McKinsey & Company

Where is the Value in Airline Retailing?

Short summary of value creation analysis

November 2019

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Executive summary

New customer engagement through retailing

Rich and differentiated content across a proliferating channel landscape

Seamless order fulfillment and dynamic offers

Higher and more direct customer engagement, transparency, options and relevance

Offer creation moving to a modernized airline production environment

Value creation opportunity of ~40B USD p.a. by 2030

Annual value creation potential of ~40B USD by 2030

4% of industry revenues or 7 USD/pax

70% of value creation driven by additional revenues and ~30% by reduced costs

60-70% of value creation through additional customer spend and ~30-40% representing value pool shifts

40-50% sustainable value creation for fast movers

One-off investments of 3-15B USD to develop capabilities and technology

Transformation roadmap to develop future capabilities

Crafting a long-term commercial and distribution strategy

Designing individual roadmap, transitional steps and business case while managing risks

Building transformational leadership capacity

Streamlining organization around retailing flows

Converging fragmented systems and siloed functions into offer and order management

Developing digital, analytics and retailing capabilities, skills and talent

Agenda

What is it – Retailing opportunity

Why does it matter – Value creation potential

What is the challenge – Embarking on the airline retailing transformation

Appendix - Methodology

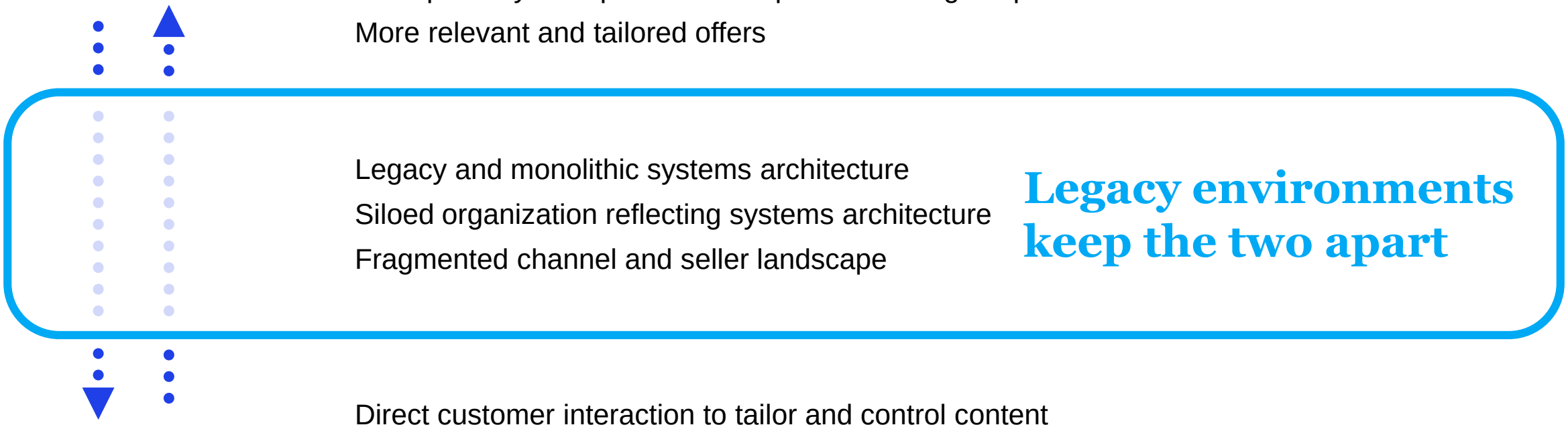
Why retailing? Creating customer engagement and moving airline distribution to the future at the same time

