agents may likewise evolve to provide more services across the entire travel experience, where currently traveller needs are not well catered for. Agents may be able to play to their strengths of being there for customers in confusing, unpleasant or uncertain situations such as the recent disruption caused by the Icelandic volcano eruption.
- Agents to focus on industry niches and expert advice in the future. Their customer offer will focus on ensuring that their clients are assisted across the entirety of the travel experience.

Ancillary revenue and value chain management are areas of opportunity.



Virtual
cabins

High speed
communications

Lifestyle
Agents

4.1 Generating future revenues

As it emerges from recession the global travel industry will face a variety of challenges. Chief among these will be the need to ensure that revenues provide for a sustainable industry. As noted, airline profitability and return on capital remain poor, while agents face an array of challenges.

In many industries, a solution to some of the issues facing the airline industry, in particular, could be a series of mergers and a reduction of capacity aimed at increasing prices and yields. However, a combination of a mismatch between long lead times for vehicle development and fluctuating market conditions, regulatory constraints and national political issues (which generally act to preserve national carriers at the least) are likely to constrain such solutions. LCCs may be able to avoid some of the market pressures facing national carriers but may face constraints of their own in terms of future growth opportunities.

A number of responses to current market pressures are possible. In particular:

- **Ancillary revenue generation** – This may involve a mixture of fees and charges for services and/or service improvements beyond the base fare. This also can include revenues from third party partners such as hotels, travel insurance and car hire.
- **Better management of the complete traveller experience and the exploration of new opportunities within it** – Both airlines and agents could focus on demand for their underlying product – e.g. transport/communications or personal services and add value through developing total travel solutions.

Ancillary revenue approaches may blur cabin classes...

4.2 Ancillary revenues – a silver bullet or fool’s gold?

Are ancillary revenues the answer?

Although once exclusively the preserve of LCCs, ancillary revenue is now a major issue for all carriers: traditional, hybrid and low cost. In terms of ancillary services, this refers to:

À la carte Ancillary Services, products and services which were previously included in the ticket price such as checked baggage/ sports equipment, seat assignment, priority boarding, in-flight meals, snacks, beverages and pillows. This also covers totally new added value services such as “elite security” lanes or guaranteed exit row seats.

Cross-sell Ancillary Services which are commission-based additional services provided by a third party supplier which a travel provider, such as an airline, sells to its customers and includes items such as travel insurance policies, car hire and hotel rooms. Cross-sell Ancillary Services can be offered by various providers including airlines, hotels and cruise companies, they can also be sold by intermediaries like travel agents.

According to IdeaWorks, worldwide airline ancillary revenues were some €11 billion in 2009 – up from only €1.7 billion in 2006. 72% of airlines worldwide derive ancillary revenue from hotel and rental car bookings.

The table below indicates the top airlines for ancillary revenue – in terms of both total revenues and as a percentage of total revenue. Although LCCs dominate in terms of the latter measure (as would be expected) more traditional full service carriers actually constitute the largest generators of ancillary revenue in absolute terms.

Ancillary revenues: 2009

Airline	Ancillary Revenue 2009 (€)
United	€1,527,310,000
American	€1,507,750,000
Delta	€1,117,120,500
Qantas	€782,903,000
Ryanair	€663,600,000
easyJet	€608,796,693
US Airways	€540,589,500
Air Canada	€534,143,000
Alaska Airlines	€368,869,000
TAM Airlines	€356,742,400

Airline	Ancillary Revenue as % of total revenue 2009
Allegiant	29.2%
Spirit	23.9%
Ryanair	22.2%
easyJet	19.4%
Tiger Airways	19.4%
Jet2.com	18.1%
Aer Lingus	14.4%
Alaska Airlines	13.3%
Flybe	13.2%
AirAsia	13.1%

Source: IdeaWorks

...however it can also act to sharpen existing distinctions.

It is clear that there is room for further growth in ancillary revenues, the question is how much. It has been suggested that airlines could make an average of at least an extra \$6 per passenger (or \$12 billion globally) by fully exploiting ancillary revenues. Given that average short-haul revenues are around \$60 per passenger, this is equivalent to a 10% increase in revenue for these carriers if these figures apply to short-haul routes. Separate estimates by the Ancillary Revenues Airline Conference 2009 forecast that ancillary revenues are likely to account for 35% of airline revenues in the future.

Further opportunities also lie in doing more to provide third party ancillary services such as hotel, travel insurance and car hire. LCC websites report a conversion rate between 0.5% and 3% among passengers seeking hotels, travel insurance and car hire, which falls below the success rates achieved by industries such as banking.

A particularly interesting development is that a focus on ancillary revenue may also see the blurring of (often sharp) distinctions between economy and business class in particular. The introduction of elements of business class service to economy class passengers may offer a (partial) remedy to the airlines dilemma of how to regain some of their recent losses in business travel revenues (see Chapter 4). The development of “premium economy” (or similar) classes is the most obvious example of this. However, the introduction of other elements of business class travel into economy cabins e.g. improved food choices, day passes to airport lounge are others.

The design of the aircraft is also beginning to be altered to accommodate these trends. For example, the Boeing 787 Dreamliner has made its cabins more flexible so that airlines can reconfigure their cabins beyond the traditional ‘economy’, ‘business’ and ‘first’ classes.

Another aspect (and one which might be seen as acting in the opposite direction to class blurring) is that “pure premium” (i.e. business/first) customers are often shielded from additional fees such as baggage check-in fees. Recent research in behavioural economics has stressed the fact that people are likely to perceive value in relative rather than absolute terms. Accordingly, imposing fees on other

Ancillary revenue can damage brand equity if not correctly applied

passengers while maintaining the quality of the premium experience may actually add to the perceived value of the core business/first product (to both business/first and economy travellers alike – although some industry experts have suggested that this might produce both loyalty and dissatisfaction (among those who do not enjoy such benefits).

In reality, what is likely is that traditional airline class structures will break down and there will be a multiplicity of travel classes in the future.

Ancillary revenue is here to stay. It holds the attraction of offering lower base fares, whereas only a few airlines derive their market share from emphasising superior quality.

Jay Sorensen, IdeaWorks

IdeaWork’s Jay Sorensen likewise pointed to set choices premium meals and early boarding (a proxy for – increasingly scarce - overhead bin space²) as areas which LCCs, in particular, might focus on. Likewise, he pointed to the fact that LCCs may sell yearly passes which entitle customers to such benefits.

This is because only a few airlines compete on service quality. Most compete on price – and ancillary revenue allows airlines to offer better prices to customers by lowering their base fares. In addition, by unbundling prices, ancillary revenue allows airlines to better cater for different demographics, with older customers paying more for quality while younger ones, more used to self-service culture go for no frills options.

²Overhead bin space has become more of an issue in recent times precisely because more airlines are trying to charge for checked-in baggage

Airlines may look to agents to help with ancillary revenue generation

Limits of ancillary revenue generation

However, some doubt that ancillary revenues will ultimately prove to be as significant as its proponents claim. Some experts interviewed suggest that there are limits to ancillary revenue generation for long-haul flights (though there are clear opportunities for short haul ones) and that airlines, in general, are more likely to simply rely on traditional price competition. There are also clear dangers in over-reliance on ancillary revenue generation.

