INTERNET – A SALES CHANNEL IN THE AIRLINE INDUSTRY

DECISION SITUATION, RELATIONSHIPS, ADDED VALUE, AND FINANCIALS

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Executive Summary
This report covers the decision situation of a producer when confronted with the question whether to use Internet as a new sales channel or not. Three areas of consideration in that decision are: The relationship to the intermediaries, the added value in the traditional channel versus the Internet channel, and financials.

The study examined these issues in the airline industry. The traditional sales channel in the airline industry includes two intermediaries between the airline and end customer. The first is the GDS (Global Distribution System), there are four dominating actors in the world; Worldspan, Amadeus, Sabre, and Galileo. They serve as aggregators of offered tickets from a large number of airlines. The second intermediary, the travel agent, is connected to a GDS and gain access to flight and ticket information through it.

Characteristics of the airline industry include:
- Low differentiated commodity product with high service content.
- High competitiveness among incumbent companies.
- Low margins, 1-2% net profits versus 5% for the average industry in the US.
- High capital intensity.
- High information intensity, (both the value chain and content of the product).

The airline industry has gone through a change process beginning with the deregulation of the market. This happened in 1978 in the US, and in 1990 in Europe. This lead to increased competition on flight routes. Since the industry became an almost perfect market, with the airlines as price takers, no single airline could increase its prices due to the competitive pressure. Cost cutting was the only way to increase an airline’s profit. Internet emerged as a way of reducing the sales costs, counting for 14% of the total costs in 1997, the third largest cost of an airline. Cost reduction was the prime reason for the implementation of the Internet direct channel. Up to 80% of sales costs has been saved, the most on commissions. Secondary reasons were changing customer demands, efforts to get closer to the customer, and competitors’ moves. Some airlines have reached break-even, operationally and including the investment.

Intermediaries generally perform a number of functions: They engaged in market communication promoting the product and brand to the customer. The search and evaluation of information on the product alternatives is facilitated. The intermediary sometimes keeps inventory. They often execute the physical distribution of the product to the end customer. The transaction of payment, and post-sales support are also normal services of the intermediary. A new sales channel such as Internet has to attend to all of them in some way.
Since Internet essentially is a way of handling information flows, the search and evaluation conducted by the customer becomes of special interest in the Internet channel. It could be a way of offering superior value if it is administered in a better way compared to the traditional indirect channel. In that way, it could justify a price premium. This study has identified four ways Internet can be used in this part of the purchasing process.

The first one is as a *vertical facilitator*, which helps the buyer choosing from a set of products in an industry by using attribute and decision rules. An example in the airline industry with an approach resembling it is United Airlines. The second is as a *meta intermediary*, which take the starting point in the activities the consumer relates to each other in his/her mind. These are not limited to one industry, therefore the meta intermediary works across industries when helping the buyer to satisfy needs, e.g. Microsoft’s Expedia. The third is in the *learning relationship*, which uses the information from the buyer to alter the product itself and customizes it. Only one product owner is involved in this case. American Airline has taken on a path leading to this approach. These three alternatives can all create customer ownership, however the level of product ownership differs. The GR matrix illustrates these relationships. The fourth and last alternative, *information contagion*, does not primarily involve an information flow between the buyer and seller. Instead, previous buyers provide the prospective buyer with feedback on their consumption experience. Especially “experience goods” could benefit from the implementation of this mechanism since they are hard to evaluate before usage.

Lessons learned from this study include: The necessity of upper management support. Focus should be on action and not analysis in spite of the uncertainties. Issues with back-end and support functions often create surprise costs in an Internet venture. The profitability assessment of the investment in the Internet channel should consider future possibilities, “IT-options”, brought by the implementation. These could bring substantial benefits. While the intermediaries can be eliminated, the functions they perform cannot. Even if the Internet channel imply bypassing the intermediaries, the pursuit of the possibilities the new technology bring should not be halted. Extensive and sincere communication with them before and during the implementation can limit the perceived conflict. After some time, the relationship can be expected to ease.
## 1 Introduction

This chapter will provide the reader with a short introduction to the subject we have chosen – the decision to implement Internet as a new sales channel. This results in a problem discussion and the main objective of the study. From the discussion, the suitability of studying the problems within the airline industry and their sales of tickets evolves.

-It says here, the Internet is the future of business.
-We have to be on the Internet.
-Why?
-Doesn’t say...

*(IBM TV-commercial, broadcasted in Sweden 1998)*

Internet is one expression of the evolving Information Age; its adoption among users has taken place at until now unseen speed compared to any media (Morgan Stanley, 1999). It also transforms the way all organizations do business, and the pace of business is also increasing (Booz-Allen & Hamilton, 1999). The organizations that succeed, understand that an effective e-commerce\(^1\) strategy has to be integrated with the organization’s strategic vision as a whole and how other related organizations will be affected by this decision. (Plant & Willcocks, 1999; Hedman & Pappinen, 1996). The speed of change, together with the extensive implications, makes it unique in character. Furthermore, there since Internet is a new factor to relate to in business, not many past experiences of others can be used for decisions regarding it. This is what this report wants to contribute with.

### 1.1 Main objective

We have defined the Master’s Thesis main objective as follows:

*To study and get a better understanding of the use of Internet as a new sales channel when a sales channel including middlemen already exist. A description is made covering the decision situation and three areas that could affect the decision – relationships to the middlemen, added value in the channels, and financials.*

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\(^1\) Electronic commerce is any form of business transaction in which the parties interact electronically rather than by physical exchanges or direct physical contact, *(What is electronic commerce, 1999)*
1.2 Choice of Industry

We have chosen to conduct the study in the airline industry because it is an information intense industry, and the consequences of its use of information technology should clearer than in other industries. An industry is labeled ”information intense” (Porter, 1998) if it has a large amount of information in the value chain (Porter, 1985) and the product.

![Figure 1: Level of information intensity of value chain combined with amount of information content of product is a way of classifying the industry’s information intensity (Porter, 1998).](image)

The airline industry is information intense for a number of underlining reasons, see figure 1. First (the product), when a plane leaves any free capacity in the form of unsold seats it is lost forever. To maximize usage, heavy information handling is needed such as multiple price range quotes, different terms for tickets, diverse distribution system etc. Second (the value chain), to make a plane fly many things must come together timely; crews, plane maintenance, weather forecasts, slot times, luggage and cargo, passenger transfers, specially requested food etc.

An example how information technology can make a difference in the value chain of an airline is the decision support system used for scheduling its pilots for the 2200 daily flights that enabled American Airlines to save $50 million per year (Forbes, 1997).
1.3 Demarcations
We have chosen to study European airlines as represented in Sweden and airlines in the US. The reason why the European airlines are only studied in Sweden is that it constitutes a minor interest in the study. Although a comparison between the US and Europe is conducted, the main goal is to give guidance to other industries from the US airlines’ experiences. In general, Europe is substantially behind the US in adopting electronic commerce, even though it now grows at a faster rate (Taylor, 1999b). Thus, less emphasis is put on the research in Europe. The airlines chosen are required to have a traditional distribution channel as well as an Internet on-line sales channel to be eligible as study objects. To be able to make analogical comparisons with other industries it is a necessary requirement. Even if security, logistics, and general penetration undoubtedly have a major impact on what we are studying, it is not a focus of the thesis. To incorporate these in the research would make it too bulky. Travel agents were only interviewed in Sweden since we considered it enough for its explorative purpose. Neither is the end customers interviewed or studied closely. Some secondary sources regarding them are however used. The time constraint is again the reason for the exclusion.

1.4 Target Audience
This Master Thesis is conducted at the program of Business and Administration at Linköping University in Sweden. It is a study within a larger project, the “Service Innovation” project at MTC (Marketing Technology Center) 2. The companies and members of this larger project was the original target audience. This is a short version of the thesis, edited for The Travel and Tourism Research Association’s European Conference 2001.

1.5 Report Layout
The report begins with an overview of the airline industry.

The chapter Decision Situation discusses questions like: What was the decision to use Internet as a sales channel based on? Which were the key drivers? How was the decision made?

The chapter Relationships in the Channel discusses questions like: How do the middlemen react to being by-passed, as the producer introduce the direct

2 "Service Innovation" is an MTC marketing research and development program operating in close co-operation with leading Swedish corporations. Http://www.mtcab.se
Internet channel that “steal” their customers? How should the relationship be handled by producers?

The chapter *Value Added in Channels* discusses questions like: Does the value delivered differ just by the virtue of the fact that the traditional channel and the Internet channel are different? Is it possible for the producer to gain better relationships with the end-customer?

The chapter *Financials* discusses questions like: Is it true that the transaction cost will be less if organizations sell their products over the Internet compared with the traditional distribution channel? Will the revenues be shifted from other sales channels or will new revenues add to the profits? Are there other considerations beside of the directly quantifiable revenues and costs that have to be taken into account in the Internet investment decision?