Customers want to engage

Frequent and frictionless engagement, proliferation of channels

Transparency over product and options to design experience

More relevant and tailored offers



Legacy and monolithic systems architecture

Siloed organization reflecting systems architecture

Fragmented channel and seller landscape

Legacy environments keep the two apart

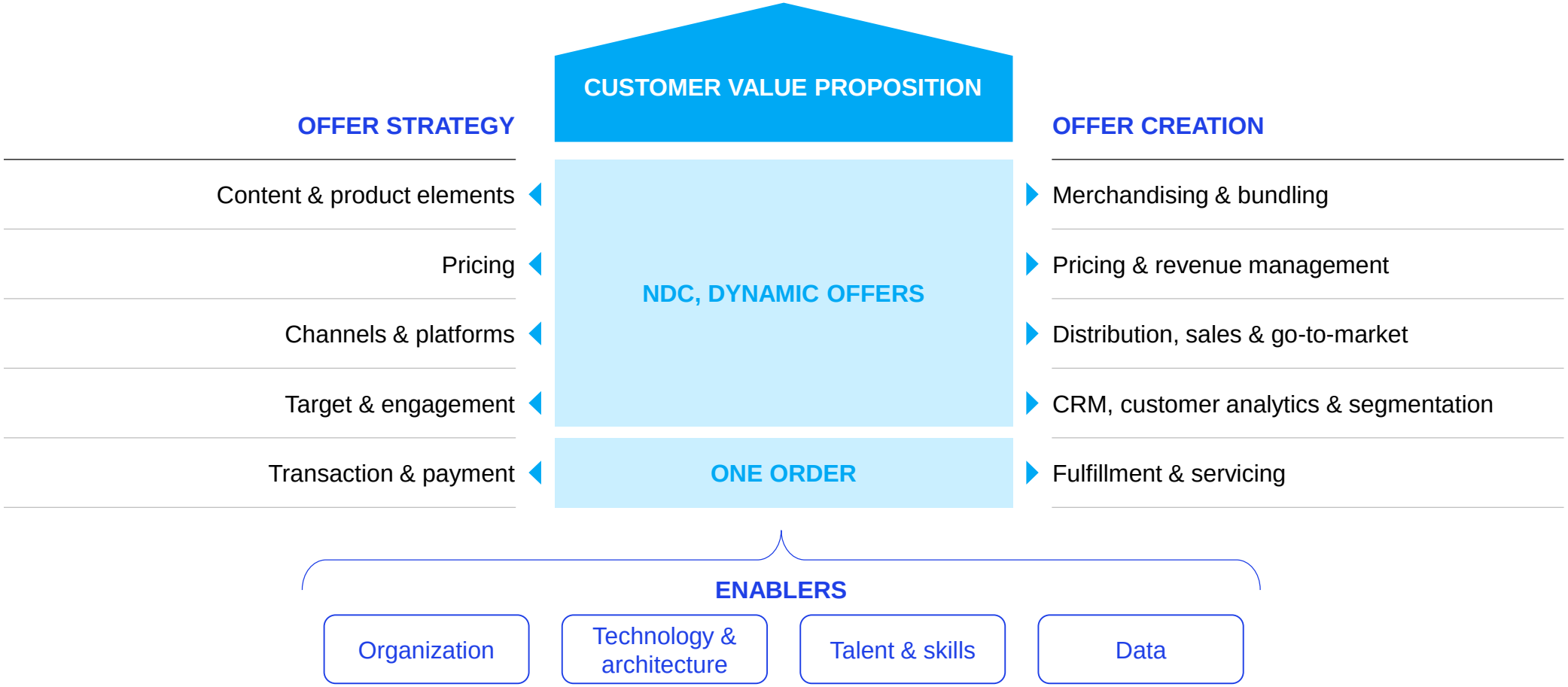
Airlines look to have the dialogue

Direct customer interaction to tailor and control content

Development of new and differentiated content along the journey

More dynamic bundling and pricing

What is retailing? Retailing involves all aspects of commercial functions and requires critical enablers



What is retailing? Richer customer engagement and dynamic offer creation in a modern production environment

