“Quit Yanking My Supply Chain”

The Challenges Facing Travel Agencies in Canada

Gordon G. Baldwin
Assistant Director,
Transportation Division
Statistics Canada,
Ottawa K1A 0T6

50F0003-XIE

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Abstract:

Travel Agencies in Canada enter the new century with many challenges. The gap that they must bridge is a possible erosion of both revenue and customers. The aviation industry has been imposing caps on commissions resulting in the requirement for agencies to sell more product to generate the same revenue. At the same time, selling more product could be more difficult as air carriers, hotels, car rental firms and cruise lines are increasingly offering more direct sales on the Internet. This web presence has enabled the product “suppliers” to deliver their product while bypassing the travel agencies in the supply chain. There is also increased competition from travel sales web-sites that attempt to attract the business that local travel agents once could have considered as their own. The paper will examine the nature of the challenges facing this service industry and the possible responses.

The Present Situation

In 1997 almost 27% of Canadian travel agencies operated at a loss and some in the industry saw more trouble ahead.[1] “At least half of the 35,000 jobs held by travel agents across Canada will vanish in a restructured airline industry that is already eliminating travel agents by slashing commissions and steering the public into direct and Internet bookings” was the forecast of past-President of the Association of Canadian Travel Agencies.[2] In a debate in the House of Commons, one MP suggested that “Travel agents should probably start looking at college and university courses for a new career because electronic commerce is pretty well going to make them redundant”.[3] What are the reasons for these predictions?

In the past, travel agents have been important for transportation carriers, hotels, car rental firms and cruise lines, acting as their agent to sell their products and services to the public. In the supply chain, they were the final link to the actual consumer. "Travel agents are by far the most important distribution mechanism for air travel, accounting for more than 75 percent of ticket sales by scheduled airlines in Canada”.[4] This importance of travel agents to transportation carriers was mirrored in the importance of the carriers commission payments to the travel agents. The compensation that the travel agents received from transportation carriers has typically been their largest revenue source. Table 1 shows that these accounted for over half of the agency revenues in 1997.

Table 1
Canadian Travel Agency Revenues by Source, 1997

Source of Revenue	Percentage
Transportation fares	53.3
Tour packages	25.8
Insurance products	5.2
Cruise packages	5.1
Accommodation	4.0
Other commissions	1.9
Auto rentals	1.6
Service fees	0.4
Other	2.7
Total	100.0

Source: Services Indicators, Statistics Canada catalogue no. 63-016-XPB, Vol. 6, No. 3, page 34, "Profile of Canada's travel agency industry" by Adib Farhat

Commissions & Service Fees

The important transportation fare revenue, shown in Table 1, is typically paid to travel agents on a commission basis. One major challenge facing this industry is that of transportation commission cuts and commission caps. The commission is typically a percentage based on the selling price of the service sold. For domestic air travel, caps or a maximum dollar amount per transaction on the commissions paid were introduced in 1996. To cushion the travel agents somewhat to the introduction of these caps, the domestic commission rate was raised from 8.25% to 9%. By the fall of 1999 this had been decreased to 5%.[5] A decrease in the percentage rate of the commission means a reduction in income for the same amount of product sold. To avoid a decline in income, a travel agency would have to:

- Increase the amount of product sold;
- Sell more expensive or alternate products or complimentary products to customers;
- Add a service fee to transactions.

It does appear that there has been more product sold but still there were still negative revenue implications. From 1998 to 1999 Air Canada reported an increase of 10.9% in passenger revenue, an increase in 4.8% food and beverage supplies (an indicator of increased passenger traffic) but the air carrier also reported a decrease of 9.5% in commissions paid.[6]

The recent emergence of an Air Canada that no longer has to compete with Canadian Airlines has also had an impact on travel agents commission income. Carriers can pay an additional commission referred to as an "override" commission to encourage travel agents to book clients on their flights rather than on a competitor. They are typically awarded on the basis of total revenue sales or "greater market share or number of segments booked.".[7] "For example, if a carrier's market share based on sales for a particular city is 55 percent, the airline would only pay the override if the travel agent books 55 percent or more of its total sales with that carrier".[8] Effective with February 2000, Air Canada announced that there would be a change in the calculation of the domestic override commission. As they no longer had to compete with Canadian Airlines for market share domestically, the override would be based on bookings to the United States and internationally. [9]

Selling more expensive or alternate products or complimentary products to customers is another option for travel agents. The equivalents of "Do you want fries with that order" are products such as travel, cancellation and medical insurance. Table 1 shows that insurance, accommodation and auto rentals generated 10.8% of travel agents revenues in 1997. If airline compensation is insufficient due to commission cuts and capping they could "stop selling airline products".[10] Emphasis could be made on other products such as cruises, auto rentals and hotels. All of these areas also are using the Internet for more direct selling of their services. This will be discussed later in the paper.

Adding a service fee to transactions to make up for less commission revenue is the response that appears to have garnered much attention. While it has been reported that "more than 50% of travel agents in Ontario charge service fees" the impact still has not been pronounced.[11] While the "proportion of revenues that travel agencies derived from service fees almost doubled in 1997" it was still less than 1% for Canadian travel agencies (see Table 1).[12] While some firms see the service fee as the solution for travel agencies, there are chains that state that "Having no service fees will be the point of difference between us and the competition".[13] It may also be difficult to get consumers to accept the service fee unless the travel agencies can demonstrate that they are providing extra value for the fee. Otherwise travel agencies could lose business to new competition such as travel services sold via the Internet.

The Internet: Threat or Opportunity?