The chapter *Network Economics* summon up the previous three chapters and themes from the perspective of Network Economics. The overall question is: Are these ideas used in the Internet channel?

The results are summoned in the chapter Conclusions and Recommendations.

In the last chapter there is a rather extensive Method descriptions. Something we feel is necessary to enable the reader to draw conclusions of our findings to his/her own context.
2 The Airline Industry

This chapter will provide the reader with a historical perspective as well as a general description of the airline industry and its place in the travel industry.

The travel distribution’s history goes back to 1950s and 1960s when travel agents sold incremental leisure trips, a business that required a lot of coaching and advising. In 1980s and 1990s, airlines noticed they were paying commission to travel agents for serving both incremental travelers and business travelers. It had changed from being a cheap channel to an expensive one. (Clemons, 1999)

The opportunities are complex and varied for all the actors in the traditional distribution channel and therefore it is difficult to determine the strategies that will add value to the different actors’ offerings (Andersen Consulting, 1998).

2.1 Highly Competitive

Before the deregulation, 1978 in the US (Sarathy & Ramamurti, 1997) and 1992 in Europe (Bouvard & Somosi, 1997), the local airline often had a market share of 60%. There was little incentive to control costs, improve their internal channels or manage the relationships with the external distributors more efficiently. This since they were able to compensate it by charging customers high ticket tariffs and needed minimal marketing. (Bouvard & Somosi, 1997)

The initialized deregulation opened up the market for competitors, which resulted in price cuts on the tickets. A fully deregulated environment permits the airlines to fly domestic routes in any other country and full access to all international routes. It has resulted in increased competition and concentration of airlines. This growing international competition pressures airlines to reduce costs and become more efficient to optimize market share. (Sarathy & Ramamurti, 1997) The airline industry of today can be said to be close to perfect competition and therefore each airline is a price taker; no airline can set the price on the market, instead it has to accept the existing price more or less.

Because of the high competitiveness, the airlines operate very close to the break-even load-factor, (passenger seats filled compared with capacity). This implies that sale of a few additional seats can turn a loss flight into a profit one. A net profit of 1-2% is normal in the industry, compared with 5% for the US average. There is a clear trend for the yield (revenues per miles flown) to get lower seen over a time span beginning in the 1950ies. (ATA, 1999). Airlines flew more than 205 million empty seats in 1997, although it was the most profitable in industry history (Priceline, 1998).
While the yield is constantly lowering, the net profit is already minimal. This means that either the load-factor has to increase or the costs must be lowered in order to increase the profitability. Cost efficiency is a primary goal in the industry (Das & Reisel, 1997).
2.2 Airlines’ Revenues and Costs

Passengers accounted for 73% of the major airlines’ revenues in the USA in 1997 (freight and cargo 10%, charter 3%, mail 1%, and other 13%). Less than 10% of the tickets sold are full fares; these are mostly last minute business travelers. The 80:20 rule applies in the industry; 8% of the total numbers of passengers make 45% of the trips. (ATA, 1999) This is one reason for the importance of the frequent flyer programs. The average frequent flyer in the US though belongs to 4.9 programs. The number is lower in Europe, more due to the geographical spread of the programs than a lack of interest. (Upton, 1999)

According to Bouvard & Somosi (1997), the ticket distribution is often the airline’s third largest cost after personnel and fuel. This is consistent with the ATA (1999) statistics: The share of the costs in 1997 for the promotions/sales was 14%, including travel agent commission. (Flying operations 29%, aircraft and traffic service 16%, maintenance 12%, transport related 10%, passenger service 9%, administrative 5%, and depreciation/amortization 5%). As much as about 10% of total costs are commissions to travel agents. This means that there is much to save from cutting the tickets sales costs.

2.3 Distribution in the Travel Industry

The traditional distribution channel links the producers to the end customers in a linear shape, see figure 3. The aggregators are the GDS, Global Distribution Systems, (sometimes called CRS, Computerized Reservation Systems). They communicate inquiries and booking requests between the producers and the travel agents. GDS’es are predominantly unknown by the customers as they have a separate role from the airlines and the travel agents. (Andersen Consulting, 1998).
The tour operators are wholesalers that buy from different producers and combine products together to packaged holidays. These are sold directly to the public or through travel agents. (Andersen Consulting, 1998).

The retailers, travel agents, have traditionally been the dominant sales channel for the producers with the 80% of airline tickets that were issued by travel agents in 1997 (Andersen Consulting, 1998; Bouvard & Somosi, 1997), see figure 3.

<table>
<thead>
<tr>
<th>Country</th>
<th>Direct Channels</th>
<th>Indirect Channels</th>
</tr>
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<tbody>
<tr>
<td>France</td>
<td>22%</td>
<td>78%</td>
</tr>
<tr>
<td>UK</td>
<td>15%</td>
<td>85%</td>
</tr>
<tr>
<td>Germany</td>
<td>10%</td>
<td>90%</td>
</tr>
<tr>
<td>US</td>
<td>20%</td>
<td>80%</td>
</tr>
</tbody>
</table>

Figure 2: The traditional distribution channel in the travel industry. (Development of Andersen Consulting, 1998)

Figure 3: Percent of tickets sales in direct channels (airlines’ own ticket offices and reservation centers) and indirect channels (travel agents etc), (Bouvard & Somosi, 1997).
2.3.1 The Travel Agent Channel Cost

Each time a travel agent books a flight through a GDS, the airline has to pay a fee of approximately $3 (Forbes, 1998). Different sources give varying answers on the level of this fee. It depends on which GDS the booking is going through and what level of service the airlines want. The airlines also have to pay the travel agent an average 8% commission on the total price of each ticket sold. Including these two fees, the distribution through the indirect traditional channel cost an airline approximately 17-20 percent of the ticket price. Also included are bonuses, credit card fees, and the airline’s own costs, such as its sales force. The distribution through the airline’s own direct channels (ticket offices and reservation centers) are cheaper, it cost about 10-15 percent of the ticket price. Through the direct channels the airline save the travel agent commission, hence the difference between the two stated percentages. (Bouvard & Somosi, 1997)

Tickets sold through the Internet allow airlines to save the commission, internal handling costs, and sometimes to eliminate the GDS fee completely or lower it substantially. Our conclusion is that it is reasonable to believe that the distribution cost, using the Internet sales channel, could be less than 10% of the ticket price.

These factors, among others, will decide the future of the traditional distribution channel in the industry. Depending on how fast the above changes occur, the different actors need to determine how proactive they need to be. When customers obtain direct benefits using Internet compared to the traditional distribution channel, it will speed up the transformation. The benefits might include lower price, more convenient hours, and better service. (Vassos, 1996)
2.4 The Travel Industry’s Customers

In the travel industry the customers can be divided in two parts, corporate and leisure. Corporate travel is divided in two parts, easy self-booking through Internet and more complex journeys booked through highly qualified travel consultants. Leisure travel is divided as well, easy bookings and packaged bookings through Internet and more complex bookings through a travel agent, see figure 4. (Andersen Consulting, 1998)

Figure 4: The importance of emerging channels, in different market segment. Source: Andersen Consulting, 1998.

Many customers in the US are using self-booking technology, which give them an access to travel reservation systems from their own computer. They can choose flights, check prices, book hotels and use additional features such as maps and destination information. In the US, it is mostly simple trips “point to point” whereas Europe travel is more complex. There are different opinions regarding the benefits of self-booking where many managers are worried it will be just another task added to already busy days. Others have experienced saved travel costs, Charles Schwab, an US analyst group, saved $1.6 from its annual travel bill as well as saved staff salary. Other benefits shown are earlier travel decisions and gaining cheaper flight deals. Travelocity, one of the largest Internet travel sites, have 30 % bookings from corporate customers. Since more trips that are complex are conducted in Europe than in the US, this has resulted in a barrier for European executives to adopt self-booking technology. Further, there are many arguing that highly paid managers do not want to be their own travel managers. (Jolley, 1998)
3 Decision Situation

This chapter describes how the decision regarding implementing Internet as a new sales channel was made. The four chapters following after go into deeper detail on the major issues involved in this decision making.

As previously described, external forces put a pressure for change in the Airline Industry – the deregulation lead to price pressure, in turn requiring cost cuts. The Airline Industry showed net margins that were half of the average US industry, and should thus be considered mature.

“There are no longer mature industries; rather, there are mature ways of doing business.” (Porter, 1998, p 84).

3.1 Internet – The Opportunity

Internet became a commercial tool in the beginning of the 1990-ies (Kalakota & Whinston, 1996), and represented a new window of opportunity. Transaction costs are lower in the new marketspace (Rayport & Sviokla, 1994), and enables savings in sales and distribution. It also allows for convenience; the change in customer demands is also suggested as an important driving force (Andersen Consulting, 1998). What was the main driving force that influenced the decision in the Airline Industry to implement the Internet sales channel?