ILLUSTRATIVE

Retailing includes NDC, ONE Order and dynamic offers

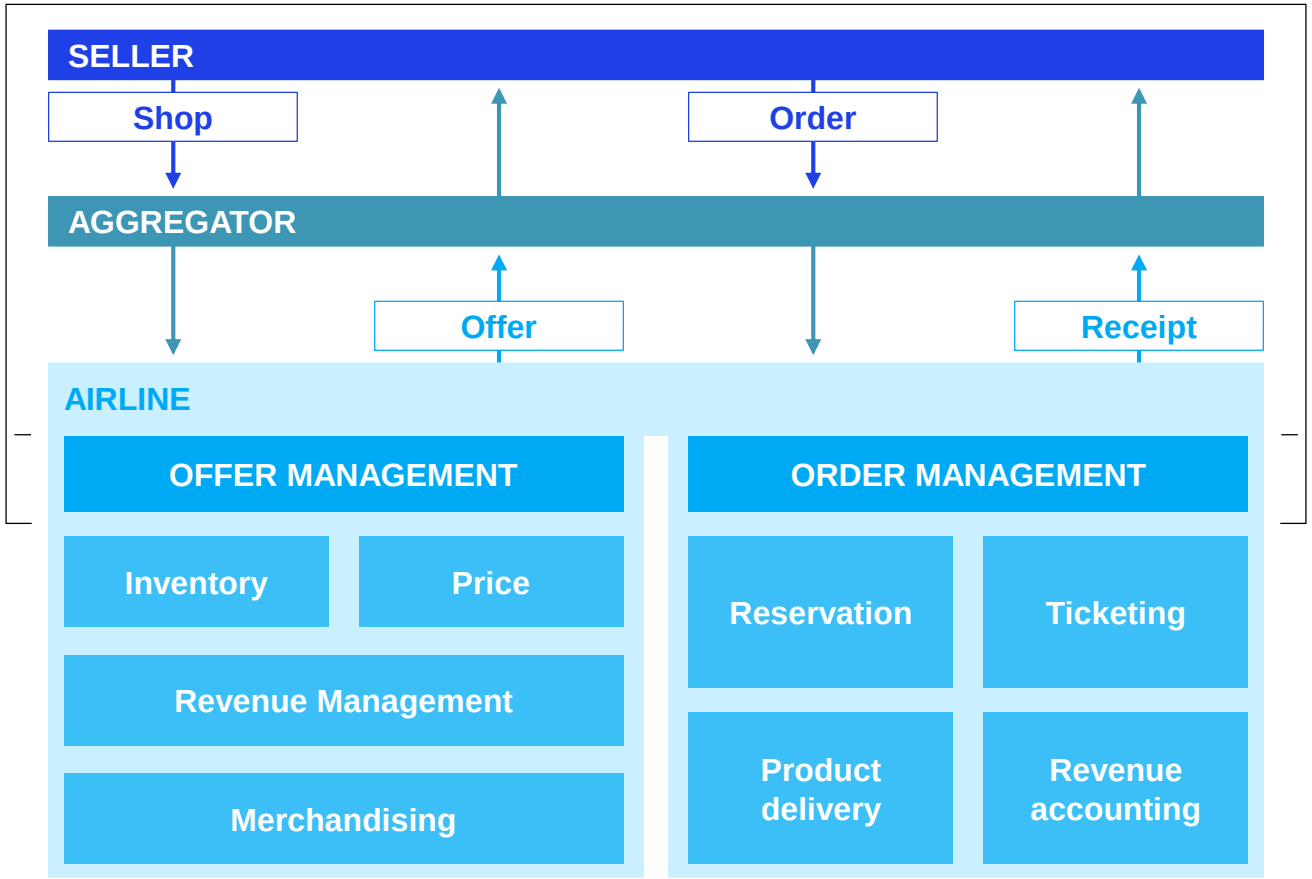
1: New Distribution Capability (NDC)

