The Internet Travel Industry: What Consumers Should Expect and Need to Know, and Options for a Better Marketplace

A Report Prepared for Consumer WebWatch by:

Harrell Associates

New York City

June 6, 2002

The Internet Travel Industry: What Consumers Should Expect and Need to Know, and Options for a Better Marketplace
Harrell Associates

Table of Contents

EXECUTIVE SUMMARY [Return to Top]

The online travel market continues to evolve, creating both risks and opportunities for shoppers. Since *Consumer Reports Travel Letter* (CRTL) conducted its assessment of travel Web sites in October 2000, many changes, both good and bad, have occurred. While a wide variety of airline ticket-booking sites remain, the market itself has become more concentrated. We see improvements in five key areas: The ability to get low fares, viable itineraries, ease of use, customer service and privacy and security policies. Yet we also see many problems remain to be solved. Some are merely growing pains of a relatively new business. Others reveal challenges created by the underlying characteristics of the travel industry itself.

The traditional travel business, operating between the launch of deregulation in 1978 — the airline deregulation era of the late 1970s — and the onset of online travel in the mid-to-late 1990s, evolved with an integrated group of players — airlines, Computer Reservations Systems, travel agents and credit card companies — whose successes were interdependent. In other words, if an airline sold a seat and made money, so did everyone else in the chain.

But the advent of online travel created new business models that altered the relationships among the key players. They became less interdependent and more competitive. Moreover, their two primary goals were now similar: First, generate revenue and build customer loyalty by selling directly to consumers; second, improve profit margins by reducing transaction costs, primarily in marketing and distribution. Instead of sharing customers, now they began to compete for them.

Providers such as airlines and hotel companies sought to reduce reliance on fees to travel agents and Computer Reservations System (CRS) operators by selling directly to consumers through Web sites. In response to this threat to their cash flow, CRSs followed suit, reducing dependence on airline and agent transaction fees (for example, Sabre's creation of Easy Sabre and the Travelocity Web site). The travel agents' response was to build online stores for leisure and business travelers. Credit card companies formed co-branded alliances with hotels and airlines to secure customer loyalty and supplier acceptance, and incorporated travel links into their online payment sites.

As a result, today's online travel market is highly competitive, but also reveals remnants of favoritism among providers and distributors, making consumer education critical. The evolution of the industry has renewed enthusiasm for government regulation. In June 2002, U.S. Transportation Secretary Norman Mineta named a former Maryland state transportation secretary to lead a nine-member congressional commission to investigate the business practices of airline sites and the independent ticket-booking sites to determine their marketplace impact. The commission is scheduled to report back to Congress in November 2002.

Until standards exist — and in the online world, there are few but market forces — consumers who know how the various ticket-booking sites work can score bargains. However, in addition to demanding a certain level of expertise from consumers, airline ticket-booking sites also vary dramatically when it comes to matching bargain-basement fares with viable itineraries, good customer service, and strong privacy and security policies. Flying from New York to Miami via Dallas and back on four different airlines, for instance, is not a viable itinerary.

Each site has advantages and disadvantages. Finding everything on one site can be challenging, but not impossible. It just depends on when and where you're going and when and where you book. Many of these challenges stem from the same issues faced by consumers in the traditional brick-and-mortar marketplace (for instance, one airline's fare getting promoted over another based on its superior position on a travel agent's computer screen). However, online technology can exacerbate these challenges, and can even obscure elements of transactions the consumer could more easily perceive in the "real world."

Furthermore, research by *Consumer Reports Travel Letter* beginning in 2000 showed disturbing evidence of bias in the way these sites presented fares to the consumer. Research in March and April of 2002 by *Consumer Reports Travel Letter* and Consumer WebWatch, a project of Consumers Union, supported by grants from The Pew Charitable Trusts, the John S. and James L. Knight Foundation and the Open Society Institute, concludes that while the problems of bias have improved somewhat, issues remain that consumers need to know about. Consumers now have many more choices because the Internet gives more providers more opportunities to create direct consumer relationships and allows a wide variety of pricing. The good news is these choices afford more selection in terms of what, how, when and from whom to buy. But Web technology, coupled with the complex nature of the industry, has created an environment in which evaluating these choices can be mind-boggling.

The independent ticket-booking sites need to address basic disclosure issues — from describing how their technologies work to clearly disclosing business deals they make with airlines that might affect the price of fares, or their position on a screen. The six largest integrated travel web sites confirmed to Consumer Reports Travel Letter that they receive various forms of compensation from airlines, despite the fact most U.S. carriers have recently eliminated the payment of base commissions to travel agencies. Sites also should better separate airline and other advertising from screens of available fares, so the consumer is not manipulated into making a choice based on strategic placement of an ad. Fees should be more clearly disclosed, earlier in transactions — not at the end after a consumer has invested valuable time selecting a flight.

In summary, the Internet travel industry is approaching a crossroads. Until some form of standardization occurs, whether by regulation, market maturity, or both, shopping for the best travel deal online will continue to be confusing at minimum. At the worst extreme, the experience is a little bit like online casino gambling — experienced players can leave the table money ahead, but often, the house wins.

Section 1 — INTRODUCTION [Return to Top]

Every second in the United States, $18,500 is spent by resident and international tourists on travel and tourism. The third-largest retail sales industry in America, travel and tourism generated over $580 billion in total expenditures in 2001. [1] The enormity of this figure parallels the scope of changes that have occurred in this industry over the past few years — ever since the Internet expanded from an institutional and educational network to a consumer network, driven primarily by the development of the World Wide Web.

Why did the Internet so dramatically affect the travel industry? What impact do the changes have on travelers? What does online booking mean to anyone who wants to take a trip? To answer these questions, this report looks at the development of the travel industry since airline deregulation in the 1970s, and how the industry developed into one ripe for change when Internet technology arrived some 20 years later. The report explores developments in the 1980s and early 1990s, when computer reservation companies established highly profitable technology networks that supported industry sales and efficient distribution; when thousands of independent travel agents flourished and prospered; when credit card companies enjoyed revenue and profit growth commensurate with increased U.S. airline passenger traffic; and when the number of airlines decreased or consolidated and often earned the lowest margins of anyone in the travel business.

The report then looks at what happened when the Internet offered commercial opportunities for online travel in the mid-1990s and how the race among old and new participants became frantic. Finally, the report discusses what have emerged as today's top online travel companies and what they offer consumers.

---

[1] Source: Travel Industry Association of America

Section 2 — Travel Industry Key Elements [Return to Top]

Travel has been around since the dawn of man. But only since the jet age has it really accelerated into a commercial activity, and only since airline deregulation has it become an equal-opportunity activity, given the cost of flying for the average American. Prior to airline deregulation, the U.S. airline industry operated similarly to a public utility company with each carrier's routes and prices set by a governing body, the Civil Aeronautics Board (CAB). Like many foreign flag carriers whose operations are subsidized by their governments, the U.S. airline industry operated before 1978 with a somewhat imprecise relationship between costs and revenues. Airfares were set by route in consultation with the airlines flying them according to a standard cost-plus formula. For both foreign carriers and U.S.-regulated carriers, this reduced or eliminated the need to compete based on operational efficiency, astute management and consumer relevance. The system virtually guaranteed airline costs would be covered.

This changed when President Jimmy Carter appointed Alfred Kahn head of the CAB. Kahn was a strong deregulation advocate who believed regulation denied consumers choice and promoted inefficiency. He pushed Congress to pass the Airline Deregulation Act in 1978, making the airlines one of the first consumer industries to be deregulated. The resulting reforms applied free market principles to the U.S. airline business, which spurred a dramatically larger, more accessible and, some say, a more affordable travel industry. According to the industry itself, because of airline deregulation consumers can buy air travel today for one-half the purchasing power of a 1968 dollar, and only one-third of a 1950 dollar.[2]

On the other hand, according to a forthcoming article in *Consumer Reports,* there are those who argue that whereas inflation-adjusted airfares have dropped 37 percent in the 22 years since deregulation, they were also falling just as much and just as fast in the 22-year period before deregulation. Furthermore, lower prices after deregulation aren't what they seem. Ninety-six percent of tickets sold today are indeed discounted, but most are also saddled with restrictions. Most regulated fares, in contrast, were unrestricted. "A discount ticket is a different quality product than an unrestricted ticket," says Daniel Ginsburg, an economist who tracks airfare-price inflation at the U.S. Bureau of Labor Statistics. In other

[2] A Report on Recent Trends for U.S. Air Carriers, Air Transport Association, March 2002; page 2.

words, consumers are paying 37 percent less for inferior quality. In an apples-to-apples comparison, deregulated full-coach fares in 2000 were, on average, 65 percent higher than their regulated equivalents in 1978, even after adjusting for inflation.

Many also believe the quality of airline service has become worse under deregulation: Planes were 16 percent more crowded in 2000 than in 1977.[3] Coach seats have been packed closer together. *Consumer Reports* readers didn't rate satisfaction with airlines before deregulation, but in 1990 they gave the industry a score of 71 out of 100, which fell to 63 in 1998, the most precipitous drop the magazine has recorded in any service industry. Consumer rights, meanwhile, have atrophied. Aside from inflation-prompted increases in dollar limits on airline liability for lost luggage and penalties for denied boarding — rights created in the regulated era — "there have been no big new consumer rights created since deregulation," says Tim Kelly, a U.S. Department of Transportation regulatory coordinator for consumer protection.

No one disputes the industry has grown dramatically in the number and frequency of trips taken: Almost 640 million passengers board one of the nation's 24,535 flights each day, 2.6 million hotels rooms are occupied each night, and more than 80 percent of the nation's 1.8 million rental cars are used for business or leisure activity daily. [4]

The other undisputed outcome of deregulation is that once price guarantees were lifted, there was a significant re-positioning of and restructuring within the entire industry as efficiencies replaced inefficiencies. Industry restructuring was repeated and accelerated again when the Internet permanently altered the industry's cost structure. The cost of distributing a ticket was halved, and then halved again in just the last five years.

[3] Source: Department of Transportation, Bureau of Transportation Statistics
[4] Department of Transportation, Bureau of Transportation Statistics; 2001 Lodging Industry Profile & Auto Rental News as published in presentation by SABRE *Transforming the Business of Travel*, March 2000.

MAJOR COMPONENTS OF THE TRAVEL INDUSTRY

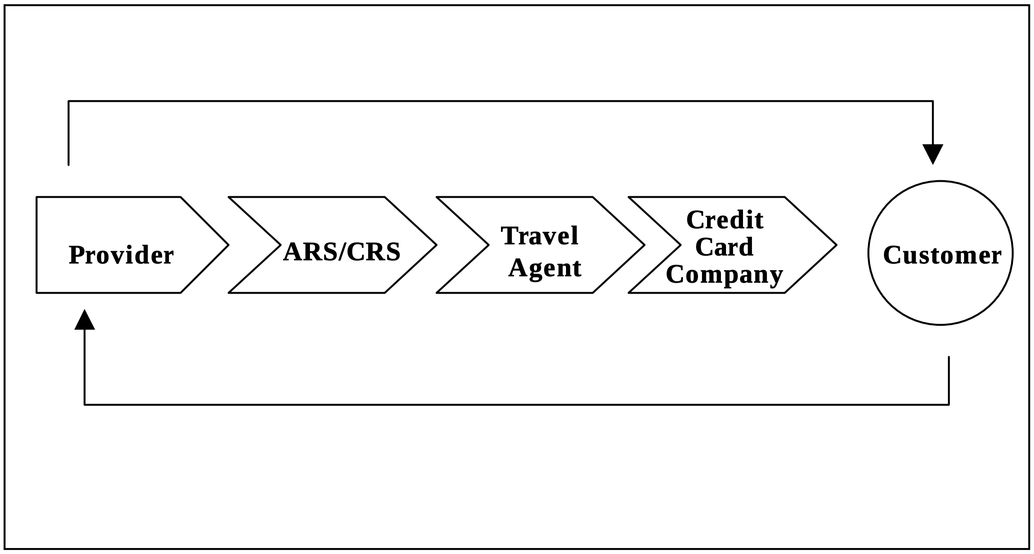
As the travel industry took off in the late 1970s and early 1980s, five major components came to comprise what this report will call the travel supply chain: Providers, Distributors, Travel Agents, Charge Card companies, and Travelers (See **Figure 1** below).