Our findings are similar to earlier research (Fredholm, 1997) in that the driving forces in the beginning was primarily cost reduction and secondary increased competitiveness. Later, the more efficient information flow and improved customer relations became appreciated. But, cost reduction was still regarded most important:

"It is a survival strategy. There is competition on all destinations... This brings the need to lower the costs.” Account Manager, 2E.

“It was more a money saver than a money maker.” Internet Manager, 3U.

3.2 Type of Change

Two different aspects of strategic changes can categorize its type: First, the degree of change intensity. Organizations face either revolutionary changes or there are incremental refinements of current strategies, continuous adoption. Second, the degree of voluntarism in actions taken. If the organizations have to
change due to external changes obvious in the industry, reactors, or if they seek new opportunities and directions, proactors, (Hellgren & Melin, 1991).

![Diagram of Four types of strategic change](image)

**Figure 5: Four types of strategic change. Hellgren & Melin (1991)**

All respondents agreed that the change, the introduction of Internet in the travel industry implies, was revolutionary. When the decision first was made it was a difference between Europe and the US regarding the level of reaction versus proaction. The Swedish respondents showed more of a reaction. Some of the US airlines also had signs of a reactional response, but the overall picture is that they were much more proactive. At the time of the interviews, when all the airlines have their sales enabled sites, they all claim to be proactive. In figure 5 (Hellgren & Melin, 1991) the US airlines are located in quadrant 1 – they were proactive to the revolutionary change, while the European airlines are in quadrant 2 – they responded more reactive to Internet. The fact that the US airlines all thought their site was the best in the industry support their self-image of proactiveness. It is not unusual for a respondent representing an organization to laud his or her own activities and position. One possibility, provided that they did have an honest opinion about their superiority, is that it is possible to differentiate an Internet site. This differentiation would mean different business strategies and prioritizing customers needs and wishes in other orders. In that case, the different objectives and goals the strategies imply, opens up for each one of the sites to be “best” in the industry from that perspective.
According to Brown & Eisenhardt (1998), the key strategic challenge is to manage change. Hamel & Prahlad (1994) are also emphasizing the importance for organization to change.

“In order to keep its lead, companies sooner or later needs to renew its leadership role, in order to renew its leadership role it must renew its industry, and to renew its industry it has to renew its strategy” (Wigblad, 1998, p 17).

If change is the only constant, and organizations need to be proactive, why then were the European airlines less proactive? Or, was Internet not an important issue? The answer probably lies elsewhere. It is hard to plan for the future, but managers cannot wait for the future either, they need to look ahead and not be left behind (Brown & Eisenhardt, 1998). Those in top management positions that neglect the Internet have even had to face personal consequences:

“A driving force for upper management could be the risk of being seen as not doing their job if they do not use Internet. Some have lost there jobs because of it. [But not in the respondent’s organization].” Internet Manager, 3U.

One example of the above statement is the firing of Eckhard Pheiffer, the CEO of Compaq, because he did not act fast enough to align Compaq with the Internet business (Sandén, 1999).

### 3.3 Making the Change

“Electronic commerce is with us, like it or not”. (Lepore, 1997, p 84)

In spite the hype about Internet businesses in the media with several articles published each week, information to facilitate the decision-making was scarce which made it harder for managers to make the decision on Internet implementation. Also, while many opportunities were obvious, some reports described organizations experience frustration, confusion and unprofitable Internet sites. (Spar, & Bussgang, 1996) It is also known that financial predictions and budgets often fail in a number of ways (Wallander). Implementing Internet as a sales channel was a major change in strategy.
The logic of the rational decision model according to Lekwall and Wahlbin (1993) is that a large and uncertain decision should be dealt with using increased amount of information and analysis. However, Brunsson (1982) point out that large changes need motivation and commitment to achieve the necessary action. But, a rational analysis works against these needs, instead an action rational approach is favorable. In this context, the balance between decision rationality and action rationality is put on its edge. While the extensive uncertainty and large investment amounts suggest a decision rational approach, the needed speed calls for action rationality. Our perception of the decision processes is that the European airlines’ decision-makers have leaned towards the decision rational approach and the US towards more action rationality. Hellgren and Melin (1991) argue that organizations in Revolutionary/Proactive quadrant, do not experience any major problems despite the change. Our judgement is, as we mentioned earlier, that the European airlines were more Revolutionary/Reactive. Organizations in this quadrant typically experience crises resulting in major changes in their strategy. We suggest that this crisis could in the case of the European airlines be the need of forming new ideologies. Brunsson (1982) argue that rational decision making is appropriate in forming new ideologies. A more rational approach was also noticed among the European airlines. This rational approach was not as present in the US airlines, an explanation could be that their ideologies already was suitable as decision rules about using Internet as a new sales channel. Since the ideologies did not need to be changed, US airlines could instead focus on action. The differences in ideologies are understandable from the perspective of the deregulation. The US deregulation occurred in 1978, giving the airlines plenty of time to develop new ideologies suitable for the Internet context. The needed change of ideologies might not have take place as Internet was forced upon the European airlines, the deregulation in 1992 happened almost in the same time as the commercialization of Internet. Brunsson (1982) say that the ideological shifts are slow to take place, and this could explain the time lags between an organization’s response and environmental threats, making this a reasonable explanation.

Though, a map of the unbroken land is emerging for the US airlines, after one to two years of the on-line sales channel introduction, the organizations feel that they can have a more systematic approach nowadays. Historical data for analysis are available, knowledge and experience are built up within the organizations, and instruments for assessing the customers’ needs quickly enough are available. Hence, a more decision rational mode is evolving. Nevertheless, it is not lowering the speed of action. As the European airlines have their new
ideologies in place they will, according to our thoughts, move more towards action, see figure 6.

Figure 6: A matrix showing the decision making regarding the Internet sales channel for the European and US airlines, with their present change in decision mode. (Own development of Brunsson, 1982)
THE AIRLINE INDUSTRY

4 Relationships in the Channel

Internet has not been the first threat to the travel agents’ position. In mid 1980ies technology made it possible for the customers to search and book flights, hotels, and cars etc directly in the travel agents booking system through a PC or VideoText terminal:

“The Swedish travel agents are facing an evolution. A straight channel between the producers and end customers is a threat to the travel agents, a threat they must meet with larger service offerings.”

(Travel Management 1987, p17)

The emergence of Internet and e-commerce may cause major shifts in the power structure of any industry. In almost every distribution channel, there exist an organization that has more power than others. (Vassos, 1996) The dominant member leads the distribution channel and exercise control (Kotler, 1997). According to Frazier (1999) an organizations power in a relationship is its potential for influence on the other organization’s beliefs, attitudes and behavior. A definition of power according to Thorelli (1986) is:

“…the ability to influence the decision or actions of others”.

(Thorelli, 1986 p 38)

The producers have power since they own the product as well as they have the financial resources to maintain product research and development. This is often true when the producer has a strong end-demand and when the distributors are relatively week. However, that is not always the case argue Stern & El-Ansary (1988), distributors may be the ones who manage the relationships in the channel and have the power. One thing is clear, there are no guarantees that the one who has control today will have it tomorrow. The one who has the power in the traditional channel – the producer, the intermediary or the end customer has the power to decide the rules in the industry. What are the factors deciding who has the power and not?

The underlying reason for airlines to use travel agents was economic factors since leisure trips was expensive to handle. When the travel agents later took care of the business trips it turned out to be an expensive distribution channel for the airlines. Other factors why airlines use travel agents (Kotler, 1997) are their ability to offer more products than just flight tickets, e.g. hotels, cars, and trains etc. Further, they have a long experience to handle leisure and business trips as well as they have the customer contacts. They act as a third party and give the
customers added value offering customers collection, collation, interpretation, and dissemination of vast amounts of information (Quelch & Klein, 1996, Alba et. al, 1997). They also act as the airlines’ channel to their market since it is an efficient way to reach customers, especially for a foreign airline not having an extended network in other countries. Today, approximately 80% of the tickets sold are still through travel agents in both Europe and the US. Some traditional travel agents in the US say though they have lost 10% to 20% of their business during the past years as customers switched to on-line ticket purchasing. (Taylor, 1998). This figure is probably not representative for all travel agents, rather it could reflect those finding it hard to adapt. In general, airlines are dependent on the travel agents, and have been for a long time, a relationship that seems hard to brake since customers continue to favor them. But, in the future, the travel agents will probably see some pressures in form of less sales because of Internet.

Since the 1950s, the travel agents have built up personal relations with the end users and have the advantage of knowing the customers. Many airline respondents emphasized that travel agents have extensive knowledge about their customers; they almost have monopoly on the relationship. The airlines first responded with the implementation of the frequent flyer program, and now the Internet. The negative side for the airlines is that the frequent flyer programs only create a relationship with those that the airlines traditionally have had a relationship with and met in the seats of their planes. In favor of the travel agents is that they also have knowledge about the buyer, which could be the organization the person is employed by and not the flyer.

“[The airline] do not choose to ignore the travel agents because they are the one who have the flyer/buyer in their hands.” Distribution Manager, 5E.

