Travel Procurement: Myths, Mistakes and Best Practices

October 13, 2003
Dublin
Today’s Agenda

• Travel procurement – is it really different?
• Airline procurement (Today’s Primary Focus)
• Travel agency procurement
• Hotel procurement
• Rental car procurement
• Q&A
Scott Gillespie’s Background

• Founder of Travel Analytics
  – Developed TANGO™ and BRAVO™ for airline sourcing projects
  – Analyzed in excess of $10 Billion of annual air spend
  – Recipient of ACTE’s Industry Professionalism and Distinguished Fellow honors
  – Named by Business Travel News as one of the travel industry’s most influential executives

• Previously A.T. Kearney’s expert in strategic sourcing of travel suppliers

• MBA, University of Chicago
## Learnings From Past and Current Clients

- AXA
- Baxter
- Coca-Cola
- Chevron
- Compaq
- DaimlerChrysler
- Dell Computer
- John Deere
- Ernst & Young
- ExxonMobil
- Ford
- Hewlett-Packard
- Hoffman-LaRoche
- Invensys
- International Monetary Fund
- Lockheed Martin
- Microsoft
- Lucent Technologies
- Procter & Gamble
- Nortel Networks
- PricewaterhouseCoopers
- Saint-Gobain
Travel Procurement: Is It Really Different?
Common Travel Management Problems – How Do You:

- Minimize transaction costs?
- Control purchases at point of sale?
- Maximize suppliers’ price competition?
- Enforce travel policy compliance?
- Make faster decisions about supplier bids?
- Agree to realistic supplier goals?
- Reduce your contract risks?
- Track your savings?

Predominantly procurement problems
### Travel Is Not a Commodity — Right?

<table>
<thead>
<tr>
<th>Common Points</th>
<th>We Could Be Talking About…</th>
</tr>
</thead>
<tbody>
<tr>
<td>“It’s a significant expense category.”</td>
<td>...Travel</td>
</tr>
<tr>
<td>“The spend is very hard to control.”</td>
<td>... or Health Benefits</td>
</tr>
<tr>
<td>“It touches most employees.”</td>
<td>... or Advertising</td>
</tr>
<tr>
<td>“You can’t just switch suppliers like you can with office supplies.”</td>
<td>... or Enterprise Software</td>
</tr>
<tr>
<td>“It really affects sales and/or productivity—but you can’t quantify it.”</td>
<td>... or I.T. Consulting</td>
</tr>
</tbody>
</table>
Why Travel Is Different

- Travel is a very large budget item
- Travel is a perishable service with high fixed costs
- Travel pricing is complex
- Travel affects most of your employees
- Travel has a very high WIIFM factor
  - What’s In It For Me?
- It can be very hard to control the buyer’s selection
- Everybody is a buyer of travel – and a travel expert!

No other expense category has these combined characteristics
It’s Not As Hard As We Might Think

Sourcing Complexity

Simple
- Carpeting
- Coal

Moderate
- Laptops
- Temp Labor

Complex
- I.T. Outsourcing
- Advertising
- Cars
- Agencies
- Hotels
- Airlines
What Does Senior Management Want?

Cost Savings

Traveler Satisfaction

You can’t succeed without knowing the answer
Seven Basic (Travel) Procurement Steps

1. Consolidate Spend
2. Specify Quality
3. Set Targets
4. RFx or Tender
5. Analyze and Negotiate
6. Decide and Contract
7. Implement and Track
Procurement of Scheduled Passenger Airlines
Myths, Mistakes and Best Practices

1. Consolidate Spend
   - Bigger is always better

2. Specify Quality
   - Airline seats are a commodity

3. Set Targets
   - Price benchmarks and volume discounts
   - Accepting “Stretch” goals too early

Myths
- Bigger is always better
- Airline seats are a commodity
- Price benchmarks and volume discounts

Mistakes
- Sloppy data consolidation
- Buying solely on price
- Accepting “Stretch” goals too early

Best Practices
- Global data consolidation at Level 4
- Quantifying quality
- Define savings

Level 4 airline data means records are able to show spend and segments at the City Pair-Carrier-Point of Sale-Booking Class level
- Selecting key fare classes
- Set savings targets after analyzing contracts
Myths, Mistakes and Best Practices