The most obvious is that passengers may switch airlines in response to the introduction of costs such as baggage check-in fees. However, the introduction of fees for the check-in of single bags (first used on US domestic routes in 2008) has now become commonplace for major carriers such as American Airlines, United and Delta.

Nonetheless, some interviewees suggest that the ancillary revenue customer value proposition is doubtful in some cases and such policies may appear openly opportunistic in others. In the opinion of these analysts, US carriers charging customers for second (or first) bags without decreasing base fares may work in the short term but it may not be a long term solution, as passenger demand tends to be responsive (elastic) in the face of such developments.

It is clear that airlines themselves are unsure of what the customer price points are and how far the ancillary revenues phenomenon can be pushed. Some interviewees point out that these uncertainties relate to the fact that airlines are used to selling tickets rather than retail services.

In general, more sceptical interviewees viewed traditional factors such as labour costs and fuel as key determining factors for airline profitability rather than ancillary revenues. Attempts to minimise the volatility of such factors, along with cyclical economic recovery, may yield greater returns to airlines in the long run than ambitious ancillary revenue programmes.

The imposition of new fees has also raised issues about long term brand equity in some cases. For example, allowing more (fee paying) passengers into airport lounges may dilute their exclusivity. In other cases, airlines may be unable to deliver on their fees (e.g. being unable to accommodate priority boarding because of infrastructure constraints). Some airlines have pre-empted these or similar concerns. For example, Hawaiian Airlines has made a conscious decision to keep basic meals free, seeing the airline as an

extension of the Hawaii brand (i.e. welcoming and relaxing). Regulatory concerns are another issue. Unbundling could reach the point that travellers face untenable fees and cannot actually fly for the advertised fare, prompting the introduction of regulation in regions such as the EU. Airlines such as Flybe have also indicated that if ancillary revenues reached 50% of total revenue, regulators would be likely to step in and protect customers. This could even prompt overregulation.

At the same time, others point to the fact that LCCs, such as Ryanair, are starting to face the limits of their own ancillary revenue policies. There has been a discernable reduction in checked-in bags for Ryanair flights for example – which has limited this as a revenue source. With ancillary revenues already generating around 20% of total revenues for many LCCs, it is more likely that they will engage in price wars to promote substitution between carriers than attempt further ancillary revenue campaigns. It is likely that ancillary services may be something of a balancing act for airlines. Ancillary services that offer win-win situations (such as improved food and seat arrangements) may indeed prove important to many airlines and would appear to complement extensions along the full customer experience.

However, there is more doubt about the long term significance of ancillary services which seem opportunistic and do not appear to enhance a carrier's value proposition. In addition, there are clear limits to the future expansion of ancillary services.



Agents can also generate ancillary revenues

Do ancillary revenues blur airline/agent boundaries?

The issues noted above raise the question of the extent to which airlines are the new agents in terms of organising hotel, car and other ground service bookings. A separate issue is the extent to which agents are looking to diversify their revenue streams.

Some interviewees have pointed to the possibility that airline websites may simply become the preferred way in which travel services for hotels, cars and even other airlines are booked.

However, it is unlikely that airlines will come to usurp the role of agents or become the primary focus of bookings for hotels and car rentals. In some cases, ancillary revenue generation by airlines has also offered spin-off benefits to travel affiliates and agents. Two large generators (in absolute terms) of ancillary revenues – Delta and Qantas – sell through travel affiliates and share some of the revenue generated by ancillary revenues with those affiliates (Travel Dividends 11/9/09).

Another potential gain is that agents may be able to generate ancillary revenues for services unrelated to airlines as a part of an integrated choice package. For example, a fully integrated system might offer a menu of ancillary revenue choices to the customer, some of which relate to airline travel and some of which relate to ground services provided through the agent.

These considerations relate to the benefits which ancillary revenue generation might offer to agents themselves.

There are already indications of how a drive to ancillary revenue generation is providing agents with income support. For example, Expedia indicated that in 2008 less than 15% of its revenue came from the sale of airline tickets. However, during the first quarter of 2009, advertising and media revenue accounted for some 11% of Expedia's worldwide revenue. In other words, Expedia appears to be making nearly as much from advertising and media as it does from airline ticket sales. This provides a clue as to one source of agent revenues in the future.



Airlines could view their business holistically – and tap into the total value chain

4.3 New models, new opportunities as foes become friends

Generic products – what do airlines and agents actually sell?

One possible future approach to the revenue challenges facing both airlines and agents is a renewed focus on generic product demand. This involves recognising their respective products in broader terms. For example, for airlines it may mean seeing their product offering as a high speed transport and communications product. Agents may see their offering in the context of providing services within a broader lifestyle industry – which could also involve tie-ins with day-to-day domestic activities³. In other words, airlines and agents could think of their businesses holistically, as they relate to the whole of the travel value chain, and focus on providing a total travel experience.

Many industries have benefited from a generic product approach in the past, although the ideas involved did not seem intuitive at first. For example, the film industry originally made profits from the exhibition of films in cinemas. Competing mediums such as television, VCRs, DVDs and the internet were seen as threats at various times. However, ultimately the film industry was able to benefit from each of these mediums – foes in effect became friends.

Likewise, mobile phones have now developed into mobile multimedia platforms, offering a wide variety of services beyond pure voice communication. The generic demand was for mobile information exchange and communication – with voice merely being a historical format for communicating.

Airlines

Airlines as high speed transport and communications brands

In theory, a generic demand approach might be employed by airlines in the future in order to maintain existing revenue sources and/or tap into new ones. From a generic viewpoint, airlines could be seen as tapping into a consumer demand for high speed transport and communications. At present these take place via air transport, however, in theory, there is nothing to prevent airlines providing a high speed transport service to customers through other transport modes or from investing in alternative forms of high value communication (e.g. videoconferencing for business people). Alternatively, airlines could simply see themselves as offering a holiday or (business) experience to their customers and

seek to maximise their returns on that business rather than seeing boarding and disembarkation from planes as the cut-off point. That is, they could think of their business holistically.

An area where this has already happened to some extent is in high speed rail transport. High speed rail is already well established within Europe and Japan and is set to continue across most global regions following European deregulation and investments in Asia-Pacific, the Americas and the Middle East. At first glance high speed rail services appear to pose a threat to airlines, especially on short haul routes – and indeed a larger percentage of travel between centres such as Paris and London is now by rail.

However, airlines have already acted to obtain a stake in these services. For example, BA has long held an effective stake in Eurostar. More recently, Air France has explored the possibility of running a rival service to Eurostar, possibly in connection with Deutsche Bahn, from 2012. Air France halted flights from Paris to Brussels some years ago. Instead passengers were provided with a seat on the high speed Thalys service and even given an IATA code⁴.



³It is acknowledged there is some overlap between these considerations of generic demand and those of ancillary revenues – discussed above. For example, booking hotels via airlines is noted as an example of ancillary revenue generation in Section 4.2 above. The focus of this Section however is on the prospects for more direct involvement by airlines and agents within the entire travel experience value chain, and considering their place within it, within a broader context. Active expansion along the value chain implies a more holistic viewpoint about the business than many of the more limited ancillary revenue initiatives which identify air travel as the essential product provided by airlines.

Integration with high speed rail could address a generic need but revenue impacts are unclear.