For many years, the airlines have had a strategy towards the travel agents similar to what Siguaw et. al (1998) is talking about, a market orientation strategy. They have worked together towards a common goal and shared information about the industry and the customers, who in turn created trust and credibility between them two, see figure 8.
This still holds true when it comes to foreign airlines in a national market, it is the local carrier that mostly has experienced the conflicts. The travel agents are in a special situation since they are agents and not traditional distributors, and are forced to follow the airlines’ prices and rules. This means that they normally offer all the world’s airlines to their customers together with hotels, cars etc. It is then important for the airlines to have a fruitful relationship with the travel agents as they recommend an airline to its customers, since the airline is one among many offered by the travel agents. If the travel agent feels comfortable and trusts the airline, it is likely to be favored. In accordance to this, the airlines pay “overrides” and bonuses to those travel agents that sell more than they did the previous year. (Bouvard & Somosi, 1997) This is an incentive for the travel agents to favor a specific airline.

In Europe, the local carriers still have a dominant position in their local market. This has also given them the advantage to control the rules in the industry, which was supported by the interviews we conducted:
“The national carrier has the advantage to decide the rules in the market. They were the first to lower the commission to the travel agencies. As much about half of our flight tickets sales are with the national carrier, which means that we have a strong dependence on the national carrier. Travel Agency Representative, 8E.

Before Internet was introduced, the airlines lowered their commission to the travel agents. This first happened in US and later in Europe. The airlines had pressure to reduce their costs since they are operating in a mature industry with low margins (ATA, 1999). In this competitive market, the airlines cannot afford to pay full commission and still be at the mercy to the travel agents. The reason for lowering the commission was that they regarded the travel agents work with advises, booking, ticketing flights, hotels, cars etc. as a cost they were not prepared to pay for. They are only prepared to pay for booking and ticketing flight tickets. The local carrier in Sweden has also undercut the travel agents. If a business customer books his/her ticket through their direct channels such as Internet, he/she will be offered a price 4% lower than the travel agent can give. So far, this concern only e-tickets to some specific destinations. This together with the lower commission and the implementation of Internet made the travel agents loose their trust and commitment towards the local carrier. A conflict started and our findings showed that the travel agents were not happy about the situation and they now have a policy regarding what airlines to favor when their customers book their tickets. This is also supported by an article in Dagens Industri (Bark, 1999a), the travel agents directed their ticket sales to other airlines since SAS acted without consideration of their partners and “shot themselves in the foot”. Since the local carrier has lowered its commission, domestic airlines have followed, but not to the same extent. Their response to this was: Why should we pay high commission when the local carrier does not? But, they strongly argued that they never undercut the travel agents and by doing so they have not experienced any conflicts. The conclusion of above is that as long as the local carrier has its dominant position and decides the rules in the industry, the travel agents are trapped.

“It is easy to lower the commission as a national carrier, it has been done in other countries too, they are the once who have driven the cuts. We are just following, but not lowering the commission to the same extent. This means that we will not have the conflict the national carrier is experiencing.” Airline Representative.

When Internet was implemented, the airlines knew they risked damaging their relationships with the travel agents, relationships that have been carefully built
up over decades. (Ghosh, 1998) But, there was little choice, they needed to cut their costs, and the third largest cost is the distribution of tickets (Bouvard & Somosi (1997). The airlines we interviewed argued that this was the most important driving force for implementing Internet as a new sales channel. The travel agents’ first reaction was that the airlines “stole” their customers since they have had the personal relationships with the customers. There were travel agents worrying about loosing their jobs, but most of them understood it was the way of the future. But, the respondents at the travel agents thought this could have been dealt with more thoughtfully. The airlines put their own needs and goals in the first room instead of the distributors and created a conflict instead of continuing the fruitful cooperative relationship they had from the beginning (Siguaw et. al, 1998). Still, our findings were the same in Europe and the US, the travel agents are still important partners and the airlines do not plan to cut them out. One airline mentioned they appreciated the help the travel agents provided, but they are able to do what ever they want. This may be right since the airline own their products but, this do not create mutual trustworthiness and cooperation (Zineldin, 1997). To the benefit of the travel agents is that the transformation from one channel to another will not happen over night. According to all airline representatives, the travel agents have realized that Internet is a reality they cannot ignore. Other industries have experienced this as well, an example is Intel who is a strong supporter of e-commerce. In the beginning there was a fear of Intel bypassing the distributors, but so far there has been little conflict. (Formemski, 1999)

Since the deregulation, the travel agents realized their role would have to change (Bouvard & Somosi, 1997). They did not know that the Internet would emerge with such a pace and the risk to be bypassed. This has shaken the travel agent community as well as other industries. To protect their position the travel agents have to change their strategies if they want to find a fruitful position in the future. Their new strategic initiatives have been e.g. to develop of their own Internet on-line sales and offer more consultant services. They have also started to charge their customers a booking fee at the same time they are giving back the commission they get from the airlines (Bark, 1999a). This is a way to show their independence and their customer orientation. This is supported by the airlines, they believe the travel agents have to differentiate themselves otherwise they will be put out of business.

In the end, it is the customers who choose where he/she will book his/her travel arrangements, direct to the airline or indirect through a travel agent. Either way, it will depend on, among other things, how the purchasing process can be conducted in the most favorable way to the customer (Alba et. al, 1997). Some
customers want to have a third party booking their trips, whereas others want to have control and book their trips by themselves. The development and emergence of Internet as a new sales channel will depend on what the customers desire and which Internet sales format that will be preferred. All airline respondents supported this, they emphasized that it is the customer who will have the power in the future. He/she is the one who decides which channel he/she will use when buying a trip:

“The customers will have the power in the future. It costs [the airline] several millions to create new channels and it is done because we believe that is what the customer wants.” Account Manager, 2E.

4.1 Relationships to the flyer/buyer

Other authors (Gummesson, 1995, Zineldin, 1998) support our findings, customers become loyal if the organization can provide benefits others cannot do. That is to say, if an organization is able to continue provide benefits, a long-term relation will be in place. It is critical to develop and maintain a relationship to reach successful exchanges. The airlines have described security, timetable, destinations, price, and services to be the most important benefits. The local carrier has even in this case an advantage since its hub is located in the country. Therefore they have more destinations, a better timetable and, ground services. The frequent flyer program is mentioned by several respondents as an instrument to create loyal customers, maybe the best way. However, some were more negative and said it is very hard to create loyal customers, in “99 of 100 cases the destination and frequency mattered the most”. Even in this case it shows the benefit of being a local carrier as they have more of these choices to offer.

When it comes to choosing airline the travel agent can always try to lead the way, show the benefits of using one airline instead of the other. One problem they face though is the airlines frequent flyer program; customers often choose the airline where they can collect points. The customers often stay with his chosen favorable frequent flyer program because of the personal benefits (Bark, 1999a); Customers/travelers often sign-up for a frequent flyer program with its local carrier since they have a dominant position which mean many destination, frequent take-off and easy access to local ground service.
5 Added Value in Channels

The purchase process’s search activity (Wells & Presky, 1996) are supported differently in the traditional distribution channel and the Internet:

“Retailers and retail formats compete in the types of information they convey effectively to customers.” (Alba et al, 1997, p 40).

Low cost and commodities products got high sales volumes early on the Internet, while high-involvement products were lagging behind (Business Week, 1998). This might lead to the conclusion that these are not suitable for Internet sales, but research suggests the online channel has great advantages in relaying information for purchases (Assadi, 1998).

![Figure 9: The second and third step in the purchasing process involves information handling (Wells & Prensky, 1996).](image)

In order to analyze the added value we have used open sources like several web pages and literature in addition to the interviews. Those organizations that are mentioned by name are not necessarily part of our sample or interviewed. None
of the example organizations have yet reached the state outlined in the frame of reference for each strategy, but there is a movement towards it.

5.1 Learning Relationship

A supplier as an airline, has a high level of ownership of the product that they are offering the customers. Most airlines of today only offer their own product, they function similar to a target relationships since they market themselves to segments of customers, see figure 13 quadrant 1. There is an awareness and possible movement among the airlines in this research towards a learning relationship, where the product is customized to the individual needs, see figure 10:

“Yes, we have one-to-one marketing on the Internet. We get a lot of information based on what they tell us and based on their behavior. So, we are able to accurately market to those customers.” Internet Manager, 3U.

“Personalization is an important development, that is possible with Internet.” Internet Manager, 2U.

Figure 10: In the learning relationship, the buyer “teach” the seller what he/she wants the product to be like. The seller in turn, sends a response back inform of a single product. As this cycle continues, higher and higher level of need satisfaction is created. (Own development, Pine et. Al, 1999).