- **Providers** — Airlines, hotels and transportation companies; these entities invested in products (planes, properties, vehicles) and services for travelers.
- **Distributors** - Computer Reservations Systems[5] (CRSs); technology companies that consolidated supplier information, inventory and pricing data, and provided a way to electronically search, book and issue tickets and documents.
- **Travel Agents** — Using CRSs, provided leisure and business travelers with one-stop shopping guidance and pricing and schedule advice to make reservations, issue tickets and provide ancillary services such as passport processing or currency conversion. They operated in a variety of market segments, such as wholesale, retail, business, leisure and specialty packages.
- **Charge Card companies** - Played a role by making purchasing more convenient and secure for consumers, and by providing corporate buyers consolidated transaction data about their company's activities, which helped them with purchasing decisions and policy tracking.
- **Travelers** — The end-user or customer, who may be leisure and / or corporate traveler, or a travel planner who books trips for an employee to take.

[5] Throughout this document we will use CRS and GDS (Global Distribution System) interchangeably. A GDS is basically a globalized CRS, which grew out of an ARS (Airline Reservations System).

Figure 1

Travel Industry Supply Chain Simplified - 1990



Computer Reservations Systems (CRSs) and Travel Technology

Deregulation meant that airlines that had previously operated under government-set fares which ensured they at least broke even now needed to improve operational efficiency to compete in a free market. While there were many aspects to this, one of the earliest changes was the development of the Airline Reservations System (ARS), its evolution into and proliferation of the Computer Reservations System (CRS), and then into Global Distribution System (GDS).

The history of Airline reservations systems began in the late 1950s when American Airlines began to try to create a system that would allow real-time access to flight details in all of its offices, to integrate and automate its booking and ticketing processes. As a result, Sabre (Semi-Automated Business Research Environment) was developed and launched in 1964. Sabre's key breakthrough was its ability to keep inventory correct in real time, accessible to agents around the world. Prior to this, manual systems required centralized reservation centers, groups of human beings in a room with the physical "cards" that represented inventory (seats on airplanes). (**See Figure 2A and 2B - Airline Reservations — Before Automation**)

History of the CRS

- **Technologies Used:**
  - **Colored Cards**
  - **Rotating Tray**
  - **Pencil Marks**

Figure 2A - Airline Reservations— Before Automation (Photo courtesy of Sabre Inc.)

History of the CRS

Figure 2B - Airline Reservations Office — Before Automation (Photo courtesy of Sabre Inc.)

This ability to keep all the data updated eventually led to the ability to price seats on airplanes at many different levels. Initially, however, since there were generally only three reservation classes per flight, sophisticated pricing strategies would have to wait. Other carriers soon followed with their own proprietary Airline Reservations Systems (ARS).

Quickly, a network concept emerged, which connected the various ARSs together and made them available to travel agents. This became known as the CRS concept. Just as the invention of the ARS enabled the automation of flight and seat control within an airline, the CRS concept automated the reservations process by placing the reservations technology for all airlines on a travel agent's desk, eliminating the need for the travel agent to call the airline to make reservations. This enabled the travel agent to spend more time helping the traveler and enabled the airline to, in essence, outsource the telephone reservation process. This saved the airlines millions of dollars, as the majority of the telephone-reservation work was transferred to the travel agent. (**See Figure 3 below, and Appendix**.)

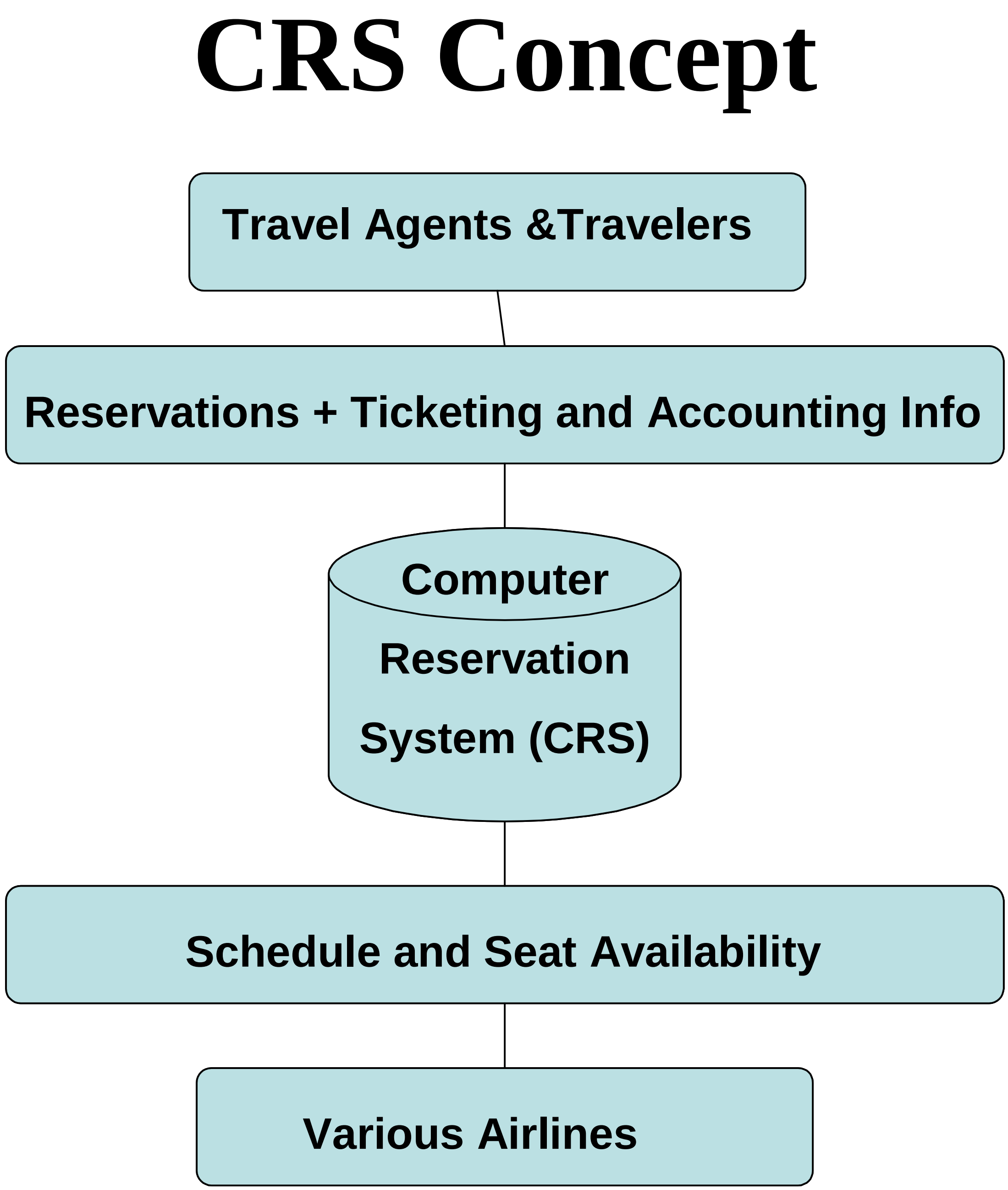


Figure 3

In 1974, an American Airlines executive, Robert Crandall, proposed that airlines jointly create, own and operate a large communication network with global reach for all travel agent offices, and prevent travel agents from taking full control of it.[6] Unwilling to pursue that strategy without antitrust immunity, airlines instead accelerated development of ARSs by expanding them to include other providers and using them as distribution tools for travel agents. In 1976, United Airlines began installing its in-house Apollo CRS in travel agencies; American soon followed. Airlines were under cost pressure, answering calls from travel agents in direct contact with the customer, then inputting reservation information into their own internal systems. Call-center staff performing this work often were unionized. Thus, the airlines' strategy to put the computer and the reservation tools directly on the travel agent's desk outsourced a substantial cost.

What the ARS had done was basically automate the "old model" of a call center at which reservations were written on cards. The technology enabled this function to be distributed not only within an airline, but also to agents and independent businesses completely outside the airlines' control. Soon American's Sabre surpassed United's Apollo in market share and secured a dominant position. The success of the ARS and CRS was clear: In the late 1980s, Apollo's annual pre-tax return on investment had reached 70 percent; Sabre's was more than 100 percent.[7]

Within the next 10 years, European airlines began developing their own CRSs. In 1987, two consortia were formed, and the European-based systems Amadeus and Galileo were designed much like the systems in the United States. Amadeus was based on SystemOne that Texas Air's Frank Lorenzo acquired when he bought Eastern Air Lines. As one industry insider put it, "Frank had to take (money-losing) Eastern in order to get his hands on SystemOne, his real objective in the transaction." Galileo chose United's Apollo system as its strategic partner. In the Asia-Pacific Rim, CRSs primarily operated closely with national airline representatives, with the exception being Abacus, a consortium of Southeast Asian airlines' CRSs.

By the mid-to-late 1990s, the major CRSs essentially became GDSs that travel agents used to check real-time flight schedules, seat availability and pricing information, make bookings and issue tickets. The GDS operators collaborated with a variety of travel service providers such as

[6] Petzinger, Thomas Jr. (1995). "Hard Landing: The Epic Contest for Power and Profits that Plunged the Airlines into Chaos." Times Books: New York.
[7] Humphreys, Barry. (1991) The CRSs.

airlines, cruise operators, hotels, railway companies and car rental companies, in addition to accepting special meal requests, managing seat allocation and performing back-office accounting functions for travel agents. At one point during this period, someone quipped that Sabre might be the most powerful non-military computer in the world.

By the mid-1990s, there were about a dozen major GDSs worldwide. Amadeus had become the world leader after merging with SystemOne, achieving a 27 percent market share; Galileo and Sabre followed, each with 22 percent. After these came Worldspan, formed by Delta, Northwest and TWA, with a 10 percent share, and Abacus and Infini, the dominant CRSs in Asia, with a combined share of 9 percent. [8] (**See Figure 4 below**.)

---

[8] Lee, Andrew. *Traveling via the Web: The Changing Structure of an Industry*. Harvard Business Review Case Study: Center for Asian Business Cases, University of Hong Kong. 1998. Page 4.