Enhanced distribution

Merchandized offers

Personalization/dynamic pricing

Offers/orders integrity



2: Dynamic offers

Contextualized and relevant offers based on each booking request

Total Offer Management of both flights and ancillary products

Continuous price points

3: ONE Order

Simplified downstream processes

Unique customer order reference/receipt

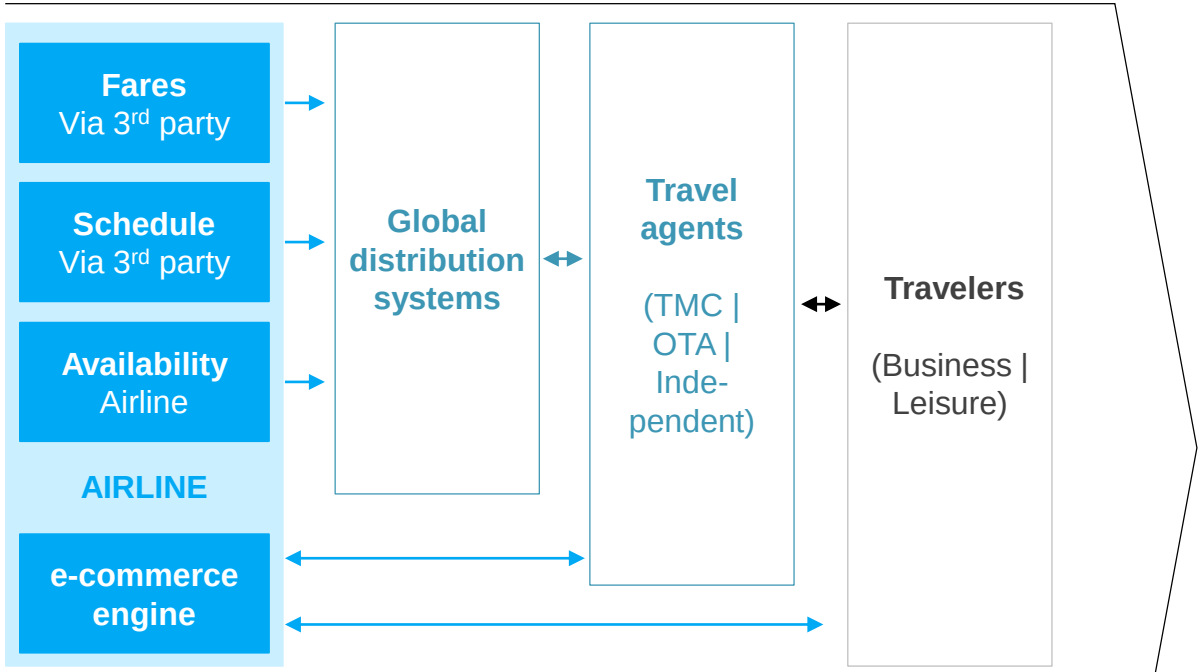
Focus on delivery and accounting

Facilitate interlining with ticketless carriers and sale of non-core ancillaries

Source: IATA

1: NDC is a new exchange format to connect and provide a rich airline offer to the customer – regardless of the channel