An example of an organization pursuing the learning relationship strategy is American Airlines, see figure 13 quadrant 2, who only offer their own tickets on the web site. They still have a long way left to become an organization utilizing the learning relationship concept in full. Nevertheless, they are considered to have come the furthest in personalization (Seybold, 1998).
5.2 Vertical facilitators

The second possible strategy in gaining customer ownership is “vertical facilitator”, the airlines United Airlines and Lufthansa\(^3\) are closed to this approach. They offer tickets on flights that they do not have ownership of. The vertical facilitator gets information from the buyer and search a matching product from those already available on the market, see figure 11.

![Figure 11: The vertical facilitator is calibrated by the buyer and taught which preferences and decision rules that he/she wants to be used. The facilitator who selects the best choice for the buyer contacts a vast selection of producers with many different products within the same vertical industry (Own development, Alba et. al, 1997).](image)

The facilitating is within the airline industry and not involving others such as e.g. insurance or luggage. The search and evaluation process online can still be developed further to be more personalized:

“By making information such as product ratings readily available and simpler to process, electronic information system should serve to enhance information search and use in purchase decisions.” (Widing & Talarzyk, 1993, p)

The vertical facilitating relationship should have most value to the customer when he is about to buy a complex trip, but these are still handled by the traditional offline travel agent:

\(^3\) [http://www.ual.com](http://www.ual.com) and [http://www.lufthansa.com](http://www.lufthansa.com)
“When it comes to the complex trips, the travel agents are better at the search process.” Distribution Manager, 4E.

A vertical facilitator also gains customer ownership, but has weaker product ownership, see figure 13 quadrant 3.

5.3 Meta Intermediaries

According to Sawhney (1999), a common view of Internet is that it will bring an extensive disintermediation. However, the disintermediation could mean taking over only some of the functions an intermediary performs.

In the physical world vertically integrated middlemen often offer information bundled with the physical product as well as core products together with complementary products. Internet enables separation of information from the core product, and the core product from the complementary products. The integrated mediators of the physical world can be replaced by a new combination of mediators, “marketspace mediators” that manages information flows, and “marketplace mediators” that manages physical flows. Instead of being organized by industry, it will be grouped cross the borders of industries. While organizations have been thinking of products, the customers think in terms of activities. This give birth to meta intermediaries that support the customers by offering a cluster of cognitively related activities. These meta intermediaries operate in the marketspace as a liaison between the way customers mentally bundles activities and the marketplace. By being the single point of contact between the customers and providers, the intermediaries gain ownership of the customers. (Sawahney, 1999)

![Figure 12: Edmunds, an example of a meta intermediary (Sawhney, 1999).](image-url)
“Travel” is well suited to be treated as a meta market: The number of activities related to travel are plenty, they have a high economical impact all together, several sources of information and product providers are needed to travel, and the middlemen add substantial costs. There are examples of Internet based travel agents that are approaching the meta facilitator mode. The Microsoft owned Expedia Travel\(^4\) has started to offer products from other industries; maps (geographical guide publications) alarm clock/radio (consumer electronics industry), suitcases (luggage industry). Its main competitor, Travelocity, has started a similar quest and offers e.g. travel books (book retailing), and weather reports (news/media industry). Both of these sites have integrated these services to a varying degree, even credit cards are offered through banner advertising by the issuers and represent the loosest coupling, see figure 33 quadrant 3. One airline made a statement indicating a possible move to become a meta intermediary:

“I believe in travel insurance. I could see ourselves offering supplemental products…” “Why not let people book other airline tickets at our site?” Internet Manager, 6E.

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\(^4\) [http://www.expedia.com](http://www.expedia.com) and [http://www.travelocity.com](http://www.travelocity.com)
Figure 13: The GR product/customer ownership matrix with some of the travel industry’s actors mapped in. Neither of them has actually reached the stage they are positioned in here, but they are moving in that direction. (Own development)

These different sales formats are different in their ability to support the purchasing process (Wells & Prensky, 1996). At present, the traditional travel agents have a medium number of categories (Alba et.al, 1997) with a high number of alternatives in each category. In contrast, the vertical facilitator has a low number of categories (flights only), but as many alternatives within the category as the travel agent. The travel agents are better at selecting a consideration set (Alba et.al, 1997) based on their knowledge of the customer compared to the vertical facilitator (as represented by United Airlines). The information provided by the travel agents about the alternatives in the consideration set is high on quantity and quality, the possibility for side by side comparisons is high. The vertical facilitator provides a medium quantity of information. The quality is depending on if the information is regarding the own product or a competing airline’s. The side by side comparison is possible, but limited to a smaller amount of the attributes (departure time, duration of flights, price etc). See figure 14

5.4 Brokers

The travel agents hold the lowest level of product ownership since they only mediate the product. The travel agents have traditionally had higher level of customer ownership than the airlines. The travel agents are now moving towards
an even higher level of customer ownership, as do the airlines. The traditional travel agents are so far best described as brokers as they offer airline tickets, hotels, cars, and insurance. They cannot be called vertical facilitators or meta intermediaries since the travel agents work as an interface (but, the travel agents work as facilitators in some sense), see figure 13 quadrant 4.
<table>
<thead>
<tr>
<th>Dimension</th>
<th>Traditional Travel Agent</th>
<th>Learning Relationship (American Airlines)</th>
<th>Vertical Facilitator (United Airlines)</th>
<th>Meta Intermediary (Expedia)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Providing Alternatives for Consideration</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Categories</td>
<td>Medium</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Alternatives per Category</td>
<td>High</td>
<td>Low</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Screening Alternatives to Form Consideration Set</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selecting Consideration Set</td>
<td>High</td>
<td>Low</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Providing Information for Selecting from Consideration Set</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quantity</td>
<td>High</td>
<td>High</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Quality</td>
<td>High</td>
<td>High</td>
<td>Low or High</td>
<td>Medium</td>
</tr>
<tr>
<td>Comparing Alternatives</td>
<td>High</td>
<td>High</td>
<td>Medium</td>
<td>Medium</td>
</tr>
</tbody>
</table>

Figure 14: Evaluation of different sales formats’ present abilities to support the purchasing process (Own development using Alba et. al, 1997).
6 Financials

Financials is the last theme that will be analyzed. The traditional investment perspective is first discussed and then the expanded one.

6.1 Initial Investment

It has been difficult to get a good answer on the cost of web sites. Some web consultants are known to give a wide range of price quotes for the same project (Vikström, 1999). A speculative explanation could be that the Internet consultants have been developed from different origins. Management consultancies – once accounting firms, advertising bureaus, and computer programming companies are all evolving to the electronic commerce area and moving towards each other competency wise. The consultants also show a wide range of the level of sophistication in regards to their understanding on electronic commerce. Furthermore, some of the Internet consultants are newly established and need reference customers, the offered price might not mirror their own costs for the project in that case.

However there are some consistency between the answers the respondents gave and the publicly available sources. Icon (1998) suggested $1.2 million and Gartner Group (1999) $1 million for a sales enabled site with interactive features. This is the kind of site that the airlines studied are using. The figures given from other sources are not precise about the level of sophistication and are therefore note taken into account in the analysis. The lower-end for the airlines initial investment is about the $1 million level mentioned in the secondary sources as average. A reason for the airline industry’s sites to be more expensive could be that it is information intense (Porter, 1998). This implies that the airline industry is more complex in information handling than the average industry, and requires a more costly Internet solution with more back-end interlinkages. The back-end is also what often causes increased costs in the development of sites (Gartner Group, 1999)

6.2 Reoccurring Costs

The only figure on maintenance costs found is $100,000 per year for a “major” site (Shillingford, 1999). An estimate of the costs for upkeeping of the site in the airline industry is $250,000 to $300,000. Again, the cost in the airline industry is higher than the average. There is much data that need to change continuously, e.g. the promotions the airlines frequently use to maximize the load factor. The fact that the airline industry is information intense (Porter, 1998) could also contribute to the reoccurring costs.
Transaction costs over Internet for the airlines are in the range of $5 to $12 according to one respondent. Using $6 that also has been mentioned the savings on transaction costs using the Internet channel could be as high as 80%, ($35 versus $6) compared to the traditional sales channel with travel agents. Cutting out the travel agents brought a major part of those cost savings. Our finding is supported by another study, which estimated that it is possible to save 75% by switching channels (Andersen Consulting, b).

### 6.3 Revenues

The Internet sales in Europe are modest, less or much less than 1% of total sales. As could be expected, the sales in the US were higher. Revenues of about half a billion dollars annually per airline, or 2-3.5% of total sales, are achieved. The answers the respondent gave showed that the revenues were often underestimated in projections. From how they described the sales increase, a speculation could be that at present time the sales are increasing in a non-linear way and that the projections were more unpretentious. Some authors mean that the number of users adopting Internet are increasing exponentially for the moment, but can be expected to slow down in growth pace in the future, all according to an S-shaped curve (Shapiro & Varian, 1998). The general adoption of Internet could reasonably be thought to mirror the development of the sales of an individual site.