Figure 4: CRS Markets - Late 1990s

Region	CRS System	Market Share*	Owner Airlines
North America	Sabre Worldspan SystemOne Gemini	22% 10% (See Amadeus) N/A	American Delta, Northwest, TWA Continental Air Canada, Canadian
North America/Europe	Galileo International	22%	United, USAir, British Airways, SwissAir, KLM, Alitalia, Olympic, Air Canada, Aer Lingus, Austrian, Air Portugal
Europe	Amadeus	27%	Air France, Lufthansa Iberia, SAS (merged with Continental's SystemOne)
Asia- Pacific	Abacus Infini Axess Topas Southern Cross Fantasia	Combined 9%	Cathay Pacific, Singapore, Malaysia, Philipine, Royal Brunei, China Airlines All Nippon Japan Airlines Korean Airlines Australian, Ansett Airlines Qantas Airlines
Africa, Eastern Europe	Gets	N/A -	Founded by SITA (aviation telecom company) to serve Africa, Eastern Europe & Latin America

* Market share numbers do not equal 100 % because not all systems were evaluated.

GDS technology developed with four functional components that, while integrated and interdependent, would later serve as points of differentiation when Internet providers entered the market and pulled apart the links of the supply chain. They were: inventory management and display; pricing- and fare-search engines; ticketing and document generators; and database reporting engines.

➢ Inventory management and display comprised the systems that captured inventory (seats, hotel rooms, cars, etc.) of providers and, through sophisticated algorithms, displayed them on computer screens in response to an agent's keyed-in request. These algorithms were critical because of the physical limitation of the number of flights that could be shown on a CRS screen. Eighty to 90 percent of bookings are made using flights that appear on the first screen; an incredible 70 percent or more of bookings are made using the flight that appears on the first line of the first screen. This phenomenon, called *screen position bias*, raised regulatory concerns when the owner-operator of the reservation system listed their flights first. Travel agents tended to prefer reservation system owners who provided them with technical support and back-office systems, training and relationship management, causing further concerns. Airlines gave agents incentives to install their proprietary CRSs so they could get "first-line" position and thus generate more sales.

- Pricing- and fare-search engines were sophisticated systems that would take an itinerary request and, based on a set of rules, determine the fare. The rules were a function of routings, stop-overs, advance purchases, length of stay and a myriad of other factors that, both fixed and variable, were essentially based on supply and demand. The infamous "Saturday night stay" rule was a key marketing tactic discovered by yield managers. It enabled airlines to assign a number of prices to the same itinerary because business travelers, spending company money, were very resistant to spending the weekend away from home.
- Ticketing and document generators allowed agents to generate a physical or electronic ticket and also queue them to remote locations, such as an airport or out-of-state office, for pick-up. One creative use of this technology was when agents would queue tickets to remote locations for printing where the commission was higher, and then ship them back for actual delivery to customers.
- Database reporting engines enabled airlines and agents to report transaction activity for a variety of purposes, including financial or accounting uses, trend analysis or passenger searches.

In addition, CRS technology required extensive communications networks to interface in a multitude of technical and geographic environments. Down time on a GDS meant lost revenue for providers, agents and the GDS, as well as frustrated travelers.

In time, more than 80 percent of airline tickets would be sold through CRSs by more than 130,000 travel agencies worldwide.[9] Most of the remaining transactions, such as hotels and rental cars, were also booked through CRSs.

[9] Flint, Perry. (1998) "End the CRS Oligopoly" in Air Transport World, Vol: 35, Iss: 4 April 1998

THE MONEY FLOW: ALLOCATION OF COSTS & REVENUES

Economics of Air Travel Distribution - Simplified (1990)

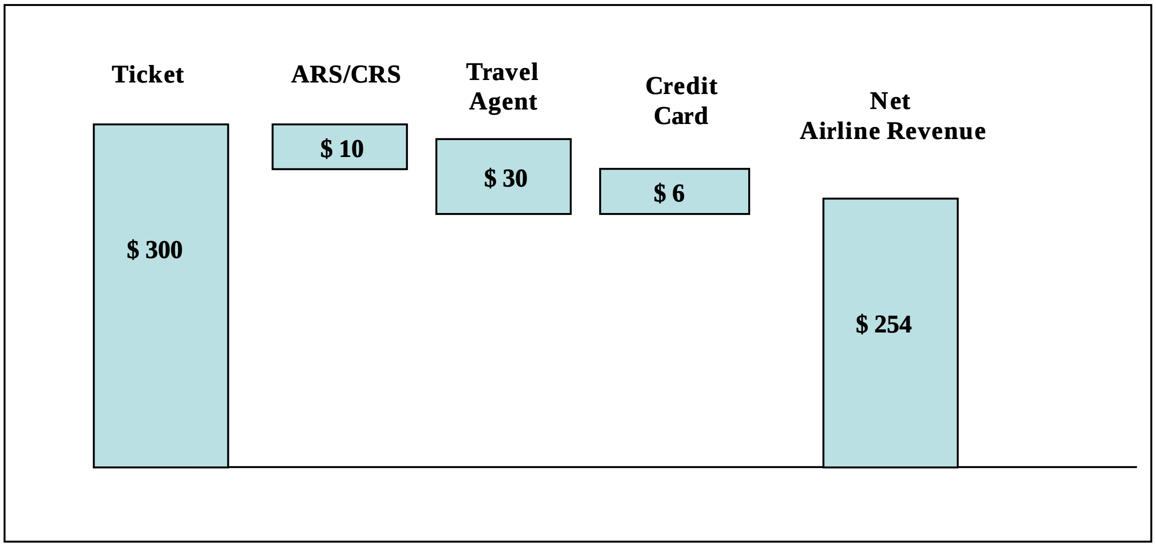


Figure 5

In the mid–1990s, the economics of travel were fairly straightforward: If a ticket cost $300, the revenue was divided so that the travel agent got about $30, the CRS $10, and the credit card company $6. The airline got the remaining $254, or about 85 percent. (**See Figure 5 above.)**

If the same ticket cost $2,000, the CRS fees tended to remain the same, since they were generally segment-based — the example assumes $3.50 per segment for a 2-3 segment trip. Alternatively, the travel agent fee, based on a standard 10 percent commission, jumped to $200, for what many airlines argued was the same or less work if, for example, the higher-priced ticket was for a business traveler, who already knew which airline and flight he or she preferred. Disparities like this motivated the airlines to put pressure on travel agents, seeking changes in the compensation system and reduction of base commission levels.

Revenue Allocation:

- An airline's revenue varied according to the public's demand for travel — highly seasonal, elastic or price-sensitive for leisure travel, and more on-demand for business travel. The airlines' key revenue tool was the yield management system, which allowed them to sell the same seat for 15 to 20 different prices, depending on which market segment the traveler belonged to — business, leisure, price-sensitive, not price-sensitive, etc. They kept low fares from the business traveler by placing a requirement to either stay over Saturday nights or buy the ticket two weeks in advance for a cheaper price. They took what some argued to be a commodity, airline seats or hotel rooms, and priced them differently based on the trip's purpose, day, time, seat location and advance demand in order to maximize revenue. The primary pricing distinction was based on the purpose of the trip.

- The travel agent's revenue was derived almost exclusively from commissions. In 1995, for example, agents were paid 10 percent of a domestic airline ticket's price, higher amounts for international tickets. To a lesser degree, hotels, transportation and cruise companies compensated travel agents, but these commissions were often difficult to collect as there was no proof the traveler actually stayed where he or she booked. Another important source of revenue, but hidden from the public's view, were supplemental "override" commissions, which airlines paid agents who demonstrated they could move traffic to premium levels, beyond an airline's "fair market share" on a particular route. These agreements are generally thought to have originated after the airlines outsourced reservations activity to travel agents. Doing this gave the agent much more control and "influence" in the traveler's carrier selection process. As override commissions could mean an additional 3 percent to 6 percent, agents were sometimes motivated to influence traveler preference toward the supplier that paid the most. For many agencies, overrides meant the difference between profit and loss, as base commissions were allocated to "covering the cost of operations" and the override "went to the bottom line." *Consumer Reports Travel*

Letter studied the possible impact of these payments in June 2001. (**See Figure 6 for the results of this study.)**

test results

travel agencies

This table summarizes the responses we received when we asked for flight and fare information from 840 travel agencies nationwide. In all cases we contacted agencies in and near the city of origin.

SELECTED AIRLINE ROUTES	TOTAL CALLS TO TRAVEL AGENCIES	PERCENTAGE OF TRAVEL AGENCIES SURVEYED				PERCENTAGE OF TRAVEL AGENCIES THAT ACKNOWLEDGED OVERRIDE DEALS*
		PROVIDED ALL AIRLINES WITH LOWEST FARE IMMEDIATELY	PROVIDED ALL AIRLINES WITH LOWEST FARE BY 2ND REQUEST	DID NOT PROVIDE ALL AIRLINES WITH LOWEST FARE	DID NOT PROVIDE LOWEST FARE AT ALL	
Atlanta-New Orleans	69	58 %	84 %	13 %	3 %	17 %
Boston-Washington	55	51	51	7	42	24
Chicago-Santa Ana/Orange Cty.	100	54	77	23	0	21
Dallas-Fort Lauderdale	57	88	93	4	4	25
Denver-Los Angeles	70	30	34	61	4	1
Detroit-Tampa	97	80	84	1	16	30
Kansas City-Phoenix	34	77	79	0	21	29
Los Angeles-Las Vegas	79	17	30	70	0	27
Minneapolis-Orlando	57	58	68	28	4	25
NY/Newark-West Palm Beach	116	60	68	2	30	22
Raleigh/Durham-NY/Newark	59	32	59	37	3	9
Washington-Fort Lauderdale	47	0	0	72	28	11.
	840	51 %	63 %	25 %	12 %	20 %

*Only about half of the 840 travel agencies responded "yes" or "no" to this question. Nearly half refused to answer; did not know; or did not respond, sometimes after multiple calls.

Figure 6

This chart shows that only about half the travel agencies surveyed immediately provided all the airline and pricing information, when asked, for the lowest-fare non-stop options on 12 different routes. This figure rose to 63 percent after the request was repeated, but 25 percent did not mention all lowest-fare options even after the second request. Furthermore, 12 percent did not provide lowest-fare options at all.

- Charge card companies derived revenue by earning a percentage or discount fee of the face value of any transaction paid for with their card. This fee ranged from 2 percent to 4 percent of the transaction value depending on the merchant's volume of business. In addition to managing the receivable on the part of the supplier, credit and charge card companies promoted the benefits to customers and merchants: Convenience, security, information reporting and increased business.

- CRSs' revenue came primarily from booking fees charged to airlines, and subscription fees paid by travel agencies and other subscribers to rent CRS terminals and receive technical support from the CRSs. CRSs segmented pricing strategies by region with transaction-based pricing dominating in North America, while net-segment based pricing was used outside North America. In North America, in 1998, the cost–per-net-segment ranged from $3 to $3.50, plus a small fee for cancellations.

CRS REGULATION

It is important to note that regulators became interested early on by Computer Reservations Systems and possible opportunities for abuse the technology created. Screen position bias, for example, was against free market principles and detrimental to fair competition. Since the CRSs were owned by the airlines and there were no legal restrictions on their administration, market abuses spread. New carriers complained of excessive fees to get their flights listed and established carriers complained of manipulated flight schedules, fare displays and searches. As a result, Congress launched an investigation in 1982, which confirmed the existence of screen position bias and other unfair practices. A comprehensive set of regulations were established in 1984, and then re-issued in 1992. They were designed to address the following four areas:

- **Displays** — Carrier-specific variables could not be used to rank flight primary displays. Secondary display bias was permitted under certain circumstances. Architectural restrictions, dealing with limiting flight searches, were allowed to continue.
- **Booking Fees** — Discrimination in fees charged to participants was prohibited. All participants were entitled to service enhancements.
- **Booking Data** — To the degree marketing data was developed, it had to be shared for a fee with all participants. In addition, owner carriers could not discriminate against other systems through "non-participation" in the other systems.
- **Agency Contract Terms** — Contractual terms with travel agents could not facilitate unfair competition. Agencies could use multiple systems.

