Business Travel News

Lufthansa Shifts Distribution Paradigm, Pushes Direct Booking Strategy

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By **Elizabeth West**

Lufthansa Group announced a new distribution strategy on Tuesday that de-emphasizes the global distribution channel in favor of direct bookings on its online consumer portals and its new travel agent portal. Beginning Sept. 1, Lufthansa will impose a €16 booking fee on tickets purchased through GDSs.

The fee would help Lufthansa counter increased distribution costs that arrive as the carrier works out unique new agreements with its GDS partners this summer. The new contracts would release Lufthansa from long-standing content-parity requirements and, instead, allow the carrier to distribute select content through the GDS while marketing special branded fares and ancillary services through alternative channels.

Lufthansa claimed to have reached a deal with Amadeus that went into effect June 1 and one with Sabre to go into effect July 1, and Lufthansa chief commercial officer Jens Bischof told reporters on a media call on Tuesday that the carrier is optimistic it can reach one with Travelport in the coming weeks. The BTN Group's *The Beat*, however, obtained a memo Amadeus sent to subscribers on Wednesday stating it had not reached a new agreement and does not support Lufthansa's strategy.

While distribution flexibility and merchandising sound attractive, freedom comes at a price for Lufthansa—a price that the airline is passing along to the booker. The carrier has calculated that an average GDS booking will cost it €18 under the new agreement structure. That's higher than traditional, content-parity GDS contracts but much higher than the €2 it would cost Lufthansa to distribute directly on its own websites. The €16 surcharge that the carrier will impose on GDS bookings represents the cost differential between these channels.

The Economics

Lufthansa's e-retail goals could affect Lufthansa’s financial performance in the long term, but the shorter term goal seems clear: to shift volume away from the GDS channel, if possible, and increase profitability for an airline group that has seen weak revenue growth in recent years. Lufthansa cut its 2015 operating profit target from €2.65 billion to €2 billion in mid 2014 and abandoned it entirely in October, citing a darkening economic forecast. Having adjusted its goal for earnings before interest and tax down to €1.5 billion for this year, Lufthansa is counting on decreased distribution costs to close additional gaps.

“Until now, the percentage of revenue generated from the sale of flight tickets by our airlines has continuously decreased. While other service and system partners in the value chain are recording increasing margins and returns, our airlines’ earnings have been compromised over time, even though they are the actual providers of flight services,” Bischof said in a statement.

Regarding the fee itself, Lufthansa is “just not willing to pay the bills of others at this point,” Bischof added during Tuesday’s call.

Those bills include financial incentives awarded to travel agencies when they meet booking-volume goals with their GDS partners. The airline industry—not just Lufthansa—has long been disgruntled with this arrangement, viewing the distribution fees that they alone are required to pay as subsidizing these payouts to agencies and as a disincentive for innovation.

“We believe the market is ready for this change,” said Bischof. “Somebody’s got to do it.”

Market Reaction

Agency and GDS reaction to Lufthansa's announcement, however, has been largely negative. Both pointed to the lack of transparency of distributing only select content via the GDS and to “discriminatory” surcharges that penalize agencies and travelers that book through GDSs.

Sabre issued the following statement: “We stand ready to work with airlines globally that wish to sell and retail their products through Sabre. Lufthansa’s proposed ‘distribution cost charge’ disadvantages consumers and travel agencies. The GDS is the most preferred and efficient channel for consumers and travel agents to shop, book and manage travel and provides consumers with transparency, choice and the ability to comparison shop.”

Travelport, which has not yet signed an agreement with Lufthansa, is noting its resistance: “We believe this proposed surcharge is not in the interests of either the end-traveler or the airline group. Meanwhile, Travelport-connected agents worldwide can still book the full, published content from all of the Lufthansa Group airlines (Lufthansa, Swiss, Austrian Airlines and Brussels Airlines) with no surcharges.” Though, technically, agents connected to a GDS that agreed to Lufthansa's new structure can do the same until Sept 1.

Bischof underscored that Lufthansa does not intend to bypass the GDS, acknowledging that GDSs account for 70 percent of its sales volume. The carrier, however, is pursuing a direct connect strategy via the International Air Transport Association’s New Distribution Capacity technology. Asked whether technology-integrated direct connects to corporate booking tools or agency desktops were up and running, Bischof responded, “We have a few that are working,” but admitted, “We have no ready-steady-go instant solutions.”