The theories (Alba et. al., 1997) implied that the price could actually be higher if the Internet channel better supported the purchasing process. We have not yet seen a price premium charged in the airline industry’s Internet sites. Rather, if the price was different it was lower, and not higher, than in the travel agent sales channel. In most cases the price was still the same in both channels. The lower prices that exist in the Internet channel are more sales promotion than a general low pricing strategy. E.g. incentives to use the channel during a campaign week or a “sale” of empty seats in a flight soon to departure.

### 6.4 Profits

Applegate’s (1999) notion that IT should be thought of as a string of investments has been verified by the respondents’ opinions and also their answers on how they act. All the airlines had made either larger revamps or constant improvements to functionality’s that required repeated additional use financial resources. The awareness of the needed continuous investments is what justifies poring more money into a loss-making venture. Just like other organizations such as Amazon.com would show a profit if they step down the marketing investments (BCG, 1998), so could the airlines’ Internet investments:
“If you ever slow down development and you are not spending as much, then you start to theoretically be profitable. But, then you are behind in some type of development. So, we are continuously putting more resources into developing new functionality’s...” Internet Manager, 2U.

A survey (Gartner Group, 1999) showed that all companies in the survey had experienced development costs that were exceeding budget. This was supported by some of the airlines in the US who said that the development costs could surprise many not previously involved in the area. In terms of revenues, several of the US airlines said that their objectives had been met or even turned out better than expected. These two findings suggest that the Internet investment is a bigger issue than anticipated, both the costs as well as the revenues are higher than predicted. Since it is a bigger issue, it becomes something involving management higher up in the hierarchy at the company. The respondents in our interviews also said that the support, understanding and involvement from top management were of outmost importance to the Internet business.

6.5 Expanded Investment Calculation

Many of the payoffs mentioned in other studies (Fredholm, 1997; Callahan, 1999) are also present in the airlines’ businesses: More efficient information flow, improved communication, enhanced customer service, reduce costs, create new products and services, reduce time to market, and increase revenues.

These could also be categorized using Applegate’s (1999) description:

The “options value” (category 1) improvements are what have been analyzed above – cutting the transaction costs. It seems that this has given more than satisfactory results. In “platform improvements” (category 2) there are a number of aspects that have contributed to the value of the investment. With Internet, it has been possible to introduce new products like electronic tickets at a lower cost. The internal reservations system is a legacy system that has gained increased lifetime by having an up to date interface, the Internet site, to reach the customers. This also means that the reach of the IT platform is expanded.

“Commerce” (category 3) improvements include creating a new channel to the customers, some corporate customers even have travel sites in their intranet. Operations have also been streamlined since the web site has alleviated some of the workload from the call centers concerning routine questions. One should not forget that an Internet site also requires support functions. “Content” (category 4) has meant that the airlines are gaining more information on their customers as they are getting closer to them. Moreover, this brings more information to base
its decisions on. E.g. the frequent flyer program is improved with the Internet site and this is a good source for some of the decision making like route planning. Moreover, the sale of tickets as the date for the flight is approaching is made possible with Internet and is an example where action is made more efficient. “Community” (category 5) is yet to be launched, this is an undeveloped value of the Internet sites.

It is evident that there are many benefits that not should be forgotten that already has meant improvements to the airlines. There are still many business opportunities, “IT-options,” that can bring value to the airlines in the future.
7 Network Economics

At present time, the number of flyers does not directly affect the value of the product the airlines are offering. It could be argued that an increased amount of flyers in the long-run leads to advantages since a popular airline is able to open more routes. With more routes, the size of the network of destinations is increased and being a loyal customer to a larger network is worth more. (E.g. bonus mileage can be gathered and redeemed on more flights). When it comes to the differences in the sales channel, which is in focus in this report, the network effects are not used deliberately. Those airlines that have feedback on the functionality of the web site might benefit from more users of the site and be better positioned to respond by improving the functionality. The perceived value of the web site to the individual would thus increase with the number of other users. One respondent mentioned this. There is no clear evidence of any more direct and obvious positive feedback loops in the sales channels.

7.1 Tipping and Lock-In

Many of the airlines are aware of the need to move fast in the development of their web sites. However, our impression is that this awareness is related to a general apprehension of first mover advantage, not network effects. Neither tipping (Arthur, 1989), lock-in (Shapiro & Varian, 1998), or Metcalf’s law (Kelly, 1998; Shapiro & Varian, 1998) are used as arguments for the quest to grow. Are these mechanisms present in regards to the travel industry’s web sites? If the travel industry’s sites would develop to fully embrace the concepts outlined in the added value theme in this report (learning relationship, vertical facilitator, or meta intermediary) a customer ownership would be established with lock-ins. It would be difficult to make customers switch into a new relationship because it would require building up the search agent function again (background variables, preferences, evaluation rules etc).

![Figure 15: Lock-in cycle (Shapiro & Varian, 1998).](image-url)
Furthermore, if this agent function has algorithms that use information from other buyers to evaluate which product to offer the buyer at hand a feedback is present. This could lead to tipping if the value the other buyers imply reach significant level. Perhaps the alternatives that involve more than the own flights in the gathering and evaluation during the purchasing process (vertical facilitator and meta intermediary) have an advantage in creating a lock-in. We think this might be the case in the airline industry since it is hard to differentiate the flight product. Unless the whole travel process is reinvented to create some differentiation, the “learning relationship” path allows for few benefits in terms of increased utility to the customer. The low utility means low lock-in and little positive feedback loops. Metcalf’s law would in other words be stronger in the two alternatives with lower product ownership; vertical facilitator and meta intermediary.

### 7.2 Information Contagion and Community

The information contagion (Arthur & Land, 1994) is about other buyers who are senders of information, in the other concepts the seller has been the sender. None of the airlines, European or US, said they actively tried to support information contagion on their website. Neither did they use community building (Armstrong, 1996; Applegate, 1999). But, since they all have a large database with frequent flyers an introduction of this feature could easily be made. It is not possible to say if there is a trend in the industry towards using these mechanisms:

“I am not in favor of community building, I prefer personalization.”
*Internet Manager, 6E.*

“We do not do it like that and will not for another 12 months.”
*Internet Manager, 4U.*

People that do extensive search (Wells & Prensky, 1996) before they decide what to buy, e.g. because earlier experience with the product is low, would gain from a feature that enabled them to obtain information on the product from other past buyers. Especially those who are afraid of flying and have a high perceived risk with the product “flying” would probably appreciate such possibility. Our conclusion is that information contagion have potential in the airline industry and would fill important gaps in the evaluation of the product before its use since it can be classified as an experience good (Alba et al, 1997). Supporting information contagion does not contradict perusing any of the three strategies presented to get customer ownership (learning relationship, vertical facilitator,
and meta intermediary). Rather, it can be implemented in parallel and serve as a compliment to any of these. Information contagion can be leveraged by e.g. a producer by sponsoring community building (Armstrong, 1996; Applegate, 1999), this would be an additional dimension for gaining customer ownership. In order to somewhat control which information that is distributed, the community could be open for members of the airline’s frequent flyer program. That would increase the probability that the participants can provide each other with company specific information. But, this leaves one problem to be solved. How should new buyers who are inexperienced with the product and therefore not members of the frequent flyer program be incorporated in the information distribution? Perhaps by lowering the entry barrier to the frequent flyer program and inventing some mechanism that foster loyalty to the airline beside of the mileage points. Since the inexperienced users obviously have limited flying history, loyalty has to be created in another way. We believe the loyalty is one way of getting a favorable treatment in the information feedback. If the information gained from the community has a high value to the individual, this is maybe all that is needed to create loyalty.
8 Conclusions and Recommendations

This final chapter brings together the findings into a conclusion. Our four themes discussed, first within the airlines industry, and then the managerial implications will be brought forward. Further, some theoretical reflections of ours will be presented.

8.1 Findings in the Airline Industry

Our opinion is that almost all organizations need to embrace Internet in some form. There are organizations that because of their size or kind of business have little to gain from Internet. But, we think large organizations need to be on the Internet since they often show complex information flows both internally and externally. A question that could be discussed to a greater extent by managers is, whether or not to sell over the Internet. This has been the overall question in this report. Our conclusive answer to this is in short: Yes!

8.1.1 The Decision Situation

Internet is mutually seen as a revolution to the travel industry. A paradox is that the decision in the US airline industry regarding the Internet sales channel was not well analyzed, rather it was made fast in order to prioritize action. The main reason was to be proactive and not let competitors leapfrog their position. The European airlines in our study did not show the same emphasize on action. They required more analysis before the decision, possibly in order to change their ideologies first. Though, a common denominator for all the airlines was the necessity to cut costs and Internet was seen as a mean to achieve this. A secondary reason for the implementation of Internet was the wish to get closer to the customers. Notably, the revenue potential was not a major consideration by any airline. The customers have also demanded convenient channels in which they can be in control. This leaves the airlines with no choice and the introduction of an Internet sales channel is inevitable.