**Myths**
- Alliance benefits
- Consortia and Online Auctions
- Airlines have the negotiating power
- Airlines won’t cancel our contracts
- The airlines have our data anyway

**Mistakes**
- Providing too little data
- Eyeballing bids
- Accepting bad goals
- Waiting too long for legal counsel
- Providing too much data

**Best Practices**
- Scenario-based RFP or Tender
- Scenario-based analysis
- Risk mitigation
- Sub-program awards
- Dynamic contract management
Best Practices: Global Data Consolidation

• Four major uses of airline data
  – Spend analysis
  – Contract compliance analysis
  – Travel policy analysis
  – Price negotiation

• Data is needed at this level of detail:

<table>
<thead>
<tr>
<th>Issuing Country (P.O.S.)</th>
<th>Origination Airport Code</th>
<th>Destination Airport Code</th>
<th>Carrier Code</th>
<th>Booking Class</th>
<th>Amount</th>
<th>Segments</th>
</tr>
</thead>
</table>

• Any agency or data consolidator that cannot quickly and accurately produce data at this level will create problems for the buyer
  – Give your agency or data consolidator a small set of itineraries; see how each itinerary is classified into the fields above
Best Practice: Quantifying Quality

• Why evaluate airline quality? Because differences exist and they impact:
  – Traveler productivity, retention and overall satisfaction
  – Supplier’s overall value relative to price

• Which dimensions should be evaluated?
  – Safety
  – Financial condition
  – Network quality
    • Capacity to serve the account’s travel patterns
    • Non-stops versus 1-stops or 2-stops
    • Equipment types
    • Code-share extensions

Often Not Relevant

Operational quality
  • On-time performance
  • Lost baggage
  • Canceled flights and denied boardings
  • Times of departure
Myth: Airline Price Benchmarking Is Valuable

Reality: It Is Inconclusive and Misleading

- Why is airline price benchmarking not valuable? Because
  - It doesn’t tell you what your pricing should be
  - By insisting on benchmark pricing you may reject an airline’s fair and competitive offer

<table>
<thead>
<tr>
<th>Gross Annual Air Spend (Expected)</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>45%</td>
<td>45%</td>
</tr>
</tbody>
</table>

Illustrative
# Best Practices: Defining Savings

## Typical Baseline

<table>
<thead>
<tr>
<th>Old City Pairs</th>
<th>Old Volume</th>
<th>Old Fare Mix</th>
<th>Old Prices</th>
<th>Old Spend</th>
</tr>
</thead>
</table>

1. Old City Pairs Old Volume Old Fare Mix **New Prices** = New Spend

2. Old City Pairs Old Volume **New Fare Mix** Old Prices = New Spend

3. Old City Pairs Old Volume **New Fare Mix** **New Prices** = New Spend

4. New City Pairs New Volume New Fare Mix **New Prices** = New Spend

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Choose a method early in the project for calculating savings

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3. Set Targets

   - Price-Based Savings
   - Policy Savings
   - Policy and Price Savings
   - YOY Savings
Myth: Consortia Improve Airline Pricing

Reality: They Are Highly Impractical

1. Airlines are biased heavily against consortia
   – In theory, consortia shift negotiating power away from suppliers so suppliers’ margins are likely to decline
   – Airline consortias have a very poor track record; they don’t deliver the agreed volume or share

2. Airline buying consortia have divergent travel patterns
   – Firm A’s HQ in London near Gatwick, major sites are Paris, Hong Kong and Houston
   – Firm B’s HQ in Paris, major sites are Frankfurt, Chicago and Oslo

4. RFx or Tender
Two More Reasons:

3. Consortia have inherently weak governance
   - Very difficult to agree on preferred carriers
   - Some consortia members will likely be unhappy with the consortia’s choice, and will likely opt out
   - How will the consortia be able to do a better job of enforcing the travel policy than the individual members do today?
   - What are the negative consequences? Usually none.