Loopholes in these regulations did exist, particularly with respect to flight information display. Carriers would monitor competitive flight schedules and design their display algorithms so their flights would appear first. For example, if a carrier was being penalized by an elapsed-time algorithm tied to connections over a congested airport, the carrier might simply change the connecting time or flight time, sometimes to wildly unrealistic times in order to improve listing position. (This practice was so prevalent it got its own industry nickname, "time shaving.") Even stranger, carriers sometimes simply invented a new algorithm — say, the number of seats flowing over one connecting airport vs. another — that would serve the same purpose. In addition, CRS rules did not apply to non-U.S. airlines owning CRSs outside the United States. Although the objectives were shared, differences existed between U.S. and European rules. While the United States and Europe disagreed on CRS industry regulation, both maintained shared objectives and open communication. The continued bias in computerized reservation systems was one of two driving forces — the other being fees — that caused providers to seek alternative ways of distributing their products and services.

Within this broad economic framework, relationships between airlines and travel agencies, and airlines and GDSs, were not entirely mutually beneficial. Money was a zero-sum game and as one segment increased its profitability, another tended to suffer financially. From the providers' perspective, particularly airlines, the significant bookings handled by agents came at a high cost. Distribution costs were one of the airlines' top controllable expenses, up there with people, fuel, and aircraft ownership. In 1997, a survey by the International Air Transport Association (IATA) indicated that CRS costs to airlines almost quadrupled in six years, from 2.1 percent of distribution costs in 1990 to 8.1 percent in 1996. And this was at a time when total U.S. distribution costs topped $18 billion. One U.S. carrier claimed its CRS cost increased 35 percent from 1993 to 1998, a period of relatively low inflation and declining technology prices. For the airline industry, distribution represented about 15 percent of the total costs in the late-1980s, and by 1990, was growing faster than passenger revenue[10].

By the mid-1990s, three important factors had gained enough momentum to drive the aggressive migration to and adoption of Internet-based travel: high distribution costs — and the obvious value-for-dollar question that was raised based on system bias; new technology that offered a cheaper alternative to GDS technology and direct access to customers; and a consumer population receptive and eager to take control of their own destinies.

Just as the airlines outsourced the labor-intensive process of researching and booking travel to travel agencies in the late-1970s, the Internet now provided them an opportunity to let

[10] The McKinsey Quarterly 1996 Number 4, page 180

the travelers do the work without the help of any airline employees or intermediaries, thus significantly lowering the airlines' costs once again.

3. TRAVEL ON THE WEB [Return to Top]

The travel industry was one of the earliest to go online. Since travel had few geographical boundaries, and, thanks to the widespread adoption of e-tickets, which airlines aggressively pushed, the airlines faced none of the logistical issues of online product retailers such as shipping and variable tax-collection schemes, the travel industry was uniquely suited for the Web. As this report seeks to demonstrate, the lack of rules presented a major problem. There was no governing or marketing body to regulate rates, or online travel services that enabled consumers to efficiently navigate all the alternatives they had.

Bill Gates reportedly once quipped that Microsoft started Expedia because no other industry was as complex as travel, with so much constantly changing electronic information and consumers who wanted to become personally involved in the reservation-booking process.

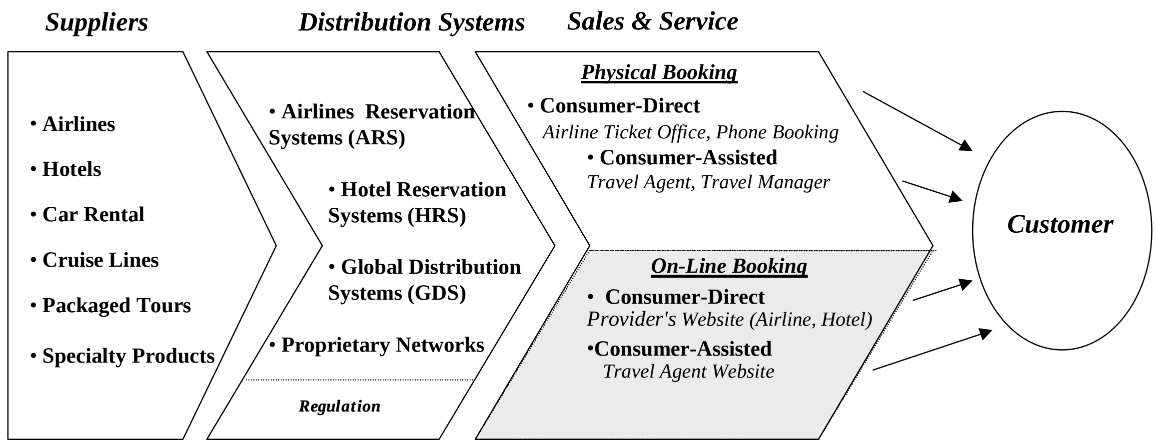
With existing players and new entrants trying to capture a slice of the online market, new travel-related Web sites were springing up or reinventing themselves constantly. Many airlines, hotels, car rental companies, CRSs and national and municipal tourist organizations went online. Participants attempted to capitalize on the opportunity in travel by developing products aimed at attracting and retaining customers. To capture traveler loyalty, travel agents and CRSs built "consumer-friendly" front-end systems for existing information systems. They also leveraged relationships with emerging online service providers to work with business and leisure travelers in a cost-effective manner. In terms of size, complexity and sophistication, these first-generation efforts, by such players as EasySabre, Prodigy and ITN (reviewed in more detail later) are far removed from today's mammoth sites.

Airlines reduced the need for intermediaries by offering direct-access software and encouraging business and leisure customers to purchase tickets directly from airlines. Each player in the travel supply chain would have its position challenged. Ability to adapt quickly would determine survival. In this new world, both the economics and even the players would change:

- **Airlines** reduced, and in some cases eliminated, costly intermediaries such as travel agents from their distribution chain. In 2001, there were 15 percent fewer travel agents in the United States than five years earlier. Airlines re-structured their distribution compensation agreements by segmenting them. Traditional transactions got one rate, electronic another. These categories were further segmented based on who, how and what was booked. In today's environment, travel agents provide less influence on carrier selection than they did in the past. Since the airlines no longer thought agents steered consumers to airlines, the airlines adjusted their compensation to virtually eliminate base commission payments in lieu of "pay-for-performance" structures. These pay-for-performance remnants of the "override" world continue to put financial pressure on travel agents' loyalties.

- **Travel agents** have redefined the way they charge consumers, in many cases unbundling their services. This may include charging a $25 service fee for issuing a ticket or a nominal fee for changing it. In the corporate travel arena, travel arrangers might pay for information management, on-site passport or back-office processing. Many travel agents invested in electronic servicing capabilities either independently or with technology partners, which had the two-fold objective of reducing their own service costs as well as providing entry into the new electronic market.
- **Global Distribution System (GDSs)** continued to consolidate and diversify their operations by unbundling their services and expanding their product offerings into other transaction-processing and information management services. These were meant to serve customers other than airlines, who were trying to reduce or eliminate GDS fees all together.

Travel Industry Supply Chain – Simplified 2002



- See **Figure 7** for an illustration of the evolving travel industry supply chain.

Figure 7

THE ONLINE TRAVEL MARKET

So how is the online travel market defined? In 1997, it was estimated to have made up 1 percent of the total U.S. travel market. Today it has grown to 11 percent, valued at over $20 billion.[11] The market was already growing prior to the terrorist attacks on New York's World Trade Center and the Pentagon in Washington, D.C., on September 11, 2001, and since then consumers have continued to rely on these sites both as "looking" and as "booking" tools.

The demographic profiles of those who made online plans at the emergence of Internet travel in 1996 were more likely to be employed, educated to the postgraduate level and a professional or manager. Five years later, online travel has gained mainstream popularity, and there are thousands of sites that offer travel information and services. They range from direct providers (e.g. airlines, hotels, ground transportation) to support services (e.g. tour organizers, travel and trade publications, hotel management companies), tourism development organizations, eco-tourism coordinators and many more. Depending on the publisher, travel Web sites could be categorized as **service providers**, **destination related** or **Internet travel agencies** (sometimes virtual branches of traditional brick and mortar agencies such as American Express, or virtual branches of Internet portals like AOL and Yahoo!).

➢**Online service providers** are branded sites developed and operated by airlines, hotels and others that want to sell directly to consumers. These sites are similar to auto dealerships in that they focus on selling the products of a particular supplier — American Airlines, for example, will not direct a consumer to United for a lower fare or more convenient service. That means if you use a supplier's site and are concerned about price, you might have to shop around to get the best price among other supplier sites. For example, based on actual research, on one routing an airline site quoted the lowest fare as more than $1,200. A check on a travel agent's site for the same trip quoted a $400 fare on the same carrier**,** with a connection via a city along the non-stop flight path that could not even be found on the carrier's own site.

In early days, provider sites might only have offered information. Today, most offer a comprehensive array of products and services online. Major airline sites offer customers reservations, electronic tickets (e-tickets), seat selection, in-flight merchandise, reward points and sometimes discounted fares unavailable elsewhere. In addition, they may offer lodging, transportation-package deals and cruises through their alliance partners. For example, American Airlines offers and redeems AA miles when a member makes a purchase on AOL. Branded airline sites are currently the fastest-growing segment of online travel providers, up 26 percent in February 2001. The most popular site (as measured by most unique visitors) is Southwest Airlines. One reason Southwest is so popular is that it doesn't issue tickets, and historically travel agents could not book them via a CRS because Southwest refused to place its information on the systems. Today, Southwest's inventory is available online only at its own site. United and American are the largest airline sites in terms of sales.

➢**Destination sites** provide information and services about a country, city or area, including details on transportation, accommodations, sightseeing, dining and local cultural events. They may or may not offer advertising, online booking capabilities or discounts and coupons. Since destination marketing is usually the responsibility of the national or local tourism boards, their Web sites usually embody this tone. Their goal

---

[11] Source: Jupiter Media Metrix; http://www.jmm.com/xp/jmm/press/2002

is to generate visits to the area, so they are less concerned with the mechanics of how the traveler chooses to get there.

➢**Internet travel agencies** are Web sites that expand traditional agents' offerings. In addition to selling regular travel services such as air tickets and hotel rooms, they also offer travel tips, destination information and other services. Many large traditional agencies such as American Express and Liberty Travel have extended their shops to the virtual marketplace. Portal travel sites such as AOL and Yahoo! link customers looking for travel services to sites that may appear on their portals, but generally are powered by one of the big Internet travel agencies listed below. The last category for Internet travel agencies is bidding sites, such as Priceline. There, deep discount travel is available, but the travel provider's brand (usually an airline) is hidden until the purchase is complete.