While the precise revenue impacts of these arrangements are not known in all cases, these measures appear to reflect a recognition of the potential blurring between high speed air and ground transport. They also allow airlines to avoid potentially destructive competition and tap into a growing market by working in synergy with high speed rail, to address an underlying demand for high speed travel⁵. The future may therefore see airlines (particularly traditional full service carriers) focusing on major long haul routes to hubs in densely populated areas in Europe, Asia and North America, with shorter haul routes covered through high speed rail.

However, caution needs to be exercised as integration with high speed rail services may only deliver modest revenue impacts to airlines. This is due to the inherent geographical limits of the market (high density population corridors in Europe, North America and parts of Asia) and the fact that high speed rail competition/co-operation is mainly relevant to short haul flights of less than 500 kilometres.

Airlines to own the end-to-end experience

Ground transfers to and from airports could be greatly improved for the traveller – something for which many would be willing to pay.

James Woudhuysen,
Professor of Forecasting and Innovation

⁴An even more extensive airline involvement was proposed for Australia's Speedrail service between Sydney and Canberra (a distance of some 300 kilometres) a decade ago. This saw Qantas as an active project stakeholder and would have seen the airline responsible for ticketing, marketing, business/first rail lounges, an integrated Frequent Flyer scheme and onboard passenger service. While the project never came to fruition, the implications are clear.

Seamless travel and integration with e-providers are revenue opportunities.

However, amongst the interviewees a fledgling consensus emerged on the need for airlines to be more actively involved in end-to-end transport. The fact that the travel experience is far from seamless was seen as a key issue here. Travelling to unfamiliar airports and destinations can be tiring and confusing for many passengers, particularly older ones, while even travel through familiar ones may still be disjointed and unpleasant, given the complexities of securities and transfers. From this viewpoint, airlines should be travel facilitators for these customers willing to pay for seamless travel – perhaps arranging a passenger pickup service, improving airport signage or offering virtual guides and baggage handling, providing quick branded transport services for passengers to hotels, and perhaps offering assistance services at selected hotels⁶. Some see easing transfers and the overall airport interface as an important revenue opportunity for airlines in particular, given customer willingness to pay to avoid its unpleasant nature.

In emerging markets, with many new flyers, airlines can gain an important advantage by offering broader travel solutions and providing integrated approaches to travel.

Renato Ramos Ramos, TAM Airlines

⁵A different example of synergies between old rivals is the relationship between the airlines themselves and sea travel. Whereas the two competed for passengers decades ago, airlines are now vital to acting as feeders for the fast-developing cruise ship market. The resulting traffic has been in the interests of both.

⁶An additional issue is whether such services will be in house or outsourced. Providing seamless service does not necessarily mean that the employees involved would belong to the airline itself and even services bearing a company livery could be operated by another entity. This will ultimately depend on the most profitable way of providing the service – the key issue is an interest in providing the service in the first instance.

Understanding traveller motivations and preferences may help unlock new sources of revenue

Likewise, some interviewees emphasised that such seamless travel experiences should be a focus for airlines in flights to emerging markets, where Western customers were less familiar with the end destination, or for travellers from emerging markets travelling to developed markets. This would help provide the total travel experience to leisure travellers, while allowing business people to maximise the amount of time spent on business, build brand loyalty in both these segments.

Airlines to build customer technology into their planes

Several interviewees made the point that new technologies could be married to the in-flight experience as a source of new revenue. This would be more than just another form of ancillary revenue generation however, as the merging of in-flight experiences and technologies would require active co-operation and infrastructure development between interested parties. For example, a North American carrier made the point that partnerships could be established with technology providers such as Apple and/or ISPs.

Others suggested that mobile smartphones with stored passenger preferences could be integrated into airline infrastructure - e.g. slotted into armrests. This would allow airlines to instantly identify traveller preferences by accessing the information travellers want to provide to improve their experience. At least one major western airline also saw this as a clear future possibility. Others made the point that more could already be done to sell to customers through existing entertainment systems, given many airlines already had access to customer credit card details.

The death of the traditional cabin class and the birth of the personal cabin

Such interfaces would allow airlines to quickly and easily understand passenger requirements – both for the flight and beyond (e.g. fare details, food and entertainment preferences, ground transport and accommodation details – or potential needs). It could also speed the blurring of airline classes referred to above – as passenger preferences of meals/entertainment/internet access etc. could be easily accommodated. Potentially, then, there could be a large number of cabin sub-categories. Some of these may be physical (e.g. first class cabins just for sleepers) however, there may also be increasing electronic segmentation of passenger classes as these preferences are catered for.

This raises the possibility that the future may see a breakdown of the traditional cabin class system and the formation of “virtual

classes”. For example, some passengers in today’s economy would have access to a wide variety of (paid) electronic services such as Wi-Fi, gaming and entertainment. Others might prefer quiet or distraction free zones. The integration of these different sub-classes with other specialised paying services (such as improved meal services or preferred seating arrangements) could result in further effective fragmentation.

This trend, combined with increased physical separation which caters for specific passenger preferences such as family travel and lone travel, would result in still further fragmentation. One interviewee suggested that there may be as many as 20 effective cabin classes on some flights in the future.

Such initiatives would help airlines maximise total revenues per passenger. Expanding along the value chain, like some ancillary revenue initiatives, could therefore lead to considerable changes to the in-flight experience itself as well as providing a win-win scenario by allowing airlines to more effectively cater to passenger needs and increasing overall revenue yield per passenger. Whether or not a customer focus was in mind, some interviewees point out that airlines such as British Airways and Lufthansa have also moved into expanding along the value chain through ownership of airline terminals – such as Terminal 5 at Heathrow, while some Middle Eastern airlines also own the entire airport. Airports, with their lucrative shopping trade, have obvious potential to be an important revenue stream for airlines.



Do or die: is sticking to the core business of flying the future?

Conversely, analysts such as IdeaWorks' Jay Sorensen believe that airlines are more comfortable sticking to their perceived core business – of running an airline. He notes that while small carriers such as Air Baltic own taxis and hotels in Riga, larger ones such as United and SAS who have dabbled in car rental and hotel ownership have gone back to their roots and focused on running their core business. Sorensen makes the point that customers and investors also appear to prefer seeing airlines stick to the business of flying.

Likewise, interviews with a major European carrier indicated considerable scepticism about attempts to expand into areas such as hotel management, given the unfavourable past history of such efforts. Flying was seen as a highly specific business – limiting the potential to expand into other areas.

It's not about direct ownership: it's the customer experience that matters

However, it is likely that expansion across the value chain does not necessarily imply direct ownership. As noted above, and emphasised by some interviewees, a key issue is whether airlines should put more energy in attempting to understand the whole trip experience and work in partnership with hotels, ground transport providers and others in providing tailored solutions to travellers.

Some interviewees also pointed to the significance of the whole trip experience and seamless travel closer to home. From this viewpoint, airlines should be focusing on the whole trip – and what motivates people to travel – rather than simply addressing the airline travel segment alone.

If this viewpoint is adopted, the implications could be significant. For example, London's Heathrow airport is favoured by many airlines for operational reasons but disliked by many passengers due to its congested and antiquated nature. Using a total travel solutions perspective, a key question for airlines might be whether they could actually attract more customers (and perhaps obtain higher long term profits) by not flying into Heathrow. While such questions are not often asked, a change of focus to think about the entire traveller experience and opportunities of deriving value from it means that they should be seriously considered⁷.