4. The economic benefits to both sides, the consortia members and the airlines, are likely nil
Myth: Online Auctions Work in Air Travel

Reality: They Do Not Often Succeed

- Problems with typical online auctions of air travel:
  - Markets are not well defined
  - Pricing is not well defined
  - Pricing doesn’t reflect quality of service (e.g., non-stop v. 1-stop)
  - Bidding structure doesn’t fit airlines’ bidding styles
  - Often only two non-stop carriers in a city pair market
    - Pricing becomes visible to both airlines
  - Airlines are very reluctant to participate
    - Requires high spend volume to justify
Mistake: Providing Too Little Data in the RFP or Tender

• Current suppliers know the details of your program
  – Originations and destinations
  – Fare class utilization
  – Countries of origin

• By not providing comparable details to potential suppliers, the buyer creates a built-in pricing cushion favoring the incumbent

Suggested data fields:

<table>
<thead>
<tr>
<th>POS</th>
<th>City Pair</th>
<th>Segments</th>
<th>Spend</th>
<th>Segments</th>
<th>Spend</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.K.</td>
<td>LHR-SFO</td>
<td>200</td>
<td>$600,000</td>
<td>1,000</td>
<td>$3,000,000</td>
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“When in doubt, we have to price high.”
– A senior airline sales executive

RFP and tenders should also indicate fare class utilization
Mistake: Buyers can “eyeball” bids to determine their value

- Except for very simple airline programs, bids require detailed analysis in the context of the entire program
  - Discounts apply to selected fare classes and markets
  - Discounts vary depending on which country issues the ticket
  - Discounts depend on availability of capacity-controlled inventory
  - Flat fares are available in selected markets and fare classes

Evaluating complex airline bids requires sophisticated analysis
Which Bid Is The Best Choice?

- UA offering 15% system-wide
- BA offering 33% system-wide
- LH offering 22% system-wide

Depends on how much spend you can put on each airline:

- UA’s best case: $3 MM x 15% = $450K savings
- BA’s best case: $1 MM x 33% = $330K savings
- LH’s best case: $2 MM x 22% = $440K savings

Would a combination of BA and LH be even better?
What Is a Scenario?

• A potential allocation of air travel spend, e.g.
  • BA as primary, UA and AF as co-secondaries, vs.
  • LH and UA as co-primaries, AF as secondary

• Key features of good scenarios:
  – Based on the strength of the buyer’s travel policies
  – Spend is allocated consistent with each airline’s:
    • Scheduled flight capacity
    • Position (rank) in the preferred program
    • Popularity among travelers
  – Projected market shares always sum to 100%
Best Practice: Scenario-based Negotiations

- Old practice: “We’ve looked at your bid, and we are quite disappointed. Unless you can increase it significantly, we may have to remove your airline from our preferred program.”
- Best practice:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>We Tendered To You</th>
<th>You’ve Bid</th>
<th>Discount We Recommend To Be Competitive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario 1</td>
<td>3.5 Mio Euros</td>
<td>22%</td>
<td>25%</td>
</tr>
<tr>
<td>Scenario 2</td>
<td>3.0 Mio Euros</td>
<td>17%</td>
<td>18%</td>
</tr>
<tr>
<td>Scenario 3</td>
<td>2.2 Mio Euros</td>
<td>No Bid</td>
<td>12%</td>
</tr>
<tr>
<td>Worst Case</td>
<td>1.5 Mio Euros</td>
<td>No Bid</td>
<td>0%</td>
</tr>
</tbody>
</table>
## Why Scenarios Are So Valuable

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Projected Savings $MM</th>
</tr>
</thead>
<tbody>
<tr>
<td>BA as primary, AF second</td>
<td>$4.3</td>
</tr>
<tr>
<td>BA as primary, LH/UA co-second</td>
<td>$4.5</td>
</tr>
<tr>
<td>UA/LH as co-primary, AF second</td>
<td>$4.7</td>
</tr>
<tr>
<td>BA as primary, AF second</td>
<td>$4.7</td>
</tr>
<tr>
<td>UA/LH as co-primary, AF second</td>
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<tr>
<td>BA as primary, LH/UA co-second</td>
<td>$4.5</td>
</tr>
<tr>
<td>BA as primary, AF second</td>
<td>$4.3</td>
</tr>
</tbody>
</table>

 Ranked by Savings

- UA/LH as co-primary, AF second $4.7
- BA as primary, LH/UA co-second $4.5
- BA as primary, AF second $4.3

### Analysis and Negotiate

- Quantify with clarity
- Negotiate with credibility
- Decide with confidence
Mistake: Agreeing to Bad Goals

Good goals are vital to creating a good contract. So what makes a bad goal?