Consumer Reports Travel Letter in 2002 evaluated six of the largest and most well-known sites: CheapTickets, Expedia, OneTravel, Orbitz, TravelNow, and Travelocity. (**See Figure 8 below for a Summary Table describing the sites.)**

Figure 8 - Major Virtual Travel Agencies - 2002

Site name	Customer Offering	Owner/ Operator /Comments
CheapTickets	Multi-channel (online/offline) full service agency for discounted leisure travel products. Advertises one-stop shopping, electronic ticketing, personalization services, and low fare search technology, access to millions of published and unpublished fares.	• Founded in 1986 with a single retail store in Honolulu; acquired by Cendant Corporation in October 2001.
Expedia	Offers full service, online travel services for travelers and small businesses. Advertises one – stop shopping, “Best Fare Search”, technological superiority. Suppliers include over 450 airlines, 65,000 properties plus packages and cruises.	• Launched by Microsoft in 1996; acquired Travelscape.com and VacationSpot.com in March 2000. • Partnership with USA Networks provides capital and resources for market expansion and new product development
OneTravel	Full service agency promoting economical leisure travel; offers air, car, hotel booking and ticketing. Advertises extensive supplier network 500 airlines, 54,000 hotels, 48 car companies, advice library and low fares proprietary “White Label” database and “Fare Beater” reservation system. Offers destination and weather information.	• Owner: Privately held • Sponsor of Style World WE (Women’s Entertainment Network)
Orbitz	Full-service online agency; suppliers include 455 airlines, 210 hotel chains, 42 car companies 30 packagers and 18 cruise lines. Promotes site as ideal surf and buy site	• Shareholders include American, Continental, Delta, Northwest and United Airlines • Partners include Hotwire — to offer travelers more flexibility in travel (co-owned by a number of major airlines and Texas Pacific Group) • Site 59 • Loudcloud — hosting and managed services for booking engine • ITA Software — new and “unbiased” flight search platform
TravelNow	Discount Travel Booking service for air, hotel and ground transportation — promotes special discounts and deals on particular routes/properties.	• Owner: Hotels.com, majority owned by USA Interactive • Site is more like Web presence than e-commerce transaction processor; many transactions handled offline
Travelocity	Full-service, online agency with extensive network of suppliers built by/ on top of Sabre CRS. Boasts Internet and wireless reservations information for more than 700 airlines, more than 55,000 hotels and more than 50 car rental companies, plus vacation packages, tour and cruises plus a database of destination and interest information. Features “Best Fare Finder” search technology, hotel mapping and concierge services.	• Sabre owns Travelocity.com and GetThere, a provider of Web-based travel reservation systems for corporations and travel suppliers. • Currently replacing management team after recent buyback by Sabre.

For consumers, online travel and its new world of self-service has brought convenience, access, speed and control. It has also brought confusion and lack of consistency — albeit a consistency once confining, but at least one that let a consumer identify a good deal or not. Now, customers whose experience with booking travel was traditionally insulated from the complexities that lay below the surface are now given more choices about how and where they book and more services from which to choose, and yes, pay for. One key theme in this latest evolution in travel has been a redefinition of who the customer is at each stage of the process, and aligning costs and revenues accordingly. In the old world, the customer paid nothing explicit for travel services. The cost of the service was bundled into the cost of the air ticket. In today's environment, where the airlines have moved to zero commissions for travel agents, the cost of services — in the form of service fees — is now apparent. The airlines contend the consumer always paid for these services, but the money is no longer driving the airlines' financial statements.

Hence, leisure and business travel consumers have much more choice today in what and how they buy. It's not just selecting the destination, date, time, carrier and seat, but whether they want to research a trip independently or enlist an agent to help, receive an electronic or paper ticket, self-select the destination and travel logistics or have them selected for him based on excess inventory at deeply discounted prices. Today, travelers can tour hotel rooms through their Web browsers, find online references from other travelers and comparison shop in the most efficient way ever.

But given what we have discussed so far about how the air travel industry evolved in the last half of the 20th century, of the airlines' dominant role in all phases of its growth, and of how regulators in the 1980s felt compelled to establish rules where none before existed, what do consumers need to know about this new, fast-growing frontier in which the power appears to be in the hands of the people?

Let's look at this new world of Internet travel in more detail.

4. CONSUMER EXPERIENCE [Return to Top]

Consumer Reports Travel Letter last evaluated four large independent sites—Cheap Tickets, Expedia, Lowestfare and Travelocity—in October 2000. Though the findings were not conclusive, they did reveal some evidence travel sites may not always be totally objective:

- On Travelocity, advertised airlines dominated flight listings.
- On Lowestfare, many TWA flights with inconvenient itineraries (obtained through a contract fare deal) were repeatedly listed first.
- On all four sites, certain airlines with viable itineraries for routes tested were not listed at all.

As previously discussed in this report, the concern about bias dates back to the 1980s, when the U.S. Department of Transportation (DOT) devised rules for Computer Reservations Systems after receiving complaints about biased displays from travel agencies and airlines. The DOT was clear about regulating only airline-owned CRSs, so that such systems couldn't unfairly aid their sister-company airlines.

None of the travel Web sites in this series of tests were owned by an airline, although all four accepted advertising. And in some cases, airlines pay for more prominent placement. Travelocity presents "featured airlines," which receive full-color advertisements linked to specific cities or airports. When you request a list of fares, Travelocity asks if you would like flights offered by the featured airline, or choices from other airlines, as well.

In *Consumer Reports Travel Letter's* 2000 testing, the featured airline on Travelocity was listed first 48 percent of the time and dominated other listings. In nine separate tests, each recording the top nine flight choices, the featured airline flew at least one leg of every trip that Travelocity posted. Many of these trips involved convoluted itineraries melded together with at least one other airline.

Lowestfare's contract agreement with TWA seems to have influenced its flight listings: In tests, that airline was listed as the first choice 50 percent of the time (in 27 of 54 tests), when no other site listed TWA first more than 23 percent of the time. The TWA routings sometimes involved connecting flights when other Web sites offered non-stops.

Missing airlines

Another concern was raised when cross-referencing test results revealed that certain airlines listed in the Apollo Galileo benchmark as offering the lowest fare and a viable itinerary were not listed on some Web sites at all. Spirit Airlines was missing from Expedia; Vanguard was absent from Expedia and Lowestfare; and Southwest appeared only on Travelocity, even though Cheap Tickets and Lowestfare receive data from Sabre, which includes Southwest.

One key airline executive said at the time that Web site marketing initiatives include preferential listing of flights. Without identifying specific sites, Al Lenza, vice president of distribution planning for Northwest, was blunt. “The effect is you will get some low fares, but not all low fares. They want to charge us overrides [bonus commissions]. They claim they can give us more business. That means some of it is biased.”

He added, “[Airlines] are getting more than just banner ads for their money. When there’s a tie [in airfares], they show up first. And they get ‘preferred carrier’ status. Advertising is OK, but it shouldn’t influence the flight selections. We’re just not going to have our inventory be used to mislead the customer.”

Multiple partnerships

Lenza does have interests of his own. Northwest owns a stake in Orbitz, a joint Web site funded by the nation’s five largest airlines. Both the DOT and a Senate committee have raised concerns about Orbitz. The independent sites and the airline sites such as Orbitz are accusing each other of bias.

Orbitz has in turn attacked independent travel Web sites. Alex Zoghlin, the site’s chief technology officer, said recently of travel Web sites, “They tell [airlines] they will move market share. That’s a euphemism for bias screens.”

Others in the travel industry have concerns about Web site bias. In response, the DOT asked for public comments on whether or not it should regulate Web sites (airline- owned or not) as it regulates CRSs, though has not yet acted.

To regulate or not?

The two leading travel Web providers have disagreed about DOT regulation. Jim Marsicano, Travelocity’s executive vice president of sales and services, said, “It wouldn’t bother us at all to have the same rules applied to the Internet.”

But Richard Barton, president and CEO of Expedia, said, “Absolutely not. The inspiration for [regulating CRSs] was that the airlines owned the CRSs. We run a retail business. Should a government body decide where Wal-Mart should place Chee-tos on the shelf?” He added that he doesn’t believe in “regulation of fast-moving, complex environments.”

Barton contended the bias issue is moot for sites such as Expedia because their “motives are different” from those of airline- owned CRSs, and “for anything... not in the best interests of our customers — competition is a click away.” He added: “The terms ‘screens’ and ‘biasing’ don’t apply anymore. That’s old technology.”

He acknowledged that Expedia accepts airline ads to promote discounted fares, but said it doesn’t change the ordering of fares. Does Expedia promise increased market share? “That’s not the discussion we have with them.”

Some may find it difficult to distinguish between flight listings and paid advertisements for airlines on Travelocity.

Screen 1: A request is made for a flight from Newark to Los Angeles.

Screen 2: An ad for Continental, the “featured airline,” appears above “all airlines.”

Screen 3: Select “all airlines,” and Continental
is 5 of 9 choices. The first flight (Continental) leaves 30 mins. earlier than asked, yet the second (United) leaves only 20 mins. earlier.

Consumer Reports Travel Letter and Consumer WebWatch continued airline ticket-booking Web site evaluation in 2002 by looking at the six largest sites — Cheap Tickets, Expedia, OneTravel, Orbitz, TravelNow, and Travelocity — three of the original four, plus three new sites. They were evaluated against five criteria:

- The site’s ability to provide the lowest fares
- Its ability to provide viable flight itineraries that make sense for most travelers
- Ease of use
- Customer service
- Privacy and security policies

The six largest sites were selected based on numerous rankings from online consulting firms. "Branded" sites sponsored by individual airlines or airline partners were not examined.

How Sites Were Tested in 2002

A team of *Consumer Reports Travel Letter* and Consumer WebWatch researchers asked these six sites for the lowest economy-class fares on 10 busy domestic non-stop routes throughout the United States. The itineraries included routes frequented by vacationers as well as business travelers. They sampled a variety of trips with advance bookings ranging in length from same day to 105 days. Nine simultaneous test sessions were conducted in all, at various times of the day and week, for a total of 540 flight queries, and the researchers recorded the first fares listed.

To establish benchmarks, the researchers simultaneously requested identical information from Sabre, the leading computer reservations system used by travel agents, but not available to consumers (Sabre is also the parent company of Travelocity, having recently re-acquired the travel site.) Despite the influx of "Web-only" fares, we found that Sabre still provided a very strong benchmark (assuming, of course, that it is used accurately and fairly by a knowledgeable agent). The U.S. Department of Transportation regulates Sabre and all other CRSs for fairness and accuracy in displaying fares and flights. Harrell Associates, a leading airline pricing consulting firm, processed the Sabre data for *Consumer Reports Travel Letter.*

It is important to note these results were based on the first displays returned by the sites. One of the reasons CRSs are regulated, as previously discussed in this report, is that it has been shown placement of fares is critical since, historically, travel agents have selected the "first fares." But the six Web sites offer more interactive screen displays than the CRSs do, and some other options offered further down the display were both low-priced and viable, when we searched for them. In particular, Orbitz offers users a wide variety of choices on its flight and fare screens.

The Bias Question

As noted previously in this report, in the October 2000 study, *Consumer Reports Travel Letter* raised concerns about some disturbing evidence of bias because tests showed a possible relationship between the airlines that advertised on those sites and the order in which flight choices were listed. These latest tests have once again raised serious questions about potential bias and the way flight information is displayed, and the waters have become even muddier. Since 2000, there has been an increase in the number of proprietary agreements between independent travel sites and airlines. The resulting Web-only fares have certainly brought great bargains to consumers. But it remains unclear how such deals have affected the ordering of flights and fares on these sites.

The agreements between independent sites and airlines and other travel providers are proprietary. But all six of these sites confirmed to *Consumer Reports Travel Letter* that they receive various forms of compensation from airlines, despite the fact most U.S. carriers have recently eliminated payment of base commissions to travel agencies. For example, Travelocity stated it has "reached broad marketing agreements with several airlines" and "receives compensation for the value and services it provides the carrier, including e-mail campaigns, promotions, sweepstakes, and banner advertising." As the report has discussed previously, airlines traditionally pay incentive commissions to agencies — online or offline — in order to increase market share.