Airlines in emerging markets may be more favourable towards seamless travel solutions for their own reasons. One such provider

interviewed for this study was attempting to encourage market growth amongst people who had never flown before but were now becoming able to do so. This involved setting up a partnership with the local bus company to act as a feeder bringing people in from the countryside. While there was no intention to directly run bus operations, the view of the airline was that they should be a travel solutions company and provide a total travel experience tailored to customers' travel needs.

In other words, the local conditions faced by airlines in emerging markets may give them a different perspective to that of traditional Western carriers when considering extensions along the full range of traveller needs.

As is true of ancillary revenues, it is likely that the future trends will in fact reflect a mix of both of these viewpoints.

There would appear to be a distinction between the caution of Western carriers in extending across (traditional) different aspects of the traveller experience and the bolder attitude taken by carriers in emerging markets. What is likely across the world, however, is that airlines will seek a way to integrate their activities more closely with the rest of the travel value chain.

⁷Of course a compromise alternative might be to provide (accordingly priced) special assistance for specified passengers at airports like Heathrow to make the experience more pleasant and closer to a seamless experience. However the point is that the issue is not often thought of in terms of overall passenger satisfaction – and potential revenue gains from this – but on narrower, shorter term considerations.



Agents could also benefit from integration with mobile technologies.

Agents

Face-to-face agents will prove their utility into the future by acting as ‘experience centres’ and supporting the development of adventure travel and the ‘silver’ traveller.

Rohit Talwar, Fast Future

Agents become lifestyle managers or business facilitators

Agents may face more challenges than airlines in exploiting a generic demand for their services. Nonetheless, as indicated, a key issue is likely to be the repositioning of F2F agents to emphasise the ability to provide services to customers. One possibility is that agents may become “lifestyle managers”, providing higher-margin, tailored services to consumers (e.g. health and fitness or less regular experiences) in their home countries and abroad.

Agents are moving beyond their traditional role as ‘airline distributors’ and will increasingly focus on providing the best communications solution to business clients - whether it involves travel or not.

Christophe Renard, Carlson Wagonlit Travel



F2F agents' experience and personalised service give them key advantages.

While airlines may be more sceptical of extensions across the value chain – such as involvement in videoconferencing - agents may be more receptive. An interview with a major business travel company indicated a move beyond the traditional areas of expertise and viewing teleconferencing as simply another way of facilitating business meetings. From this perspective, selling a high quality videoconference would be simply providing the best solution to the customer. Likewise, interviewees pointed to selling videoconferencing rooms and facilities in hotels as an alternative, or supplement, to flying.

In other words, F2F agents' concept of their business may be evolving to become something like travel and communications facilitators. At the same time, some pointed to the fact that there were limits to how far agents could stray beyond travel, given that travel knowledge is a highly specialised field.

Fixing the 'ground' issue – delivering a seamless experience

Several interviewees also pointed to the fact that either airlines, agents or both could (or would) more fully exploit the concept of seamless travel on the ground through better integration with technology providers. Not only would more services be provided in the air but integration with applications such as smartphones would provide location specific, real time, interactive information on plane and local train/bus timetables, hotels and key sites of interest near a traveller's location. Location-specific software packages could be sold through, or developed by, agents, for a traveller's upcoming trip.

Development of these systems would recognise the disconnect between the fact that while some aspects of travel are becoming more easy and luxurious (e.g. resorts, major hotel facilities) moving to and from airports and around unfamiliar cities can be a time-consuming and stressful experience for many travellers and that many would be willing to pay to avoid. This issue has already been referred to in the case of airlines, but systems which can reduce the stress involved also offer a potential new

revenue stream for agents in particular. These may not only be digital but human as well (e.g. dedication of additional staff). Another suggested a "Trusted Traveller" service could be an important revenue stream.

Once again, addressing the disjointed nature of ground transfers/unfamiliar environments may have tremendous revenue potential for airlines and/or agents but this is an issue which has not been fully addressed by either to date.

Fundamentally, however, the issue of extension across the value chain ties in with that of the future role of agents. Agents' challenge in the future is to add value to their clients. It is likely that there will always be a group of people in society who want personalised advice. Therefore, while some interviewees noted that F2F agent numbers may only be one-third the number of those in 1995, they also suggest that this may represent some form of critical mass.

Agents as sages

These trends may also reflect the fact that booking online can present customers with a multiplicity of (confusing) choices and can on occasion be very time consuming. F2F agents therefore can save time and money for travellers as well as providing more specialised and expert advice for those willing to pay for it. Agents can also act as experience centres – providing customers with essential details and specialised information on destinations - saving them the time of doing it themselves. Some interviewees suggest that F2F agents who master these skills – and who realise that customers who have money are generally time-poor – will thrive into the future. This is especially the case given that many websites are poor at organising more complex itineraries beyond A to B.

Likewise, there is a feeling that agents will be there for you in the event of difficulties – as exemplified by the disruptions caused to European flights following the volcanic eruption in April 2010. In contrast, booking separate elements (such as cars/hotels) through an airline website may not offer the same level of customer support – the essential role as integrated administrator is missing.

All of these factors represent a form of value which people are willing to pay for. While all have been present to some degree in the past, these comparative advantages may be further emphasised as agents break away from their traditional role and the need for some form of personal support becomes more urgent. F2F agents who re-focus on these elements of comparative advantage – such as superior customer service and listening to what their customers are looking for - and who develop niche markets are likely to be the ones who prosper in the future.

Rather than moving into new areas of the value chain per se, it is probably more accurate to say that the future will see F2F agents re-focus on particular aspects of their business in which they can use their traditional advantages to their maximum effect.



5 Changes in tastes

Key points

- Demographic changes and health changes mean that the populations of Western countries are **living longer** but are also fitter for longer.
- These trends suggest that future years will see more travellers with more free time, who travel for **longer periods** and who are still able to incorporate a variety of travel experiences.
- Older consumers are likely to have **higher service expectations** and, in many cases, higher disposable incomes. This could provide an opportunity for both airlines and agents.
- Western consumers are straying away from destination based travel to **experience-based travel**. This also implies that airlines and agents who recognise this may be able to profit from it. It reinforces the need for a **comprehensive approach** to the travel value chain.
- The travel market is likely to become **increasingly fragmented** in the future providing opportunities for F2F agents who chose to specialise in particular geographies and/or segments.
- The fact that people may place a **premium on agent service** and advice in an age of anonymity and when new and unfamiliar destinations are increasingly available reinforces the need for agents to play to their traditional strengths while incorporating new technologies.
- There is little certainty among experts about where citizens from **emerging nations** may travel to or how their tastes may differ from Westerners. However, the formation of large **émigré communities** in Western markets suggests these might still be significant destinations.
- The recent recession sparked gloomy predictions about the future of **business travel**. However, it has rebounded strongly, though premium class yields are still 15% below pre-recession levels.
- **Videoconferencing** is likely to supplement rather than supplant business travel due to industry growth and the continuing advantages of F2F contact.
- Some form of **business class** is likely to survive but classes in general are likely to become increasingly fragmented
- **F2F agents** could benefit from business travel in the same way as for leisure travel – by emphasising **personalised service** and spreading across the complete traveller experience.

Airlines and agents should pay attention to meeting the potential offered by ageing in Western countries.

5.1 Leisure travellers

What broad trends are we likely to see?