1. The goal is unrealistically high
   - Sets the contract up to fail from Day 1

2. The goal is realistic, but overlaps with another airline’s goal
   - Sets one or more contracts up to fail from Day 1

3. Too many goals in the contract to manage effectively

4. Allowing the entire contract to be re-priced should any one goal be missed

5. The goal cannot be managed proactively by the buyer
   - QSI-based goals (Buyers need the QSI market shares on all city pairs)
   - Share of cabin (Buyers need the cabin mapping scheme for all airlines)
   - Ticketed revenue (Risky if travel spending is likely to fall)
   - Share of ticketed revenue (Gives the airline visibility of buyer’s total spend)
   - Flown revenue (The worst possible measure for a buyer)
What Else Makes for a Bad Goal?

6. The goal is not indexed to the carrier’s capacity
7. The goal gives the airline the right to data that can be harmful to the buyer, e.g.,
   - Share of ticketed revenue
   - Classified or confidential information about travelers or destinations
8. The goal covers more markets than is covered by the discount
9. The goal is poorly defined, e.g. “70% share of segments on US to/from European markets”
   - OK, but what is the denominator?
     - Is it all segments bought in these markets, or
     - Is it all segments bought in these markets where the airline has viable service? – What is “viable” service?
Mistake: Providing Too Much Data About Contract Performance

- Buyers should provide airlines with enough data to evaluate performance against the contract’s goals
  - What is the “Minimum” fair data?
- Providing Other Airline (OA) revenue allows the receiving airline to infer its competitors’ pricing
- More data may allow an airline or third party to better measure O&D volumes, especially if the buyer’s travel agency provides no or poorly constructed O&D data
  - But each airline has its own rules for building O&Ds from coupon data

From a buyer’s perspective there seems little to be gained by providing too much data
What Is the Minimum Data to Report?

If The Goals Are:  
85% share of all segments LHR-ORD  
70% share of all spend on US to/from Europe markets”  
6,000 sectors exit UK per quarter  

Then Why Not Report What Was Done?  
“82% of segments”  
“76% of spend”  
“5,900 sectors”

This approach seems fair from the buyer’s perspective … but it will not go over well with many airlines
How This Might Play Out…

**The Airline Says:**

“Sorry, but we really do need to see all your data – every city pair, including spend”

“Yes, but we need to be sure the data is correct”

“Certainly, but the agencies don’t always do the best job at reporting true O&Ds”

**The Buyer Says:**

“Why is that? Our contract doesn’t list goals for every city pair, and all our goals with you are segment-based goals”

“Well, our math skills are probably as good as yours”

“Then do please ask the agencies to fix this. The sooner they do, the sooner you’ll be happy with our data”

Airlines want accurate data
Another Way It May Play Out...

The Airline Says:
“Sorry, but we really do need to see all your data – every city pair, including spend”

“Because we need to measure the ongoing economic value of the contract compared to its projected value”

“Yes - but without this data we cannot and will not improve your deal”

The Buyer Says:
“Why is that? Our contract doesn’t list goals for every city pair, and all our goals with you are segment-based goals”

“So if we meet or exceed our goals, you will maintain, and possibly increase, our discounts?”

“Fine, now it makes sense”

Both sides need to know how well the deal is working
And Another Way It May Play Out...

The Airline Says:
“Sorry, but we really do need to see all your data – every city pair, including spend”

“The Buyer Says:
“Why is that? Our contract doesn’t list goals for every city pair, and all our goals with you are segment-based goals”

“The Airline Says:
“Because unless we get this data we will not offer you any preferred pricing”

“The Buyer Says:
“Are you really willing to jeopardize your business with us over this issue?”

“The Airline Says:
“Yes. We are – it is that important to us”

“The Buyer Says:
“OK, we’ll consider our options and let you know our decision”

Data has value, and should be negotiated as part of the contract
An Equitable Solution?

- Show the airline its spend and segments, and the Other Airlines’ (OA) segments

Suggested data fields:

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<tr>
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Best to agree on contract performance data before awarding the contract.
## Best Practices: Tracking Savings

Best way to track savings: Have your agency report the published fare for every ticket purchased, as well as the fare at which each ticket was issued.