Consumer Reports Travel Letter was interested to see what happened when a smaller carrier operated the lowest-fare flight offered in Sabre. This is particularly important for Orbitz, given its controversial ownership by major carriers American, Continental, Delta, Northwest, and United. In the spring of 2002, key members of Congress were asking the U.S. Department of Justice to examine Orbitz for potential antitrust violations, particularly because the site receives guaranteed lowest fares from its owners on many routes — fares not routinely available to other travel sites. This followed the launch in April of a review of Orbitz by the Inspector General of the DOT.

The result was that in the 18 cases in which Sabre's first pick was a small carrier, Orbitz offered a higher fare in 11 cases, or 61 percent of the time; the other five sites offered a higher fare from 5 percent to 50 percent of the time. However, in these cases *CRTL* did not see a pattern of Orbitz favoring major carriers over smaller competitors.

Are such omissions or reordering of fares the quirks of a complex pricing mechanism or examples of bias? It's impossible to know. But it is fair to say that—even overlooking the issue of ownership — the relationships between Web sites and their airline advertising and marketing partners have raised reasonable doubts in both the studies. The DOT recently announced another extension, in addition to numerous previous extensions, of its review of the

CRS regulations, so federal oversight of online travel commerce does not appear to be imminent.

Viability of Flights

As price remains the most important feature for online travel shoppers, this was the key criterion of the research, however saving $25 while adding 10 hours and 2 stops to your trip is usually not a choice many travelers would readily accept. To determine flight viability, *Consumer Reports Travel Letter* looked at:

- A single-airline itinerary
- A departure time no more than one hour prior to that requested.
- A departure time of no more than four hours later than that requested.
- No more than one connecting flight, but non-stop flights preferred.
- A connecting time of no more than three hours.
- A connecting airport no more than 700 miles from a straight-line route between origin and destination.

In the 2000 study, most sites provided an attractive ticket price as a first choice, but sometimes with very impractical itineraries. The best sites then provided viable itineraries about half the time. Two years later, the two best sites provided viable itineraries 55 percent to 60 percent of the time — better, but still far short of Sabre at 98 percent. Expedia in particular didn’t seem to listen when an evening departure time was requested. For example, Expedia listed as a first offering an Atlanta-Miami departure at 7:30 a.m. when researchers requested a departure at 6 p.m. In fact, in 11 separate cases, Expedia’s first offering was at least 10 hours earlier or later than the requested departure time. Expedia’s connecting flights also strained credibility at times. For example, a round-trip from Atlanta to Miami included stops in Dallas on the departing flight and Washington, D.C., on the return. Another Atlanta-Miami trip included stops in Charlotte on the departure and Newark on the return.

Ease of Use

Consumer Reports Travel Letter determined five elements key to navigating an integrated travel site:

- Broaden or narrow airport search parameters.
- Specify the number of stops en route.
- Select a seat.
- Modify the flight information mid-search.
- Re-sort search results by price, departure time, or total flight time.

In both the 2000 and 2002 studies, the top sites far outperformed the second-tier sites in this area. The top sites are investing more in customer interface and user-friendliness, while some of the second-tier sites are holding steadfast in their niche — such as CheapTickets, which has restricted search capabilities and advance purchase requirements.

Customer Service

In evaluating customer service of online travel Web sites, *Consumer Reports Travel Letter* looked at several criteria:

- Toll-free numbers and availability of customer service help
- Email responsiveness
- Cancellation / refund policies
- Change Fees

While the sites vary in their customer service capability, the top sites again edged out the smaller sites — particularly in the 2002 study. It's clear the smaller sites are vying for a niche market, while the largest ones are clamoring for dominance. This can be good news for consumers, provided they are aware of the trade-offs.

5. Current Internet Travel Concerns & Quick Tips [Return to Top]

This report has discussed the history and evolution of the airline ticket-booking industry into the Internet age, and demonstrated empirical testing of independent integrated sites that raises concerns about bias. Now, in summary, the report will review the most salient, current concerns for consumers and discuss ways in which the consumer can better navigate potential pitfalls. The concerns fall into two broad areas: **Industry issues** and **consumer issues**. **Industry** issues involve the proverbial clash of titans — the major travel players, providers, CRS distributors and travel agents. **Consumer** issues focus on the plight of individual travelers — system functionality, ease of use, reliability of results, and the most important consumer concern, getting the best transportation at the best time at the most reasonable price.

Industry Issues

The industry titans are each pointing out the bad things the other is doing. As a result, there are currently about half a dozen cases where members of the group are urging the U.S. government to regulate some other member. This report's goal in this very complicated situation is to fairly present all sides of the major players' main issues in an **easy-to-understand way**.

Airlines

Airlines believe that it costs too much to distribute their product and are pressuring CRSs and travel agents to reduce costs. Considering the travel agent community is very disaggregated, with tens of thousands of agents, airlines began by reducing base commissions paid to travel agents. They began in the mid-1990s and had just completed the final round when base commissions were reduced to zero. Agency compensation actually continues under the guise of pay-for-performance incentives and override payments designed to reward agents for providing premium market share for airlines. Airlines have also developed their own booking sites on the Internet to facilitate direct bookings, and are luring travelers to these sites with “Web-only” fares, i.e., very low fares available only at their Web site. In addition, the major U.S. airlines have established their own Internet travel agent, Orbitz, designed to circumvent travel agents and CRSs, though Orbitz currently depends on a CRS for much of its functionality. Orbitz has been given “most favored nation” access to low Web-only fares, and is using that facility to grow its business from a start-up in the middle of 2001 to the third-largest non-airline Internet booking facility one year later. These fares were initially thought of and criticized for being exclusive. Now it appears the arrangement is not exclusive, as other Web sites and some brick-and-mortar stores are also getting these fares, either from the airlines directly or via Orbitz itself. Airlines reason that it is the net fare that matters, and they should be free to offer their lowest net fare (Web fare) on a selective basis. If this means offering these fares only through the distribution channel that does not further dilute that low fare (with CRS booking fees and travel agent commissions), then so be it. Airlines also believe that CRSs abuse their dominant market position and should be investigated by the government.

CRSs

CRSs believe their costs provide good value, and challenge anyone to develop a better mousetrap than Amadeus, Galileo, Sabre or Worldspan, in which they have invested millions of programming hours to develop. They think their product, while perhaps not the perfect distribution machine, provides an efficient solution for the most complex and demanding electronic business in the world. They vigorously support Internet travel agents that use CRSs, such as Travelocity and Expedia. They don't like the airlines' complaints about high costs, and believe that the airlines’ creation of Orbitz is an abuse of market power and should be investigated by the government.

Travel Agents

Travel agents are furious that the airlines have reduced their commissions and are angry that they created Orbitz to bypass them. They believe the government should investigate the airlines and Orbitz. In fact, they also support a government investigation of themselves, to show how much they contribute to the industry. At press time, this investigation, originally mandated two years ago and funded in October 2000, was set to get underway in mid-June, 2002, with a mandate to report back in the middle of November 2002. The investigation will have a broad scope and will include both brick-and-mortar agencies and Internet agencies. Travel agents also create uncertainty in this complicated mixture — some might say havoc — through incentive agreements with the airlines providing compensation for shelf position in the office, on the phone, and most recently, on the Internet.

Some say it’s analogous to the supermarket contest for premium shelf space involving Wheaties vs. Cheerios. This time, however, it’s being played out on the Internet as airline flights and fares suddenly disappear from the screen as commissions are cut and other “marketing arrangements" remain unconsummated. For example, earlier this year it was widely reported one major airline had its screen position adversely changed after it reduced commissions and did not promptly offset this action with other marketing arrangements. Also, *Consumer Reports* documented a case in which a major carrier withdrew its seats from an agent that it didn’t think was properly marketing the airline’s flights. Agents retort that they should not be forced to represent providers that do not compensate them for their services, especially if the marketplace is not willing to do so in the form of service fees.

In summary, the entire set of industry players is or might soon be under the government’s microscope as the DOT investigates Orbitz, CRSs and travel agents. The U.S. Department of Justice is examining Orbitz and the airlines for possible antitrust violations, and Congress is asking the General Accounting Office to investigate the CRSs.

Consumer issues mostly concern the booking process and include such issues as ease-of-use, reliability of results, and most importantly, the best price and value. First, know that good, and sometimes great, deals can be made through online travel sites. Remember that providers want repeat business. Patience and flexibility can go a long way. Surf when shopping for travel online. Take the time to look at different sites and return a few days later. Also, remember the “law of diminishing returns.” The information is all out there somewhere, but it may not be worth five hours to save $50 on a ticket.

Here’s some advice when using online travel sites, whether booking or just looking:

Quick Tips for Buying Tickets Online. [Return to Top]

- Compare airfare results on several different Web sites to find the best deal. Remember that bookings are in “real-time” and can change rapidly. Expedia and Travelocity allow users to create an itinerary and hold the reservation. Although they don’t guarantee price, you can return to the reservation later if you decide to book the flight.
- Make sure you understand the site’s fee structure. Neither Expedia nor Travelocity charges a flat fee for transactions, regardless of the airline. However, such fees often

vary based on the airline's agreement with the site — these deals are nearly always in flux. Just because one site charges a fee for a given airline doesn't mean all will.

➢ Check the rules before you buy: refundability and reusability, transferability and upgradeability. Find out if your "great" deal allows you to accrue frequent flier mileage or if there are any "hidden concessions."

➢ Be flexible. Often a lower fare is available if you're willing or able to choose alternate travel dates, flight times or airports. Many large U.S. cities have secondary airports nearby. Also, connecting flights, while adding time, can also save money as long as the routing and extra time invested is reasonable.

➢ There can be a difference between the price of an e-ticket and the price of a paper ticket, particularly if you book online. If you choose to have a paper ticket sent to you, be aware it is likely to come with an additional charge.

➢ If you're using a travel agency, let the agent know about the deal you've found online and see if the agent can beat it. Inquire about the agency's preferred-supplier deals with specific airlines, and ask if those agreements can provide any benefits. And don't forget to find out how much the agency is charging for a booking fee. Nearly all do these days.

➢ Once you find a low airfare on a specific airline, go to that carrier's own Web site and see if you can find an even lower fare.

➢ If Southwest flies the route on which you're planning to travel, visit its site to compare your search results, since it is the only major carrier that doesn't display its fares and schedules on any of the agency Web sites. Southwest's fares can rarely be beat. [Also note Southwest cannot publish schedules or fares to and from their main hub in Dallas, Texas, except from neighboring states, for regulatory reasons too complicated to discuss here, even though one can get to Dallas by hop-scotching Southwest's flights.]

➢ If you're flexible on your travel dates and times, consider using one of the Web sites that allows booking of deeply-discounted and completely nonrefundable airline tickets. There are real bargains on Cheap Tickets, OneTravel, and TravelNow for those willing to accept restricted airfares and connections.

➢ Some sites include airline advertisements on their search pages. Don't let them confuse you. Be sure to view all the available options.

- Whenever possible, book your airline ticket several weeks in advance. You’ll have a better chance of securing low-priced seats that often sell out first.