Lufthansa's new distribution structure, therefore, leaves corporate travel buyers and agencies two immediate options: pay the fee or book directly on a Lufthansa Group website. Bischof remarked that Lufthansa sites are equipped to access corporate negotiated rates and some corporate clients have already gone this route. "We've been using corporate identifiers for some time now," he said. "It is a practice already in place," though exact volume numbers were unavailable.

For agents, Lufthansa offered its lhgroup-agent site as an alternative to the GDS channel. While Lufthansa indicated the site is fully operational, it is in a "soft launch" phase and has not yet been promoted to the general agency community.

To many, this looks like paltry provisions.

"This new fee will add millions of euros to the costs of corporates, and complexity," said Hans-Ingo Biehl, executive director of VDR, a German travel managers association. "Lufthansa isn't offering another channel at the moment that allows corporates to direct connect. Lufthansa.com and the Lufthansa agent portal are not appropriate for mass corporate bookings. The TMC provides the ability through the GDS to compare and you can't do that through lufthansa.com."

The American Society of Travel Agents issued the following alert to its members: "The Lufthansa Group announced it is in the process of developing a new booking method to enable its 'sales partners' to connect to their IT systems directly based on IATA's NDC standard. The exact meaning of 'sales partners' in this context is unknown. IATA's NDC is still in the development stage, though some limited commercial implementations do exist, so the timing of the Group's new booking method is unclear."

Should TMCs Have Seen This Coming?

Jörg Martin, principal of Germany-based CTC Corporate Travel Consulting, said travel agencies share responsibility for the current distribution predicament and that corporate clients will pay the cost of travel management companies failing to innovate.

"The TMCs haven't invested in technology to make themselves independent from the GDSs," said Martin. "They remain tied to the GDSs by letting them do the work of delivering an office environment for the TMCs. The trend to reduce distribution cost has been clear since zero commission came up. First we had commission cuts, then credit card fees came. GDS fees were the next logical step on the road map."

And while Martin sympathized with Lufthansa's desire to control its own distribution destiny, he did agree with the agencies and travel managers that the carriers did not execute with them in mind.

"The only complaint I have against Lufthansa is that it didn't first establish a direct connect into online booking engines," he said. "Corporates understand that airlines want to reduce their distribution costs, but let's coordinate it. It will be tough but eventually there will be an integrated process for delivering direct connect content to the OBEs. There is no way large corporates can book directly on airline websites."

Breaking The Paradigm

Scott Gillespie, managing partner at tClara and longtime managed travel industry consultant, said Lufthansa's move inevitably will throw a lot of anxiety into the market for the next year, given its potential to redefine the commercial relationship between agencies and GDSs, plus its potential to raise costs for corporates that can't book directly with Lufthansa. But, he said, plenty of other industries tolerate exactly this type of distribution.

"The GDSs have a valid point. It will make it harder for buyers to compare on a like-to-like basis, but that's not unusual in many industries," Gillespie said. "Frankly, suppliers and distributors work together to create unique offerings all the time. A computer is not configured in the same way at Staples as it is at OfficeMax. Consumers tolerate it."

The real significance, Gillespie said, is the fact that Lufthansa and its GDS partners were able to broker these deals at all.

"It shows remarkable negotiation on both sides. Even if lower volumes go through the GDS, the higher fees could make the move cost neutral for both the airline and the GDS—if the economics were worked out," he said. More important, "it breaks the paradigm; the GDSs and airline found a way to agree on new commercial terms. It gives other airlines the room to explore this type of relationship."

Conversely, he said, "it also gives competitors to Lufthansa the ability to play up the fact that they didn't go in this direction."

On that last count, Travel Leaders Group CEO Barry Liben predicted trouble for Lufthansa.

"Lufthansa's announced strategy is at best disappointing and at worst counterintuitive. Their move effectively places them at a competitive disadvantage on airfare pricing," he said. "Simply put, consumers who comparatively shop on price will pay more to fly on Lufthansa. For the vast majority of our clients, the economics will dictate that we book them either on other carriers that serve those routes or through codeshare partners."

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