Traditional flight distribution

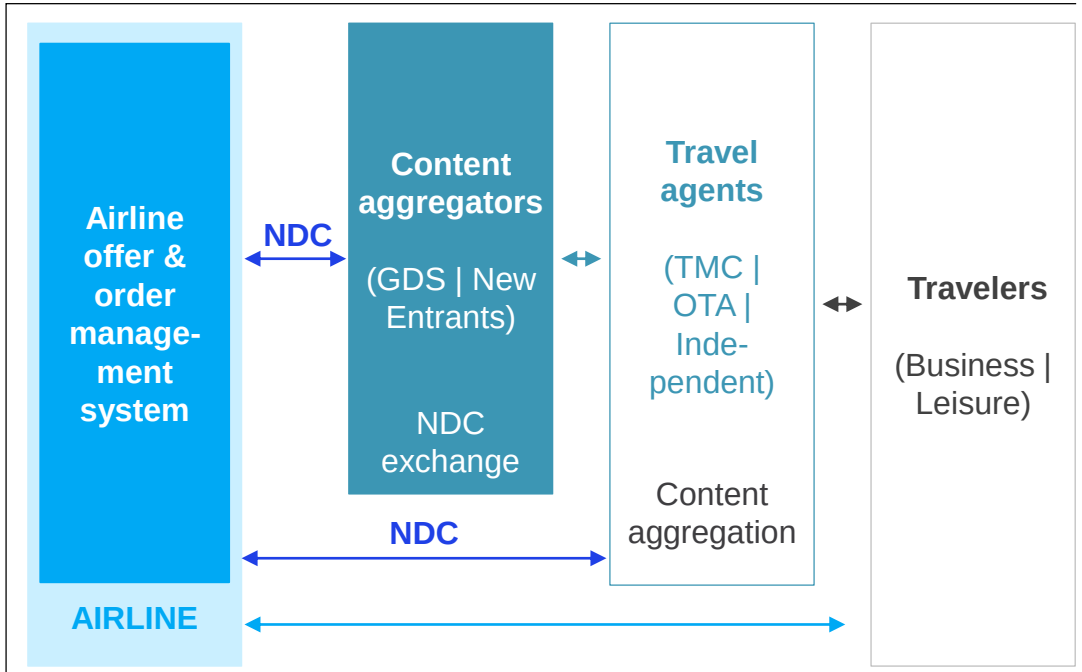


No direct customer interaction/knowledge beyond direct channels

Offer creation in indirect channels done by **GDS/TMCs**

EDIFACT languages

NDC-based flight distribution



Offer creation moved to **airline environments**

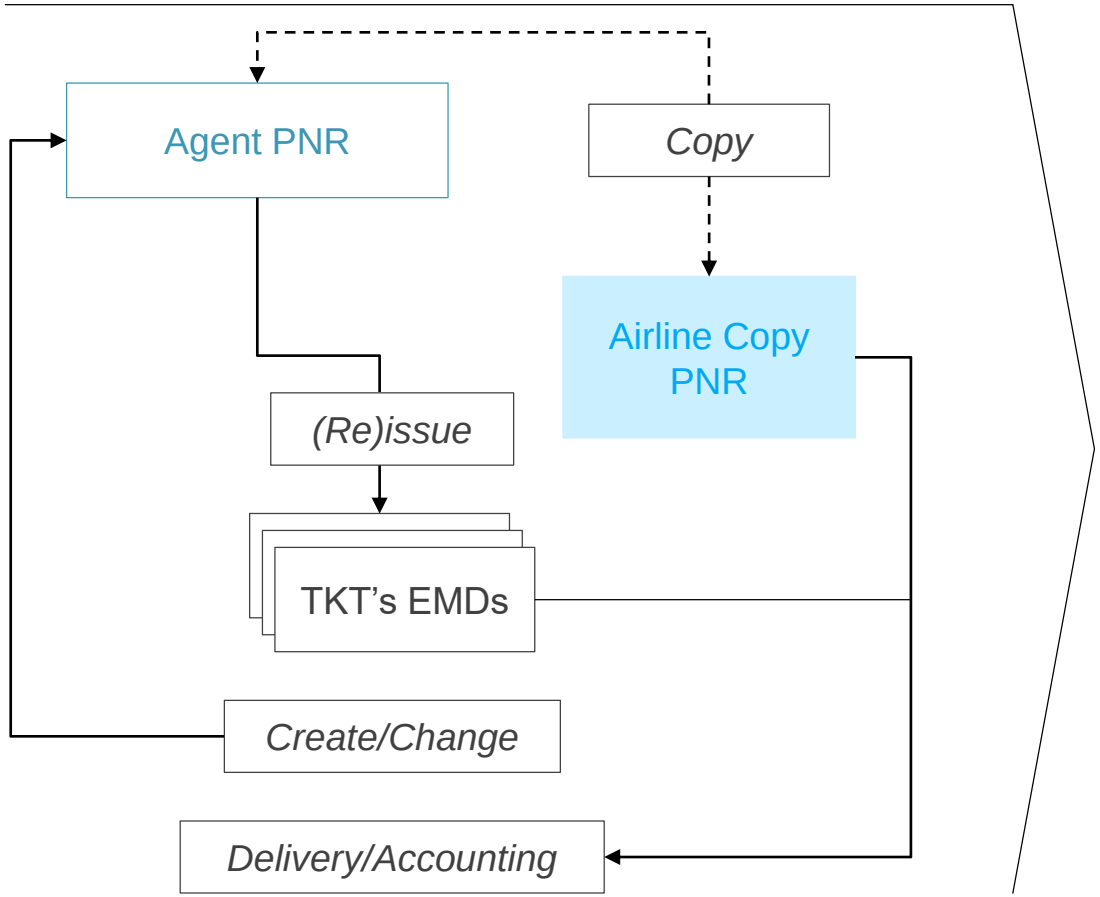
Options for **direct connections with airline**

Communication standard through NDC (XML-based)

Source: IATA

2: ONE Order creates a single integrated customer record to streamline distribution and settlement processes

From …



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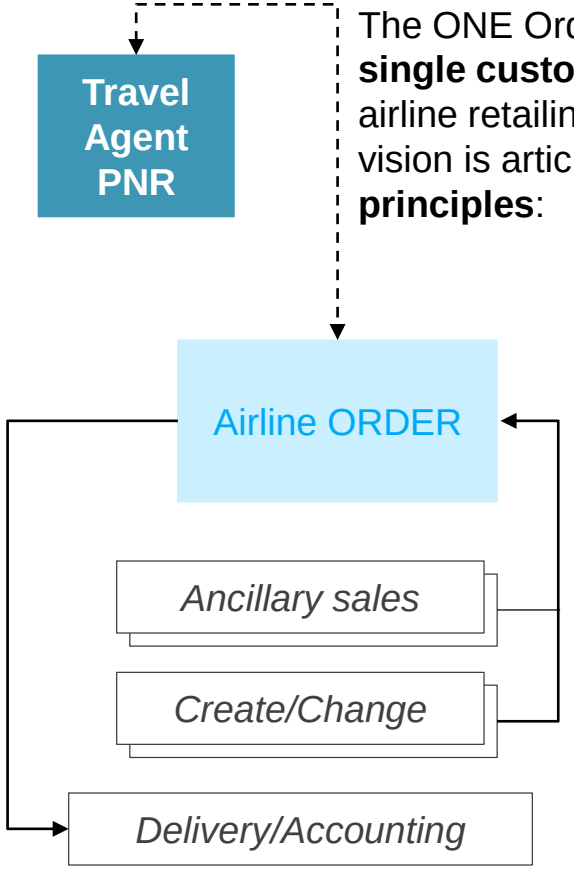