If one looks at the topics of discussion at meetings and conferences of travel agents, there seems to be equal weight being given to the Internet as both the biggest threat and the biggest opportunity to travel agencies. The threat comes from increased competition from travel web sites and virtual travel agencies which consumers can easily reach to book travel. It also comes from those suppliers of the services that travel agencies sell (airlines, tour operators, hotels, car rentals, cruises) selling their product directly to consumers and by-passing travel agents in the supply chain. How big is this threat? A Vice-President of the Alliance of Canadian Travel Agents was reported as saying that "the percentage of tickets sold through travel agents in North America has increased and is now around 83%. Internet sales are only about 1% and the airlines do the rest".[14]

If the level of Internet sales of tickets is so low, why are travel agents worried? They are concerned that there will be fast growth in this area. The United States based on-line travel site Travelocity states that "since its launch in March of 1996, Travelocity.com has registered more than 9 million members and logs more than 100 million page views per month.[15] A report released by the Travel Industry Association of America in the United States claims that 52.2 million used the Internet for travel planning and 16.5 million actually made travel reservations over Internet in 1999 (these estimates were based on a sample of 1200 in August 1999) in the United States.[16]

While in 1997 Air Canada and Canadian Airlines entered the direct selling on the Internet of only heavily restricted discount fares, this has since been expanded to their full product range. "There are many reasons that the air carriers would be attracted to this method of selling their services. Among the attractions are:

- a cost effective means of reaching many potential clients;
- the direct selling aspect can reduce commissions;
- personal computer users tend to be higher income and have a higher propensity to travel;".[17]

The potential client base for direct Internet sales is quickly growing in Canada. In 1998, "Fully 45% of households reported having a computer, almost twice the proportion from five years ago when 23% reported owning a computer. … 25% of households reported having access to the Internet from home compared with only 17% in 1997.".[18] "Higher income households were nearly five times more likely than the lower income households to be regular users of computer communications in 1998".[19] As the home computer with Internet access is being quickly adopted by higher income families and as “There is a strong relationship between income and the tendency of people to travel by air” the risk to travel agencies of being by-passed in the supply chain by their suppliers selling directly to the public is increasing.[20]

But bypassing travel agencies could hardly be described as strengthening the supply chain. In the mid-1990’s it was suggested that ”Supply chain performance is measured by the ability of logistics systems to improve customer service, lower costs and increase market share for not only the firm; but, all participants in the supply chain.”.[21] By the late 1990’s a different philosophy was being expressed namely “organizations must now consider scrapping rather than optimizing their value chains... In fact, many are pre-emptively destroying their own value chains...They use digital technology to break the rules, implicit or explicit, that dictate how buying, selling or producing goods and services is done. They form new relationships with customers...The company will not need an expensive sales or distribution function because it will outsource order processing to the customer.”.[22] In his appearance before the Standing Committee on Industry, the Executive Director of the Association of Canadian Travel Agents summed up the situation as “competition between affiliated retailers and suppliers does exist and is increasing”.[23]

There is not universal agreement as to the savings for suppliers in by passing the travel agency link in the supply chain. While “In the U.S., Delta Airlines calculated that Web sales were four times cheaper than selling tickets through a travel agent, the most expensive method for the airlines.”[24] it has also been stated by the Saskatchewan branch of the Association of Canadian Travel Agents that “it is probably less expensive for the airlines to pay travel agents than to set up a system to handle all of their own ticketing”.[25]

As mentioned earlier, SABRE, the reservation system provider that operates the Internet travel agency Travelocity.com, claims to have sold over 3 million airline tickets online since 1996 and “logs more than 100 million page views per month”.[26] These two figures perhaps provide support for the travel agencies’ claim that there are many costs not presently born by airlines, hotels and cruise lines that a pronounced move into direct selling to the public could incur. The Travelocity numbers show that for every passenger purchase there was a very high volume of looking and researching before, or even without, buying. When a travel agency does the selling, the airline, car rental firm, hotel or cruise line must pay a commission only on the actual sale regardless of the amount of time that the travel agent has spent finding possible routings, prices and options. When a sale cannot be completed, the cost is solely the travel agent’s.

Whether or not there are savings for the carriers, car rental firms, hotels or cruise lines, there may be other reasons to directly market electronically. Another marketing interest is to obtain information on customers or potential customers. For example, “Continental [Airlines] plans to harness technology that will track visitors’ e-mail addresses to register which flights they request when they visit the site”.[27] By directly marketing to a greater extent than in the past, a better understanding of the requirements of their actual customers may enable a better refinement of products, services, prices and marketing.

Travel agencies themselves can adopt the Internet as a means of reaching the public cheaply and in a greater potential sales area than previously. This was the general advice of the CEO of United Parcel Service to industries that were essentially middlemen: “this new model doesn't mean that all middlemen in the supply chain simply go away. They'd just better be wired and ready to respond fast when the end user pulls the supply chain.”.[28] The travel agency can deliver value to the customer in terms of product knowledge, consumer choice of products and possibly better prices. “An American Express report in November said domestic air fares had increased 34% since February 1996, but that the average fares actually paid had increased much less than that because corporations were using “a sophisticated travel agency’s low-fare search tools and requiring employees to accept the lowest logical air fare”.[29] Travel agencies, by adapting the new technology for wider access to other markets, fast consumer access and easy dissemination, along with the value of knowledge of products, prices, and destinations that they have traditionally had, may be the evolutionary solution required to survive.

Conclusion

Travel agencies in Canada are under pressure from potential decreases in revenue due to commission cuts and caps. Another potential threat to revenue is increased competition from their traditional suppliers bypassing them with more direct sales to their customers, especially by means of the Internet. A possible response for travel agencies appears to be their adoption of the Internet to widen their geographic reach, to provide better service to customers and to remain a viable link in the supply chain.

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