Many observers have pointed to future developments such as the rise of the BRIC (Brazil, Russia, India and China) and other emerging economies, with travel traditionally being strongly correlated to GDP and the ageing of the population in Western countries.

Richer, older and going somewhere

Changing demographics can provide new opportunities to airlines who adapt to these developments.

Catherine Dyer, WestJet

Life expectancy is increasing and older people are fitter than in previous generations due to medical, diet and lifestyle changes.



Western travellers will seek out new and exotic experiences.

Despite recent moves to raise the retirement age in some Western countries, the implication of this is twofold: that there will be more people with more time to travel in the future and that these people will actually be fit enough to undertake a variety of travel activities (including more adventurous ones in some cases). Also, older passengers tend to have substantial disposable incomes, higher service expectations and (despite their increasing health) higher support requirements. Meeting the tastes and needs of this group could offer airlines (and for that matter agents) a significant potential revenue enhancements.

These considerations reinforce the fact that thinking about the total trip experience for different and emerging segments could be an increasingly important source of future revenues for both airlines and agents.

Older travellers seeking new destinations

High air capacity (resulting in relatively cheap prices) on some routes could be decisive in driving future tourism trends. Florida, for example, could become a substitute for some European destinations.

Chris Tarry, Founder, CTAIRA

There is a clear trend towards new and often more adventurous travel destinations as travel markets fragment (e.g. into adventure, cultural and traditional sub-sectors). Some interviewees identified trends such as European travellers increasingly journeying to Egypt, Turkey and beyond in preference to more traditional summer destinations such as Spain whilst some travellers are questioning the sustainability of newly created destinations such as Dubai.

Likewise, some interviewees suggested that Western markets would see a rise in the length of trips and/or trips further afield as older travellers tended to have more time on their hands. Since travel is often motivated by the need for inspiration, Western travellers in general may seek more distant locations rather than familiar ones in the future. This would again suggest European holidaymakers, for example, might increasingly travel to destinations further afield such as the Caribbean in the place of Spain or Italy.

Thrill seekers that want experiences not just visa stamps

The travel market is fragmenting. Activity-based travel (sailing, surfing, safaris and entertainment events) are sectors that have shown strong growth – and will continue to do so in the future.

Mike Beaumont, Thomas Cook

More generally there is a trend from destination based travel to experience based travel. It is no longer enough to simply go to, say, France or Kenya – consumers want to immerse themselves more fully in local cultures and experiences to have a truly satisfying travel experience. This re-emphasises the fact that airlines and agents will need to shift to thinking of air travel as more of an experience rather than as a functional A to B process. This is the route to substantial revenue opportunities by tapping into such shifting desires.

The dichotomy of comfort versus authenticity

Many people are starting to mix and match their travel choices – choosing to use low cost carriers but to stay in 5 star hotels upon arrival.

Paul Simmons, easyJet

While Westerners, in particular, are likely to want new experiences, it is also likely that there will be something of a trade-off with infrastructure provision. Countries with better levels of infrastructure may be more attractive to travellers who are increasingly tired of the complexities of travel, however countries with poorer infrastructure might offer a less crowded, more authentic experience. Ideally, airlines and agents who offer the optimal service package to their customers could benefit from this apparent trade-off (e.g. offering special assistance packages to travellers where infrastructure is poorer.).



The digital nomad

Making use of the opportunities offered by mobile and online usage will be key in airline and customer interactions in the future.

Marcus Casey, Lufthansa

The travel experience will become increasingly digitised. Those who have grown up with the internet are now travelling and their appetite for connecting with people and content at all times will be a major driver of changing tastes.

We are rapidly reaching a point in time whereby seamless travel is not only an opportunity but will indeed become an expectation. Such digitalisation again raises the question of how F2F agents can evolve.

All of these trends may themselves be affected by confounding factors such as new taxes and/or environmental concerns, though to date there is no substantial evidence that these will have major impacts on the growth of global travel (see box below).



Taxes and the environment: will consumer behaviour change?

Governments across the world are reviewing taxation policy in a bid to cope with large budget deficits. At the same time, there are growing concerns about the environmental impact of travel and of airline travel in particular.

Aviation is to be included in the EU Emission Trading System (EU ETS) as of 2012. The allocation of permits and/or individual actions by governments may force a rise in the cost of airline travel.

While airline leisure travel in particular is often quite responsive to price changes, this may vary significantly from route to route. It also needs to be remembered that while taxes may seem large in relation to some airline trips, they still only represent a part of the airline trip price.

Further, from the viewpoint of some transport economists, taxes are just another part of the generalised cost of travel. From this viewpoint, consumers look at the total price of a trip (airfare, other transport, food and accommodation)

when making their decision to travel or not. The tax component of the total holiday (or business trip) price may be relatively small when compared to other factors such as currency fluctuations, airline capacity (noted above) and/or accommodation or package deals.

This was reflected in the comments of a number of expert interviewees who suggested that, while unwelcome, higher taxes were unlikely to inhibit global travel in the future. Others said that in real terms airline travel is much cheaper today than in the past, and even substantial tax rises were unlikely to alter this.

Whether connected to tax rises or not, environmental concerns may be an issue in curbing travel demand. Some interviewees said that airlines would be forced to demonstrate their environmental credentials much more directly in the future. Given that a large amount of attention has focused on air travel, in some cases this may mean shifts of travel mode (e.g. to high speed rail) which may add to the case for airline involvement in this. Agents may be better placed than airlines to cope with this change given that they are not tied to one mode.

F2F agents will increasingly focus on niche markets.

Will F2F agents still be relevant?

While the above changes pose challenges and opportunities for both airlines and agents, an underlying issue is whether F2F agents will remain relevant in an era of changing consumer tastes and the rise of online booking and self-service.

Some interviewees argued that sources of value would increasingly be found online through pay-per-click or advertising-based models. Some 60% of travel sales are already managed online in some regions such as Scandinavia. From this point of view the future would see people paying for a service that accesses other people's research about a destination, making F2F contact less relevant.

However, prior to the rise of the internet, agents' effective monopoly over most travel information sources meant that customers were in some respects told what they wanted. The breaking of this 'information monopoly' would seem to have resulted in better informed - and more demanding - customers. Apart from simply shifting away from agents this means that service delivery expectations are likely to have risen over time for those who might consider F2F agents.

For agents, the future is likely to be about focussing on market niches and specialisation. The fragmentation of the market means that a very large number of niches could emerge. For example, at one level, segmentation could be an experience level adventure, cultural, or sun, sea and sand travel. In combination with (or separate from) this, segmentation may also be on a geographical basis - e.g. specialising in tourism in areas of Egypt or Brazil.

Easing the stress of airport environments and providing 'trusted traveller' services will provide opportunities for airlines and agents respectively.

Jim Mann, TUI Travel

F2F agents are advantaged by the thirst for new destinations.

Many interviewees pointed to the opportunity for agents to become the trusted brand, which has two implications:

- For Westerners whose travel choices are becoming increasingly fragmented and becoming more diverse it means that agents will remain an important resource, given that many are likely to head to less familiar destinations.
- For travellers from emerging markets, the unfamiliarity of the travel experience means agents will play a significant role in determining travel plans.

It is likely that successful agents will exploit their traditional role as information aggregators - saving time and money for their clients. However, this is dependent on their willingness to embrace and work with new technologies rather than against them.