<table>
<thead>
<tr>
<th></th>
<th>Published Fare (Undiscounted)</th>
<th>Issued Fare (Discounted)</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>C Fare</td>
<td>$400</td>
<td>$350</td>
<td>$50</td>
</tr>
<tr>
<td>Y Fare</td>
<td>$300</td>
<td>$275</td>
<td>$25</td>
</tr>
<tr>
<td>Q Fare</td>
<td>$150</td>
<td>$150</td>
<td>$0</td>
</tr>
<tr>
<td></td>
<td><strong>$850</strong></td>
<td><strong>$775</strong></td>
<td><strong>$75, or 8.8%</strong></td>
</tr>
</tbody>
</table>

Not all agencies can or will do this
Best Practice: Dynamic Contract Management

If you are not managing your goals, you are not managing your program.

- Control the display of available flights
- Buyer compares actuals to goals
- Airline compares bookings to goals
- Contracted goals
- Data is reported
- Back-office reports:
  - Market shares
  - Spend/sectors
- Contracted Airline

7. Implement and Track
Airline Sourcing Project
Stress Test
Available at
www.travelanalytics.com
On our Free Tools page
Or send an e-mail to
scott.gillespie@travelanalytics.com
Travel Procurement: What Works, What Doesn't
- Agencies
- Hotels
- Rental Cars
## Travel Agency Procurement: What Works, What Doesn’t

<table>
<thead>
<tr>
<th>Technique</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price benchmarking</td>
<td>• Difficult to define “transaction” and factor in the menu pricing</td>
</tr>
<tr>
<td>Online auctions</td>
<td>• Difficult to clearly specify the services and volumes</td>
</tr>
<tr>
<td></td>
<td>• Very few major suppliers</td>
</tr>
<tr>
<td>Consortia purchasing</td>
<td>• Sure, why not?</td>
</tr>
<tr>
<td></td>
<td>— Larger transaction volumes drive lower costs</td>
</tr>
<tr>
<td></td>
<td>— Switching suppliers is a credible threat</td>
</tr>
<tr>
<td>Unbundling of services</td>
<td>• Effective and probably necessary</td>
</tr>
<tr>
<td>(menu-style bidding)</td>
<td></td>
</tr>
<tr>
<td>Single global provider</td>
<td>• Not necessary and probably not very effective</td>
</tr>
</tbody>
</table>
## Hotel Procurement: What Works, What Doesn’t

<table>
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<tr>
<th>Technique</th>
<th>Comments</th>
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<tbody>
<tr>
<td>Price benchmarking</td>
<td>• Fairly effective when comparing similar volumes</td>
</tr>
<tr>
<td>Online auctions</td>
<td>• Requires significant preparation</td>
</tr>
<tr>
<td></td>
<td>• Proven to be effective in many North American markets</td>
</tr>
<tr>
<td>Consortia purchasing</td>
<td>• Commonly practiced by travel agencies</td>
</tr>
<tr>
<td></td>
<td>• Fairly difficult for corporations to execute</td>
</tr>
<tr>
<td></td>
<td>— Different locational needs</td>
</tr>
<tr>
<td></td>
<td>— Travel policies not strong enough</td>
</tr>
<tr>
<td>Chain- or brand-level negotiations</td>
<td>• Very effective for streamlining the RFP/Tender process</td>
</tr>
<tr>
<td></td>
<td>• Not very effective for obtaining best prices</td>
</tr>
<tr>
<td></td>
<td>• Local property negotiations typically produce best prices</td>
</tr>
</tbody>
</table>
## Car Rental Procurement: What Works, What Doesn’t

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<td></td>
<td>— Requires significant preparation</td>
</tr>
<tr>
<td></td>
<td>— Suppliers are very resistant</td>
</tr>
<tr>
<td>Consortia purchasing</td>
<td>• Can be effective</td>
</tr>
<tr>
<td></td>
<td>— Bigger volumes drive cost reductions</td>
</tr>
<tr>
<td></td>
<td>— Fairly easy to switch suppliers</td>
</tr>
<tr>
<td></td>
<td>— But suppliers are resistant</td>
</tr>
</tbody>
</table>
Thank You!

Discussion?