The ONE Order vision is to **move towards a single customer order record**, modernizing airline retailing, delivery and accounting. The vision is articulated around **three core principles**:

Combined, single travel record

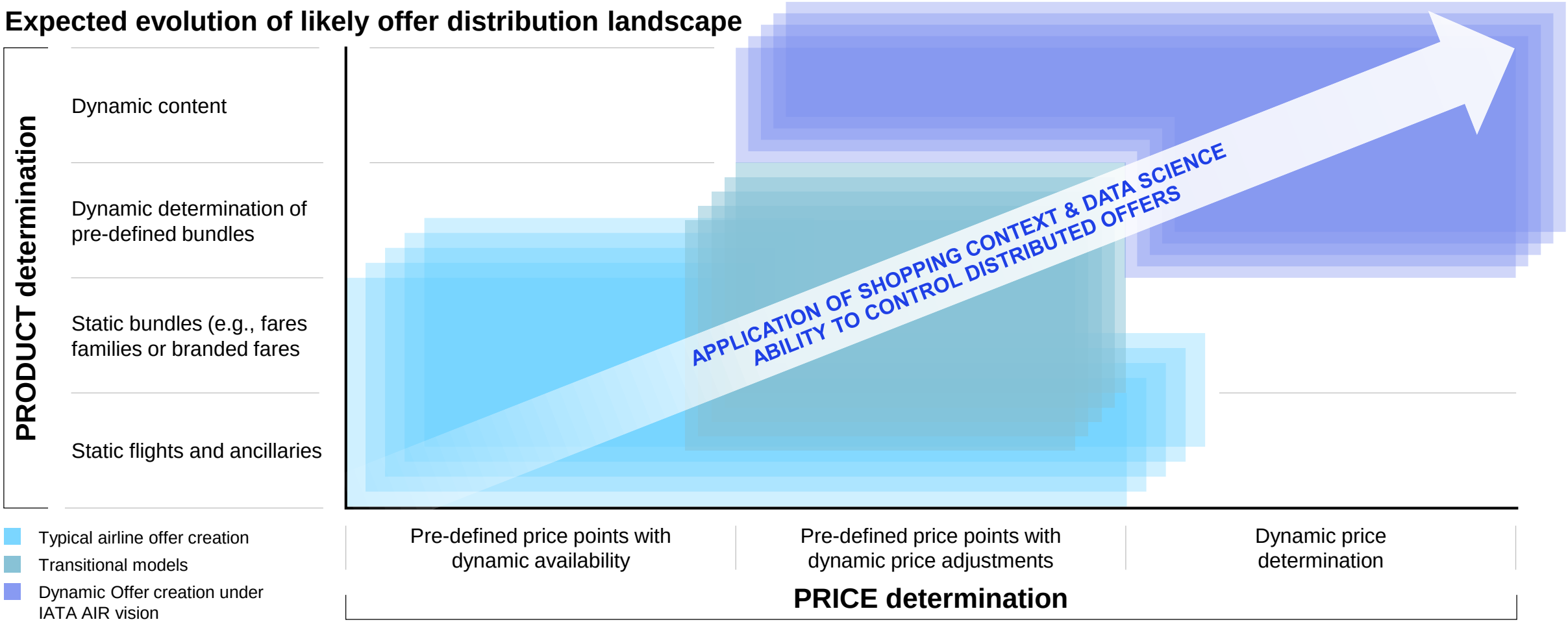
Reengineering the travel commerce processes

Efficient billing and real-time synchronization of relevant information between all parties