What is clear is that the resurgence of F2F agents is not regressive. The 'new' agents will not be like F2F agents of the past. Instead, technology will be part of what fuels their relevance and makes them able to fulfil the needs of customers. Having access to better agent interfaces, greater content and information on travel options and the ability to interact with customers in new and different ways means that they will be able to provide a superior level of customer service not previously possible.

Another important issue relates to the opportunities agents might enjoy as a result of the development of emerging market economies.

There is uncertainty as to where emerging nation travellers will go.

Do emerging countries have different tastes?

India's growing middle class is travelling to more distant destinations, however as yet there is less desire for the adventure travel experiences as currently favoured by Westerners.

Manoj Chacko, Kingfisher Airlines

While the current travel market is geared to the habits of Western travellers, emerging markets and the rise of the BRIC economies are likely to overturn this model in the future.

The argument that emerging economies have different tastes to Westerners may be true in a literal sense. Some interviewees made the point that travellers from emerging markets such as India and China have a particular emphasis on their traditional foods rather than European ones. Likewise others noted that few Western hotel rooms are set up to meet the preferences of Asian travellers.

Apart from obvious implications for more authentic restaurants, this might mean that both airlines and agents which recognise this demand could also derive value by tapping into it (e.g. ensuring that such travellers are provided with information on the most appropriate hotels, where to get the best home country cuisine at their destination and/or taking care to arrange bookings at appropriate restaurants).

The macroeconomic forecasts discussed in Chapter 3 above give some broad outlines on the future composition of travel patterns. Nonetheless, there are differing opinions on precisely where future travellers from emerging markets will travel to – though this is obviously an issue with enormous revenue implications for airlines, agents and end destinations themselves. Some interviewees suggested that travellers from some markets such as India were not especially interested in travel to Western nations (such as the US). Instead they were more focused on cultural vacations and preferred local destinations such as Sri Lanka and south-east Asia. Likewise, a Latin American carrier suggested that in the coming

years most of their new flyers were likely to stay within the region to visit family and friends.

Others suggested that travellers from major markets such as China were more likely to be intrigued by the culture and traditions of destinations such as Europe. Some argued that those from emerging markets will prove to have similar destination tastes as Westerners or will quickly converge with the hotspot destination tastes of Westerners in the next decade, as they become more experienced travellers, particularly in the case of countries such as China.

Nonetheless, GDP growth is likely to remain the single best predictor of overall travel growth in emerging nations, a fact also suggested by the macroeconomic forecasts in Chapter 3.

Migration and the formation of émigré communities can be a big driver of subsequent travel.

John Kester, UNWTO

An important point, however, is that a globalised world will see more émigré communities emerge, even if these “émigrés” are only transient. This has obvious implications for travel both to and from the BRIC countries.

In the face of such uncertainties, airlines will tend to “hedge their bets”, with one major carrier stressing the need to balance targeting of emerging markets with ensuring that traditional routes are maintained.

However, a limitation for Western airlines is that those travellers from emerging economies may come to prefer local carriers, since these carriers may well be more attuned to their cultural needs.

Another obvious difference from Western nations is that the proportion of older consumers will remain lower in the emerging markets for some time to come. The trends in respect of ageing Westerners noted above may therefore be less apparent for travellers from emerging markets.

Face-to-face agents will remain important in emerging markets whilst internet penetration starts to rise and online shopping becomes more prevalent.

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Jose Rivera, Rumbo

The role of agents in emerging economies also poses some complexities. While internet usage is high in some major urban areas in emerging markets, some interviewees pointed out that penetration in many localities is low, as are connection speeds. Along with information infrastructure and system architecture issues, a relatively high level of credit card fraud in emerging economies (and/or some cultural aversion to credit card usage) may also have acted to inhibit the growth of web-based travel solutions.

In addition, those in emerging markets wishing to travel may face many of the same problems Westerners do when considering journeying to new destinations (i.e. lack of familiarity about their destinations and uncertainty over travel details). For these reasons it is likely that, while online bookings will ultimately be as significant as in Western countries, F2F agents in emerging markets will have an important role to play for many years to come.

These factors also have important revenue implications for Western-based agents, given the opportunities to either penetrate emerging markets directly and/or offer support services locally via means of alliances.



5.2 Business travellers

Will long term trends change business travel?

The recent recession saw increased speculation about the future role of business travel and whether it was in long term decline. This is an area of obvious interest to both airlines and agents.

A number of interrelated arguments along these lines emerged during this project, including the following:

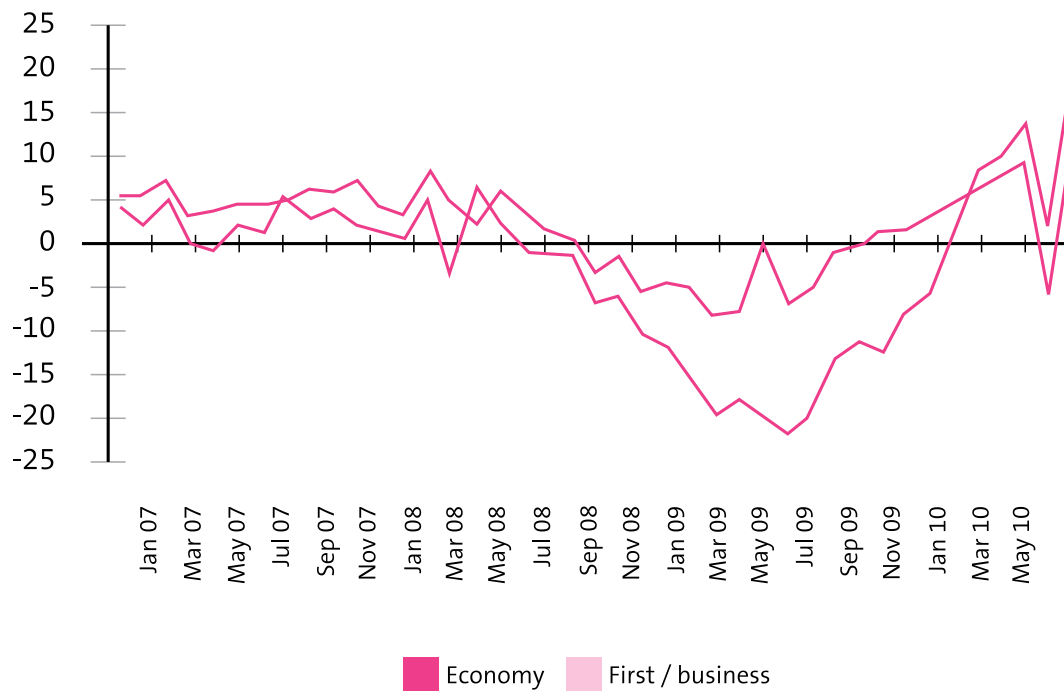
- The **global recession** meant that apart from companies doing less business overall, items such as travel would be among the first to be cut, as these might be deemed expendable. According to an estimate at one point in 2009, by The Association of Corporate Travel Executives, over 70% of corporations trimmed their travel budgets by 10-20% in that year.
- A **slow and uncertain** return to growth (in Western countries), as referenced by the World Bank and other institutions, means that these trends would not be short term but would be persistent.
- **Cultural shifts**, including a disdain for high spending business practices, coupled with increasing environmental concerns would have permanent effects on business travel as environmental awareness increases, air travel may become a corporate responsibility issue.
- Advanced **videoconferencing** was seen as a potential threat to business travel, with the recent volcanic disruption to European flights emphasising the need for such alternatives. Despite the technology being available for some time, it is only now that video-conferencing is becoming more widely used, as improvements have made possible a greater degree of interactivity.
- Even if business travel occurred it would be at a **lower cost** – e.g. using coach/economy class rather than business class, reducing airline (and potentially agent) yields. The major expansion in the budget travel market and the long term fall in the relative cost of many types of economy class fares means that in the future premium travel may well continue to be in relative decline in volume terms when measured against economy travel.