6. APPENDIX [Return to Top]

Illustration 1 — Computer Reservations Systems (CRS) Simplified

Illustration 2 — Computer Reservations Systems (CRS)

Illustration 3 — Travel & Credit Card Data and $$$ Flow
Current Tradition Travel Industry

Illustration 4 — Web Travel Structure
Travel Agent Sites "Sitting on a CRS"

Illustration 5 — Web Travel Structure
Travel Agent Sites with Direct Connections

Illustration 1
Computer Reservation Systems (CRS)
(Simplified)

CRS Functions

Maintain and Update
  Airline Schedules
  Airline Flight Inventory (Availibility)
    by Booking Class -- 10 per Flight (approximate)
  Airline Fares & Rules
    from the Airline Tariff Computer (ATPCO)
Search for low fares, Price and Issue Tickets
Track Tickets & Accounting for Airlines and Travel Agents
Track flight status -- Arrival, Departure, Timeliness, etc.

Display Interface with Travel Agent

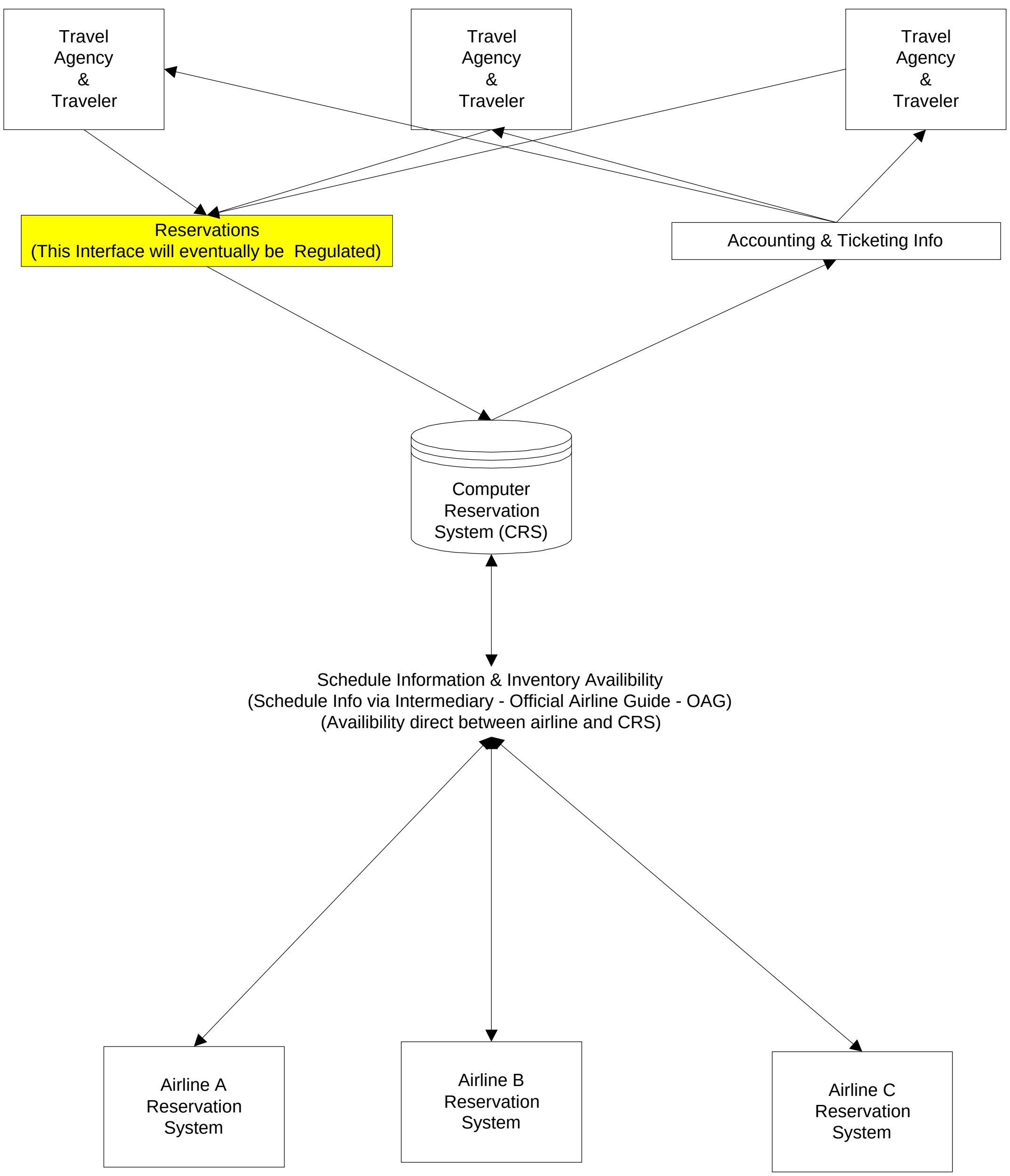


Illustration 2
Computer Reservation Systems (CRS)

CRS Functions

Maintain and Update
  Airline Schedules
  Airline Flight Inventory (Availibility)
    by Booking Class -- 10 per Flight (approximate)
  Airline Fares & Rules
    from the Airline Tariff Computer (ATPCO)
Search for low fares, Price and Issue Tickets
Track Tickets & Accounting for Airlines and Travel Agents
Track flight status -- Arrival, Departure, Timeliness, etc.

Display Interface with Travel Agent

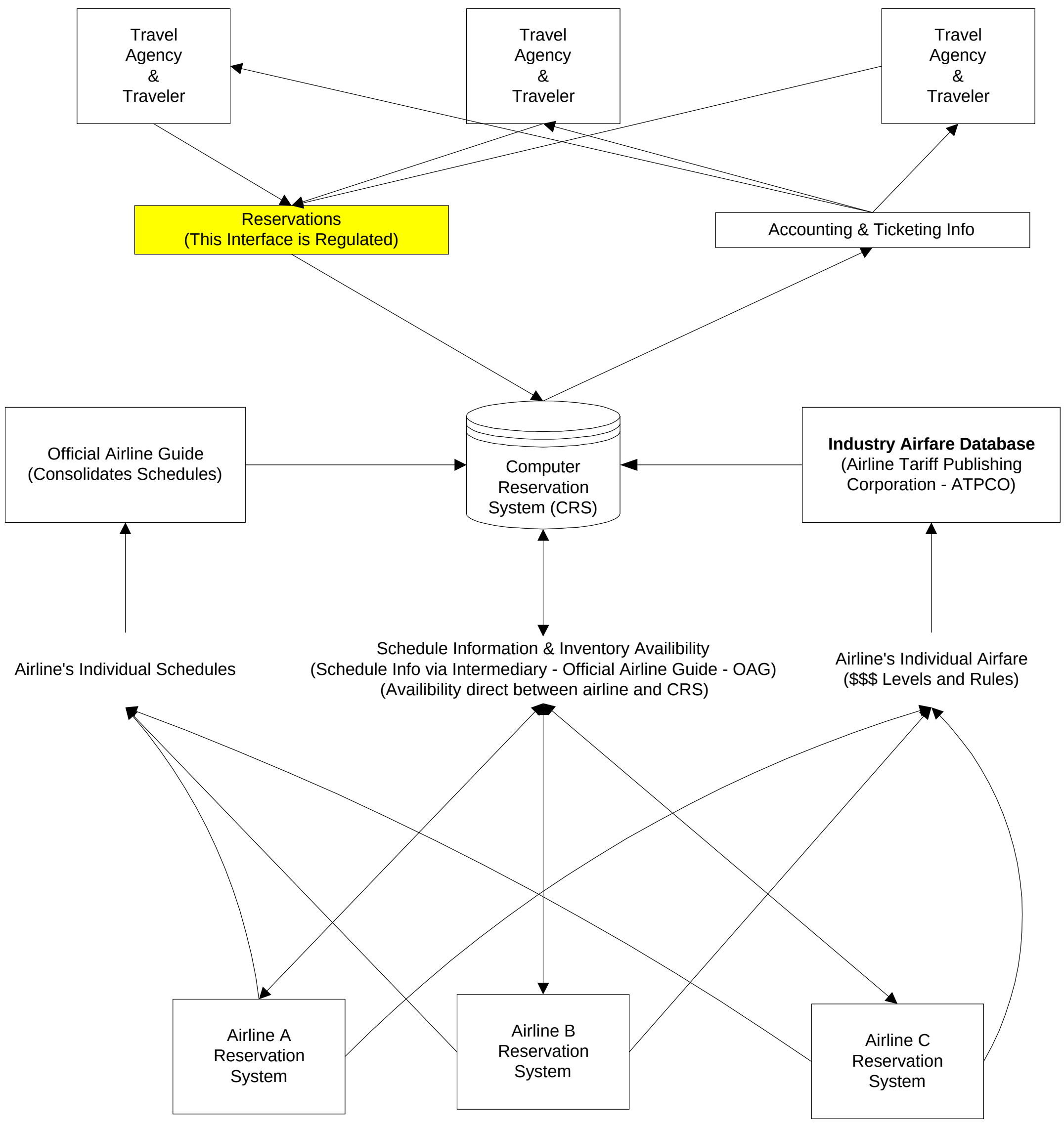


Illustration 3
Travel & Credit Card Data and $$$ Flow
Current Traditional Travel Industry

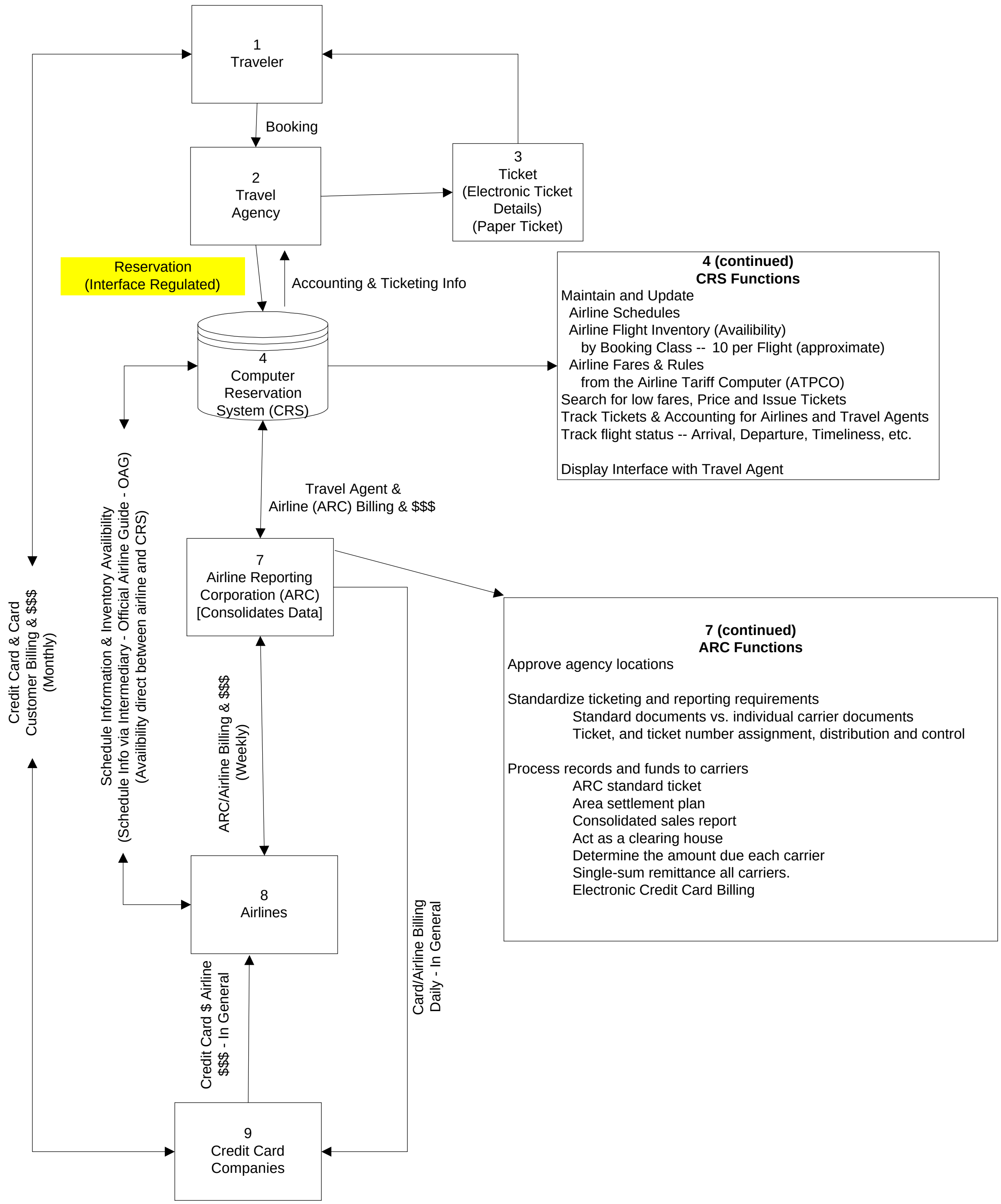


Illustration 4 -- Web Travel Structure
Travel Agent Sites "Sitting on a CRSs"