The Internet Managers have emphasized the importance to have upper management awareness, understanding, and support during the launch and during the continuous work. The Internet channel needs constant supply of financial resources since new features are required to stay competitive and not suffer from having the customers locked in by other organizations.
8.1.2 Relationships in the Distribution Channels

The shift from the traditional distribution channel to the Internet channel is not as significant as the shift within the airlines own direct sales channels. Since, the introduction of the Internet sales channel was revolutionary in many ways, the travel agents felt threatened in the beginning. The tension between the airlines and the travel agents is not severally affecting the business of today. This because the change from the traditional channel to the Internet channel will not take place instantaneously, rather probably more slowly, especially in the beginning. This means that the airlines will remain dependent on the travel agents for probably some years. As much as 80% of the total sales still take place through the travel agents in the US, now two to three years later, the sales have only lowered a few percentage units. Airlines conducting business in a foreign market are even more dependent on the middlemen since they often do not have their own distribution network and they often have a more unknown brand.

Airlines still support and nourish the relationship with the travel agents and offer them sales promotions activities, sales incentives and bonuses. In broad terms, it is “business as usual”. Each airline understand the need of a good relationship since they are just one of hundreds of competitors in this dominant sales channel. The travel agents understand that Internet is the way of the future and one of their responses has been the implementation of their own Internet sales channel. As the airlines have two main channel types, direct and indirect, they need to take both in consideration and treat them in different ways.

8.1.3 Added Value

The customers appreciate the control and time independence the Internet channel offers. They do not have to rely on a third party to book their trips, they have the freedom to choose the place and time for it. In addition, they are able to ask more questions that they would feel uncomfortable to do with a travel agent. It is necessary for the airlines to analyze their Internet users’ behavior constantly and to adapt the content and structure of the site. The airlines biggest advantage gained by the Internet channel is the possible closeness to the customers. Also, another business benefit for the airlines is the possibility to gain customer ownership. This customer ownership is created due to the benefits the customers perceive in the Internet channel. A better information gathering and processing is feasible with a number of alternative Internet sales formats. The customer ownership and closeness bring the advantage of getting more feedback on how to develop the flight product and its services.
The added value the travel agents provide is mostly connected to booking complex trips, these trips cannot yet conveniently be booked through the Internet channel. While this applies to all customers, there are also advantages that relate to specific customer segments. For instance, organizations that appreciate the travel statistics that include all travels normally turn to a travel agent. The competency of the travel agents is in many cases the reason for using them both for individuals and organizations.

### 8.1.4 Financials

The experience from the airlines is that Internet is a viable sales channel and some have already have made profits according to the traditional investment analysis. All the airlines responded that they would not hesitate to invest in Internet again if they had the opportunity. Much of the benefits came from the saving alternative costs and it also opened up new opportunities. An impression from the airlines is that they constantly improve their Internet channel and they never feel they can rest. The pace is higher and the competition on the Internet is more intense. Some of the respondents said that the cost related to the back-end could be a surprise to many.

The barriers for the adoption of Internet have not meant any important implications for the decision about using Internet as a sales channel. The reason is that these are hurdles all the airlines are facing, i.e. it does not change the competitive environment. It is a concern for all commercial Internet sites and will eventually be satisfactory solved as technology develops and the behavior changes among the customers.

### 8.2 Managerial Implications

Managers should not focus on lowering the uncertainty regarding Internet, instead they should emphasize on action. Making a business case is appropriate to get an understanding of the Internet implications, but, complete predictions should not be asked for. Managers need to get an understanding of the new rules of business related to network economics. For instance not to be a victim of “tipping”. Internet is a major strategic decision since it involves large amount of money and implies changes in all areas of the organization. Combined with the uncertainty this means that top management need to be involved.

There is a reason for the existence of the intermediaries. The functions that they provide cannot be eliminated even if the middleman itself is. To keep the trust of the middlemen it is important to communicate to them that Internet is bound to
evolve. If you create an understanding, it is possible to lower the tension and avoid conflicts. Even if the producer a dominant market leader it is still important to establish this understanding regardless if the producer will take the lead in the introduction of Internet.

In a future scenario, there will probably exist multiple channels. The choice of channel will depend on a number of factors; situation, customers, products, convenience, uncertainty etc. It is also likely that new actors will emerge, that will compete with the producer of the customer ownership. These new actors are not only new to the industry but, also of a new kind. These could create lock-ins without having product ownership, e.g. vertical facilitators, meta intermediaries, and community owners.

Managers should be aware of that investing in Internet is more of a commitment than a single action. IT investments are especially difficult to evaluate with all the future business benefits that are hard to anticipate. But, the value of these should not be neglected. A long-term view on the investment is critical to assess its value accurately.

8.3 Theoretical Reflections

We have studied the new phenomenon, Internet, using old theories. In large they hold true. The theories of network economics that are advocated by some researchers are useful when studying Internet according to our experience. There are researchers that express the need for more empirical studies on network economics, unfortunately we cannot contribute substantially since we found no evidence of deliberately using these concepts. Something that we can add to the knowledge of Internet business is how different customer ownership mechanisms relate to each other as shown in the GR matrix.
9 Method

This chapter begins with a description of the scientific approach with the aim to enable the reader to judge whether our research is conducted in a scientific way. Further, we describe the foundational concepts and techniques that have constituted the work with this report. In the end of the chapter possible sources of errors is discussed.

9.1 Scientific Theory and Methodology

“If yesterday’s truths are today’s untruths, the truths of today might well be untruths tomorrow.” (Thurén, 1991, p 11)

![Figure 16: Research and chapter layout (Arbnor & Bjerke, 1994).](image)

**Scientific theory**

- What is science and knowledge?
- Explain vs. Understand?
- How do we view reality?

**Methodology**

- Methodical procedure
- Method

**Fundamental conceptions**

- Paradigm: *What is science and knowledge?* *Explain vs. Understand?* *How do we view reality?*

**Method approach**

- Working paradigm: *Methodical procedure* *Method*

**Research area**

9.2 Our Paradigm

We believe with the fast changes now occurring due to the society’s shift to the information age make it less useful to establish general laws like the positivists (Andersson, 1979) prefer. The risk of formulating a law that becomes one of tomorrows “untruths” is too big. Lovendahl and Revang (1998) support this view and argue that:

“…rather than looking for causal relationships and models that may help us explain ex post and predict ex ante, postmodern researchers and managers may look for pragmatic concepts that help focus action and attention.” (Lovendahl & Revang, 1998, p 769).
Therefore, we will put more emphasis on descriptions and bringing important issues to the surface. I.e. we do not consider ourselves to be positivists. Neither do we join the ranks of the hermeneutists (Andersson, 1979). Our interpretations of the interviewed respondents are to a great extent limited to interpret “what is said”. Since we cannot enter the situation of the different actors/respondents that the hermeneutics require to make a deeper interpretation. We are unable to answer questions like: “Why is the respondents making this statement – because of family reasons or is he/she leaving the organization?” Instead, we have to rely on what is said semantically, and that it is a good representation of truth. This leaves us somewhere between the pure positivists and hermeneutists.

9.2.1 Conception of Reality

Our idea on reality is somewhere in between objectivism to subjectivism. We are not seeking for causal relationships rather we believe that all information is context dependent. Relations are probabilistic and relative rather than fixed and factual. Information flows make organizations and environment change together. This means that research results are relative and specific for the immediate context where they were developed. Never the less they can be similar in other industries and contexts. This leads us to a systems method approach (Arbnor & Bjerke, 1994)

Figure 17: Six views on reality with corresponding method approaches (Arbnor & Bjerke, 1994).
9.3 Our choice of method approach

The method approach we have chosen is mainly the systems view since it supports the paradigms and view of reality of ours. It is not possible to generalize results, but analogies can be made e.g. in other industries. The focus in studies with this approach is the forces that affect the system as a whole. The sum of the parts of the system may differ from the value of the parts \((2+2+2=7)\). Because of this, the relations between the parts of the system are of great importance. The systems view is open for the possibility of both multifinality and ekvifinality. The theory of reality gets better through a better explanation/understanding of acting in the systems elements. (Arbnor & Bjerke, 1994)

![Diagram of the system studied](image)

**Figure 18:** Boarder of the system studied. The elements in the system will get different levels of attention. (Own development).

9.4 Working paradigm

The working paradigm can consist of several steps as shown in figure 19.

![Diagram of working paradigm](image)

**Figure 19:** The different parts of our working paradigm (Arbnor & Bjerke, 1994).

The *methodical procedure* our research follows, is influenced by the systems approach we have taken. The systems approach sees society as a complex system of different actors each influencing each other. Since it is difficult to have a complete understanding of the system studied, the methodological procedure might have to be adjusted as a deeper understanding is achieved during the process. In our case, the procedure first chosen has not changed significantly.
The method is also influenced by our systems approach. Proponents of the systems approach favor a development of the problem formulation during the research process since a better understanding of the system is gained. We changed the problem formulation somewhat as we gained a better pre-understanding. Initially we had the intention to study the cannibalizing of the distribution chain only, with the purpose of contributing to the decision situation. Instead, we chose to use a broader formulation of the problem and also study other concerns the producers have when making the decision to implement Internet as a sales channel. The study came to cover the decision itself, relationships, added value in the channels, and a financial perspective. We found that the interrelationship between these areas were important to understand in order to comprehend the situation as a whole. See figure 20.