Many of these fears were expressed in the depths of the recent recession. Post-recession, however, there are signs that business travel is recovering strongly. For example, recent data from IATA shows some encouraging trends for premium (i.e. business and first class) travel with an annual growth rate of 18.7% being recorded in May 2010 – exceeding the recovery in economy seats where an annual growth rate of 10.2% was recorded (as illustrated on the next page).



% Growth,
Year-on-Year

Passenger Traffic Growth by Ticket Type



Source: IATA

IATA notes that growth, in both premium and economy classes, is driven by business travellers rather than holidaymakers. As world trade has expanded, business travellers have returned. However, consumers are still affected by fears over debt and concerns about potential (or real) unemployment.

However, IATA reports that the premium travel segment was still some 10% below its pre-recession peak in May 2010 (whereas 'economy' travel was 5% below it). Furthermore, despite fast growth in early 2010, premium yields were still some 15% below their pre-recession levels in May 2010.

Also, while the short-run recovery may have allayed some fears about the immediate extent of the decline in business travel, longer term issues remain.

F2F meetings will remain an essential part of doing business.

Will business travel be affected by changing tastes?

Business travel is recovering from the recession in line with the economic cycle and it is unlikely that technologies such as videoconferencing will reduce the fundamental need for face-to-face contact in the future.

John Gustafson, US Airways

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Some interviewees warned that while business travel would recover, high levels of capacity on some long haul routes (e.g. Europe to Asia) would constrain a bounceback of yields from business travellers. Others suggested the longer term growth rate of business travel would be lower than in the past due to the lingering effects of recession and that it would be impacted by the spread of high speed rail travel in some short haul markets. Some carriers are more optimistic, suggesting similar themes have appeared in past recessions, only for business travel growth and yields to recover quickly. In some of the faster growing markets, some carriers have not experienced a fall off in business traffic at all.

Recent economic analysis by Oxford Economics in the United States (The Return on Investment of US Business Travel, Oxford Economics (2009)) has pointed to the importance of business travel in the longer term. Key findings from that report included:

- Executives and business travellers estimate 28% of current business would be lost without in-person meetings.
- Roughly 40% of prospective customers are converted to new ones due to F2F meetings compared to 16% without such meetings.
- For every dollar invested in business travel, companies realise \$12.50 in incremental revenue.
- The average US business would forfeit 17% of its profits in the first year by eliminating business travel.



Business class will survive – but fragment.

Therefore, while there may be a slowdown in growth in some markets, business travel is unlikely to disappear.

It was suggested that recent disruptions to flights have enhanced the appeal of videoconferencing as it highlighted the need for a backup plan.

However, while videoconferencing may have some impact on airline revenues, recent survey work published in the Harvard Business Review (2009) suggests that it has its limits. The survey of 2,300 Harvard Business Review subscribers suggested that while 44% of respondents expected videoconferencing usage to increase in the future, many saw videoconferences as inferior to F2F meetings, especially in areas such as sales and business development.

Some interviewees also pointed out that while cost-cutting measures may have residual impacts on Western companies, those in the BRIC economies, where growth is much faster, would not face such constraints. There was likely to be less concern about business travel in general and/or the use of videoconferencing in particular as a cost-saving device.

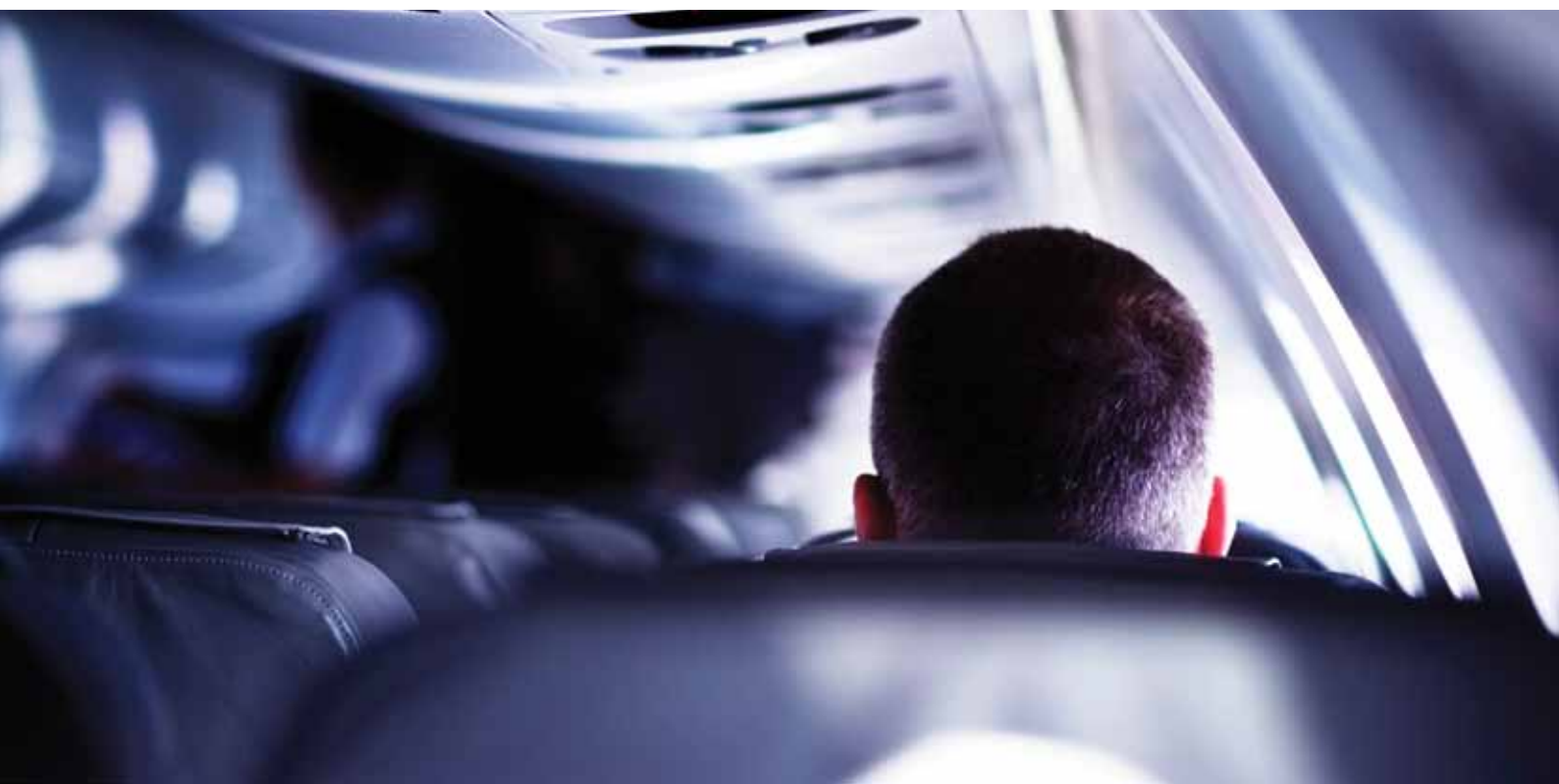
Many interviewees saw that while videoconferencing might have some impacts on travel revenues, it would do so in the context of a growing travel and communications market and

that videoconferencing was complementary to air travel (or an enhancement of it) rather than a substitute for it. In other words, videoconferencing might encourage a growth in the volume of communications between and within firms rather than displacing air travel.