Source: IATA

3: Airlines move from static to tailored and dynamically priced offers

Expected evolution of likely offer distribution landscape



Source: IATA

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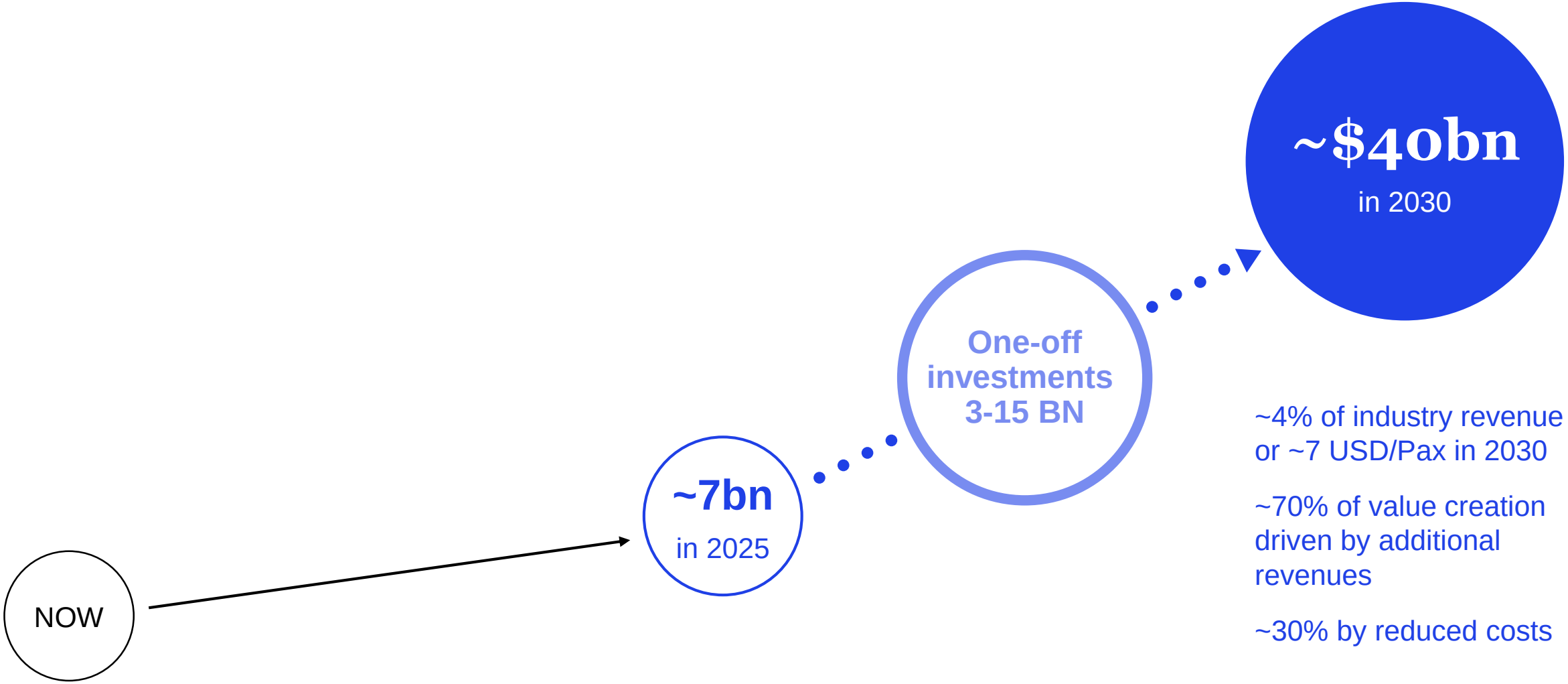
What is the challenge – Embarking on the airline retailing transformation