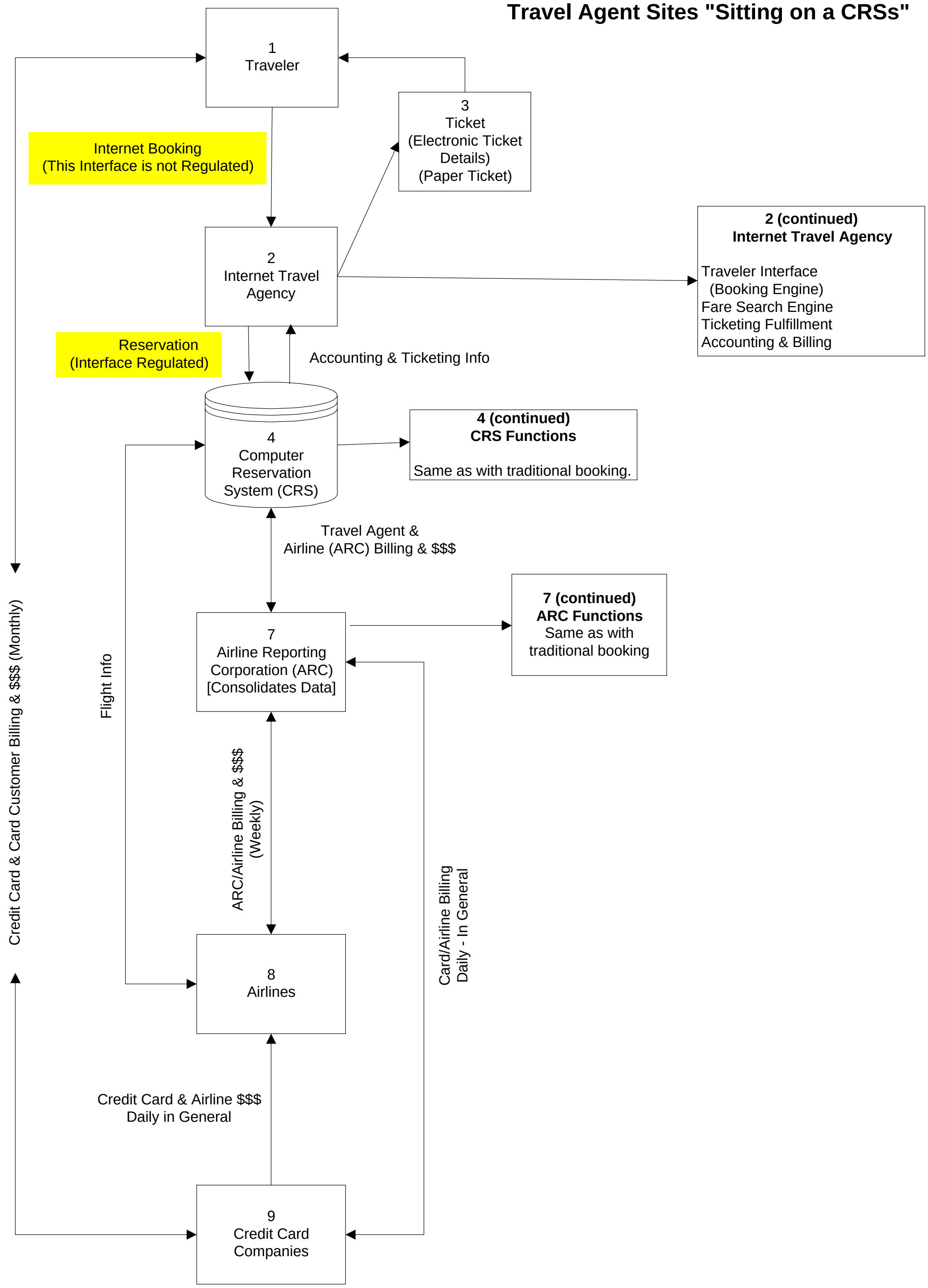
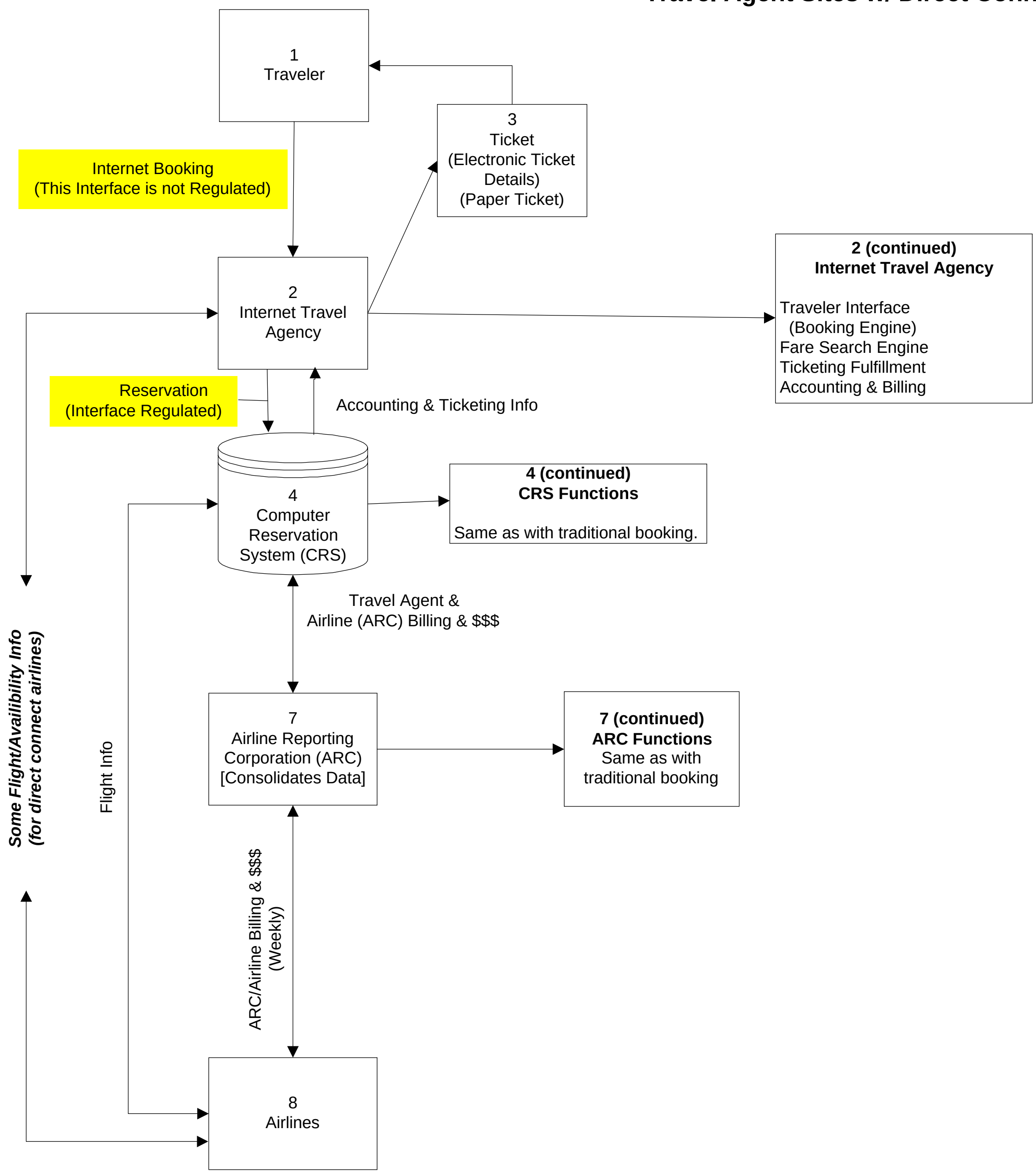


Illustration 5 -- Web Travel Structure
Travel Agent Sites w/ Direct Connections



7. BIBLIOGRAPHY [Return to Top]

Air Transport Association of America. State of the U.S. Airline Industry - A Report On Recent Trends for U.S. Air Carriers, Washington, D.C. http://www.airlines.org

Atkinson, Robert. *The Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting Consumers*. Progressive Policy Institute. January 2001. http://www.ppionline.org/documents/disintermediated.pdf

Barton, Richard. *Expedia Inc.: Scale and Profitability;* Morgan Stanley Internet, Software and Networking Conference. January 9, 2002. http://media.corporate-ir.net/media_files/NSD/EXPE/presentations/MorganStanley.pdf

Peter Costa, Doug Harned, Jerrold Lundquist, *Rethinking the Aviation Industry*. McKinsey Quarterly, 2002, Number 2. http://www.mckinseyquarterly.com/

Grant, Belinda. *Trends in US Airline Ticket Distribution.* McKinsey Quarterly, 1996, Number 4. http://www.mckinseyquarterly.com/

Harteveldt, Henry. "*New Hotel Portal Won't Dislodge Current Leaders*" (February 20, 2002) http://www.forrester.com/ER/Research/Brief/Excerpt/0,1317,14600,FF.html

Lee, Andrew. *Travelling via the Web: The Changing Structure of an Industry*. Harvard Business Review Case Study: Centre for Asian Business Cases, University of Hong Kong. 1998. http://www.business.hku.hk/research.centres/cabc/

Lee, Andrew. *Computer Reservation Systems: An Industry of its Own.* Harvard Business Review Case Study: Centre for Asian Business Cases, University of Hong Kong. 2000. http://www.business.hku.hk/research.centres/cabc/

Petzinger, Thomas Jr. (1995). "Hard Landing: The Epic Contest for Power and Profits That Plunged the Airlines into Chaos." Times Books: New York.

Speck, Eric. *The Partnership Imperative: Transforming the Business of Travel*. March 18, 2002. http://www.sabre.com/events/index2.html?b=1&a=http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=TSG&script=404&layout=-6&item_id=%2715%27

Williams, George. *The Airline Industry and the Impact of Deregulation.* Ashgate Publishing Limited: Hants, England.