Reports of its demise are greatly exaggerated, however...

Despite diverse opinion, it is most likely that business class will survive the harsh winds of the downturn. However, some interviewees made the point that the business/economy fare differential had become too glaring, leading to the abandonment of business class during the recession for many companies. With the recovery it is most likely that airlines will secure revenues from either 'premium economy' or more personalised 'virtual' classes. In this view, business class was unlikely to get much better than is currently the case, limiting any revenue gains. Some analysts therefore pointed out that any recovery in business travel would not necessarily be matched by an equivalent recovery in business class.

Lastly, as suggested above the ultimate picture may be more complex, with the physical and virtual fragmentation and the breakdown of traditional airline cabin classes.



F2F agents may explore their roles as business facilitators.

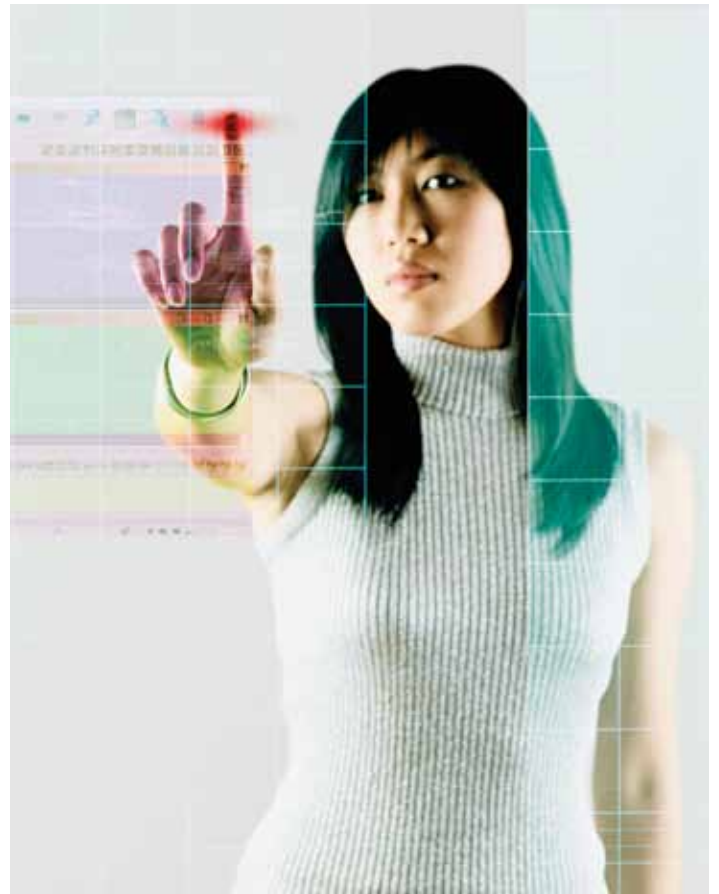
What role will agents play?

Businesses which purchase travel through agents (either business travel agents or TMCs) have traditionally emphasised the need for personalised service and cost savings. This is a need which is likely to become increasingly important rather than less so in the future.

As indicated, there may be some potential for business-focused agents to expand into areas such as videoconferencing itself if they adopt a 'total' viewpoint about the best way to meet client demand. More broadly, the offer of virtual meetings – e.g. through conference centres or hotels- is one that may appeal to businesses, compared with the cost and inconvenience of travel in some circumstances. Alternatively, agents could become more actively involved as a business meeting facilitator and organiser when actual travel is desired.

Overall the picture presented by these trends and thoughts is that rumours of the death of business travel are greatly exaggerated. Business travel will recover from its cyclical downturn and continue to grow globally, assisted by strong growth in the emerging economies.

While airlines and agents may be required to be increasingly flexible in meeting changing needs in the future (e.g. flexible cabin classes, more attention to overall business solutions by agents) there is little doubt that business travel will continue to be an important source of revenue for both. Whether business class as we know it will also remain is the question.



6 Conclusion

How to secure growth and profitability remains an important issue for both airlines and travel agents. Nonetheless, current trends point to significant opportunities for both.

Airlines could benefit from taking a broader approach to their business, with a greater focus on passenger preferences and needs. There are clearly areas where passengers are willing to pay for improved services and support. The rise of ancillary revenue has highlighted some of these, occasionally to the surprise of airlines themselves (e.g. willingness to pay for better seating and superior meals).

However, there are also opportunities to tap into the broader travel experience and to address the weak points or gaps in the current system. These involve thinking about travel as an end to end process (akin to how many passengers view it) and could include areas such as better management of the ground interface (seamless travel), paying more attention to passenger preferences (e.g. which airports are preferable from a passenger perspective) providing passenger support in trips to less familiar destinations, and much better integration of smartphones and other related technologies.

The growth of mobile technologies and the spread of electronic data exchange, provide airlines with the opportunity to match passenger preferences much more closely in the future and tap into these sources of value. However, unlike the simpler aspects of existing ancillary revenue services, this requires both a willingness

to take a broader view of the travel process and closer cooperation with other service providers.

Agents potentially face even greater challenges than airlines in managing their future business. However, there is a continuing need for the expertise which face to face (F2F) agents bring and online booking faces clear limitations. Indeed F2F agents who manage their business skillfully and re-emphasise their traditional roles look set to benefit from a number of future trends which will allow them to exploit their traditional sources of comparative advantage such as personalised service.

The fragmentation of the travel market, the growth of less familiar destinations, time poverty, an ageing population with specialised needs and the growing recognition that support is needed when things go wrong all point to opportunities for F2F agents. As is the case with airlines, improved integration with new technologies (e.g. analysis of customer preferences, selling real-time information products through smartphones) would also allow agents to more closely gear their product to traveller tastes, with benefits to both customers and themselves.



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8 Contributors

Amadeus and Oxford Economics would like to thank those people that willingly contributed their ideas and time to the development of this report. In addition, to those listed below, a major carrier from the Middle East and several executives from Amadeus took part in interviews.

Mike Beaumont, Thomas Cook

Marcus Casey, Lufthansa

Manoj Chacko, Kingfisher Airlines

Professor Peter Cochrane, Cochrane Associates,
founding director of eBookers

Catherine Dyer, WestJet

John Gustafson, US Airways

John Kester, UNWTO

Jim Mann, TUI Travel

Renato Ramos Ramos, TAM Linhas Aéreas

Christophe Renard, Carlson Wagonlit Travel

Jose Rivera, Rumbo

Paul Simmons, easyJet

Jay Sorensen, IdeaWorks

Rohit Talwar, Fast Future

Chris Tarry, CTAIRA

James Woudhuysen, Professor of Forecasting and Innovation,
De Montfort University

The opinions and viewpoints expressed in this report do not necessarily reflect wholly those of the contributors.

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For more information:

mediarelations@amadeus.com

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