MILLIONS OF REBATE DOLLARS TO BE CUT BY XMAS?

# TMCs in firing line as airlines, GDS lower the boom on downstream fee-split benefits

by Jack Handley

**TRAVEL management companies are again firmly in the firing line as global airlines and GDS structure new — and crucially, individual — financial relationships to take effect from December this year.**

Already, projected outcomes are that TMCs in particular may suffer crippling losses as the legacy financial framework funding travel distribution is 'binned' once and for all.

Leisure travel agents face the same changes, but the impact will be less because they usually do not have contractual relationships with their 'one-booking-a-year' holidaymaker customers.

The economics of the new airline-GDS model will be revealed in the form of new contracts that are predicted to limit (and perhaps eliminate) TMC booking fee rebates through GDS.

For some Australian agents and TMCs, the change was first announced in late 2002 when Galileo GDS began to inform the market that future Galileo contracts would link any airline segment fee rebates to the segment fees paid by the same individual airlines to Galileo. Significantly and frighteningly, the calculation for lower rebates would not be percentage-driven, but dollar-for-dollar.

In the Galileo lawyer's Elizabeth Street, Sydney offices, there was to be no negotiation. Angry TMC and agent clients achieved nothing. The new contracts would carry the killer clause.

## Three-year agreement runs out in December

ALTHOUGH early GDS were all airline-owned and the business was highly regulated, by 2003, most airlines had sold their ownership stakes.

The GDS thus became stand-alone businesses and they successfully petitioned the US government to deregulate the marketplace for travel distribution services.

As agents and TMC stakeholders watched from the sidelines, airlines and GDS entered into a series of three-year agreements that gave the airlines some fees relief in exchange for full content guarantees for the various GDS.

As a result, most agents and TMCs went back to sleep, satisfied that the status quo meant money in the bank — at least for the foreseeable future.

While they slept, some airlines used the three years to support GDS alternatives — almost exclusively web based booking systems — that were claimed to alter the economics of travel distribution in the airlines' favour. (Last year, 2005, some airlines even voiced support for a clutch of new entrant technology firms and made threats that they would consider switching to them, withdrawing content from GDS altogether. By and large, however, the new entrants achieved nothing. Alternatives to GDS are still thin on the ground and typically functionally inferior to GDS.)

Sabre and Amadeus GDS, however, gave some credibility to these threats when they announced a content backup agreement in March 2006 that guaranteed cross-content availability should such a worst-case scenario develop.

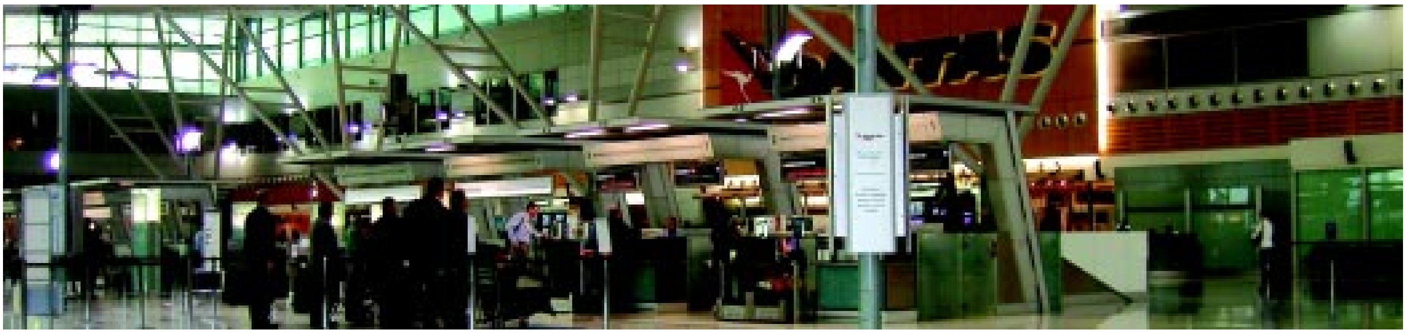
In effect, Amadeus and Sabre said that they would supply the airline content to each other's agents and TMCs if either one 'lost' an individual airline's inventory. Result? The airlines went back to their lawyers seeking advice on the Sabre-Amadeus pact.

More recently, American Airlines and Continental Airlines have announced new agreements with Worldspan GDS but with no details revealed to a wider audience. Speculation has been rife that downstream incentives will disappear entirely and TMCs and their client corporations will have to pay for access to content.

It means that corporate travel managers may have to budget for zero GDS pass-through financial incentives by 2007 and moreover, there could be a significant content access fee added to each airline ticket.

This could mean millions of dollars, cumulatively, in the bottom line impact for corporate buyers.

And it's possible there are new, signed airline-GDS agreements being kept secret today under confidentiality clauses that will have all the effects outlined above — and maybe possibly worse.



The GDS was not prepared to budge.

The concern for TMCs was easy to see: If airline 'A' paid Galileo $5 per segment and Galileo paid the downline TMC $2 per segment, the TMC could rebate the same $2 to its corporate accounts.

But under the new rules, if airline 'A' negotiated a new fee to Galileo down from $5 to $3 per segment, then the TMC's income also immediately dropped, but it didn't drop to 3/5ths of $2, it dropped dollar-for-dollar — down from $2 to zero — and it dropped suddenly, without the safety net of a contract term cushion period.

The only 'concession' was that Galileo promised to tell the TMCs and agents whenever renegotiations with individual airlines were on the table, but not to shield them from any flow through impact. As the GDS was going to lose nothing from the change (in the example above, the GDS would lose $2 from the airline, but make $2 back from its cancelled rebate to the TMC), TMCs noted there was little incentive for the GDS to champion their fight against the smaller fee.

So, with the new rules looming, each TMC as a matter of urgency needed to renegotiate the terms of its business arrangements with its customers, re-program its own accounting and customer activity reporting software and adjust profit forecasts and budgeting.

Analysts said at the time that the impact would be bad enough if every GDS and every airline implemented the same change, but would be worse if only a few airlines and not every GDS did so — or if airlines and GDS implemented them in different ways.

In the latter scenario, the TMC would never know from one month to the next what its segment rebates would be, if any, and therefore the TMC would have to find new ways to secure corporate clients — and to fund its business.

Now, just months away from D-day, it seems the outcomes for some may be worse still: If a corporate customer has a longstanding agreement to fly Qantas and if Qantas signs different financial agreements with each of Amadeus, Galileo and Sabre, then a TMC may well find the GDS on its desktop is one of the two that doesn't have the most beneficial Qantas agreement and therefore isn't the best GDS for that individual corporate client.

And if a TMC's major corporates individually prefer United, Air New Zealand, Singapore Airlines, Thai, Emirates and Japan Airlines (to pick a few at random), then the issues are much worse — no single GDS may be able to provide all the required services or at the 'best' rates.

To put it in a wider perspective, it is estimated that up to 50 per cent of the segment fees paid globally by airlines to GDS are spent downstream by those GDS in order to sign up the TMCs that manage the corporate customers that book the airlines that pay the GDS segment fees.