![Figure 20: Development of problem studied during the research process from being limited to cannibalization (i), to also include other factors important in the decision making situation and the decision situation itself (ii). (Own development).](image)

### 9.4.1 Create a Pre-Understanding

The working paradigm covers several activities performed during the research process. The first is creating a pre-understanding, see figure 10. We already had some pre-understanding that was industry specific, either from working in it or previous studies on it. Our theoretical background includes studies in e-commerce, marketing, and business strategy.

An explorative approach was used to develop the pre-understanding further. This to get an even better insight to the industry and problem area. We
interviewed one airline representative, four travel agent representatives, and one GDS representative. Some literature studies were done in addition to this.

**9.4.2 Method for Collection of Data**

A qualitative multi case like study was used to gather information from primary sources. Face-to-face interviews were most common. Some telephone interviews were also made. The secondary data sources include annual reports from airlines, consulting firms’ reports, industry organizations’ reports, articles, books.

Descriptive research was done to some extent; it was most present in the investment theme of the research. The relationship and delivered value themes of the research can be classified to be more explanatory research and a model is developed. The intention is not to do predictions but to suggest possibilities.

**9.4.3 Research Objects and Sampling**

Only one industry is studied (the travel industry) to keep as many exogenous variables constant as possible between research objects.

<table>
<thead>
<tr>
<th>Method Approach</th>
<th>Unit of Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analytic</td>
<td>The Human Actor</td>
</tr>
<tr>
<td>Systemic</td>
<td>The Company</td>
</tr>
<tr>
<td></td>
<td>The Industry</td>
</tr>
<tr>
<td></td>
<td>The Society</td>
</tr>
</tbody>
</table>

**Figure 21:** The industrial field matrix approximately illustrating the method approach and its relation to the units of analysis in this study (Development of Hellgren et al, 1993).

The airline industry was chosen because of several reasons. Industries that are information intense have more advantages from an implementation of electronic commerce and will be more prone to advance with the technology. This will lead to a wider usage over different functions. Airlines were also early to adopt the Internet in their business; in January 1995 British Midland launched a sales and online payment site (IBM, 1999). Therefore, a study over a longer time span is possible. The travel industry has been active and aggressive in deploying electronic commerce applications and has taken the lead in many ways. Travel is one of the largest industries for electronic commerce on the Internet and is
widely regarded as one of the services most conducive to sell via Internet. (Andersen Consulting, 1998) In 1998, airline tickets were one of the most sold items on the Internet. Travel counted for $654 million in 1997, and is projected to reach $7.4 billion in 2001, according to Forrester Research’s estimates. Datamonitor predicts that the travel industry will account for 35% of the online sales in 2002. (Hof et. al, 1998)

The research aim to study the traditional sales channels’ versus the Internet channels’ benefits where there is a clear distinction between the different parties in the channel. In the case of the airline industry, the intermediaries are all separate legal entities with their own separate interests. Some ownership links do exist, but these are not expected to affect the independence to any greater extent due to the competitive laws.

We saw service level (differentiation), route network (scope), and revenues (size) as the key mobility barriers (Porter, 1980), and use these to form strategic groups in the airline industry, who’s members are expected to behave similarly. Our choice is supported practitioners in our explorative study and previous research (Lawless et. al, 1989; Porter, 1980; Veliyath & Ferris, 1997; Thomas & Ramaswamy, 1993; Sarathy & Ramamurti, 1997). The airlines used as study objects in our research belong to a strategic group that show a high service level, a large and international route network (both their own and through the alliances they participate in), and they are among the top ten in revenue size in Europe and the US respectively. The respondents representing the airlines of this group were selected with judgmental sampling, as were the other interviewees (see figure 22).
<table>
<thead>
<tr>
<th>Company</th>
<th>Position</th>
<th># Exploitative Interviews</th>
<th># European Interviews</th>
<th># US Interviews</th>
</tr>
</thead>
<tbody>
<tr>
<td>Travel Agency</td>
<td>Airline Relationship Mgr</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Travel Agency</td>
<td>Travel Agent Representative</td>
<td></td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>GDS</td>
<td>Representative</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Airline</td>
<td>Distrib/ Internet Mgr</td>
<td></td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Airline</td>
<td>Account Mgr (Travel agency)</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Internet</td>
<td>Account Mgr</td>
<td></td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

Figure 22: Respondents, their kind of position, and corresponding number of interviews (own development).

9.4.4 Interview Process
A form with questions has been used to assure consistency between interviews. Most questions were formulated in a way that rendered open answers. Some interviews were made over the telephone, but most at meetings at the workplace of the respondents. In addition, follow up questions was asked. Audio recordings were used to store the information and notes were used as a support during the interviews. It freed our attention by not having to focus on making notes.

9.4.5 Organizing Interview material
The audiotapes have been typed in order to systemize the material and get a better overview. These transcripts were not of the exact wording of the respondents; instead they were rephrased to be more concise. The interview answers regarding the investments where codified were possible. Each respondent has been asked to comment on each typed transcript.

9.4.6 Analysis and Conclusion
The empirical findings were analyzed from the perspective of theories, models, and secondary data sources. Similarities and differences between each

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5 Note that the positions are not always the official title held at respective company, instead they are sometimes changed to be more generic. The intention is to be descriptive of the respondents work tasks.
respondent as well as between the Swedish and US respondents as a group were brought to attention. The results are presented together with the theories etc in the respective chapters.
9.5 Credibility

An important part in evaluating the credibility of a scientific research is how the empirical data were gathered and treated. The relationship between measured score and the actual/real score is inferred using two approaches, validity and reliability.

9.5.1 Validity

There is no “safe” way to make the assessment on validity, to make the judgment we use several validity concepts (Lekvall & Wahlbin, 1993; Churchill, 1995):

*Face validity.* Interview questions were formulated and presented to some industry professionals during our explorative study to see if they were suitable.

*Content validity.* Several questions were used for the themes. A higher content validity could have been achieved if only “cannibalization” was studied. Our impression is that all studied themes are all affecting each other, in accordance with the systems approach. Therefore, in the trade-off between content validity and better systems understanding, we feel the design of the research is well balanced, taking time into account.

*Construct validity.* An area in which a risk for misunderstanding that would have impact on our results is in the financial theme. E.g. when the cost of the investment in the Internet sales channel is asked about, the respondents could use different meanings of terms and how the cost are defined. To avoid having a figure that represented something else than we intended, follow up questions were used to make sure that the same definitions were used. is necessary. During the research process, we have paid attention to this risk of low internal consistency, but we have not discovered any case of it.

*External validity.* Due to the systems view, it is little possibility to generalize, but analogies can be made (Arnbör & Björke, 1994). By describing the research process and method, the reader can judge if the findings are applicable in a similar vain that lawyers and physicians work with cases (Merriam, 1994

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6 A construct is often unobservable e.g personality. In order to be able to communicate judgements of constructs they are defined in terms of a set of observables.
9.5.2 Reliability

The reliability (Churchill, 1995) can also give an indication of the quality of the method.

Before our interviews started, we gave the respondent instructions to indicate when he/she did not understand the question. When this happened we rephrased the question and from the answers, we made the judgment that, this was not a problem in the end. Since an interview guide was used the variation in the way to pose questions is lessened and enables another interviewer to repeat the same interview similarly enough to get the same answers. Random factors, e.g. that the respondents have guessed, should not affect the results negatively. Our impression is that when the respondents gave a speculative answer they indicated that this was what they were doing.

9.6 Critic of method

The systems view requires the researcher to study all parts of the system. By failing to study one factor the result as a whole can be false. The reason for this is the interlinkage and synergies that cause the sum differ from the “value” of the parts. By removing one component, the relations and some of the synergies might be removed. (Arnbor & Bjerke, 1994). Since we did not get primary data on the customers/travelers from interviews or other sources this might have had a negative effect on the quality of findings. However, this issue has somewhat been addressed by getting information from other actors on their perception on what influence the customers/travelers etc. A downside is that the information was already filtered, interpreted and recodified by the secondary source.

A case study implies entering the study object in a deeper way than what we have been able to due to the time constraints. Consequently, it might be better to call it a “case like approach”. We believe that with a longer time and more material collected there is a kind of marginal effect on the contribution that it brings. Moreover, with our information needs in mind, our judgment is that we would still come to the same conclusions from our research even with increased amount of empirical data.
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Internet Manager 2U, May 5 1999.
Internet Manager 3U, May 4 1999.
Internet Manager 5U, May 17 1999. (Telephone Interview)