Appendix – Methodology

By 2030, the industry could create ~$40 billion in additional annual value

SCHEMATIC



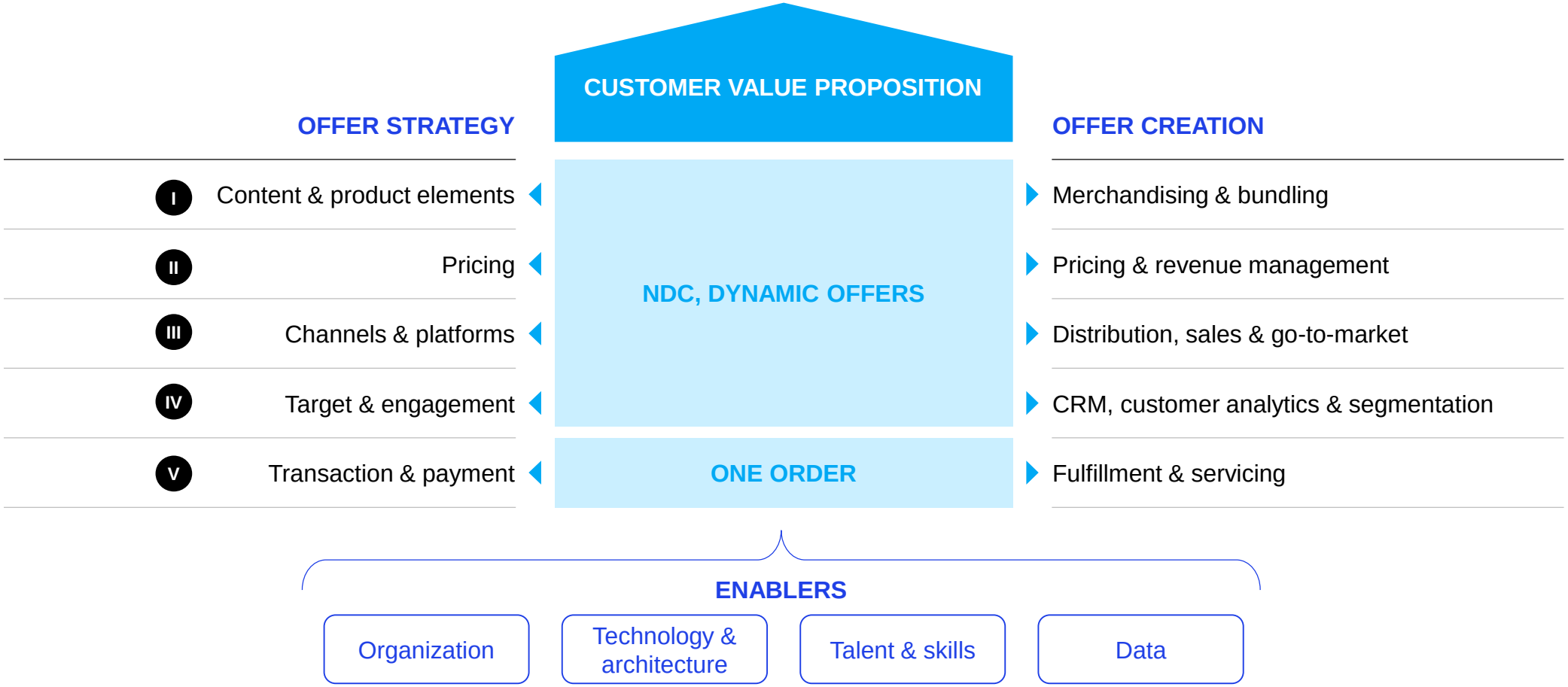
Across different industry and adoption scenarios, airlines capture value from additional consumer spend and value pool shifts

Total value captured (by airlines)[1]

		A1 "Incremental NDC development"	A2 "Large airlines emerge into travel platforms"	A3 "(Online) Intermediaries emerge as platforms"	A4 "Greenfield platforms for travel"
		• **GDS evolve to become NDC aggregators** and offer value-adding services to airlines and travel intermediaries • **Airlines produce offers with greater ancillary/content variety**, but no pricing paradigm shift • **No structural change in value chain**	• **Larger airlines bundle offers across different aspects of travel journey** • Large spread in outcome – first mover/fast followers own customers through direct access	• **Intermediaries reach scale** through consolidation and ability to provide superior customer experience and value-adding services • **Intermediaries distribute enhanced airline offers,** and airlines work with intermediaries to differentiate content	• **Greenfield platforms (e.g., Amazon) fully own customer relationship** through global retailing, airlines shifting to 'fulfillment service providers' • **Platforms create richer customer profiles** and requests sent to airlines to bundle better offers • **Crowding out of intermediaries**
VALUE CREATION	**Total 2030 value captured**	**15 bn**	**39 bn**	**22 bn**	**17 bn**
	in % of 2030 revenue	***1.5%***	***4.0%***	***2.2%***	***1.7%***
	thereof:				
	Additional consumer spend[2]	10 bn	23 bn	15 bn	12 bn
	Value pool shifts	5 bn	16 bn	7 bn	5 bn
	Cumulative value creation 2020 - 2030	**~50 bn**	**~165 bn**	**~75 bn**	**~60 bn**
One off Investment required at airlines[1]		~3 bn	~15 bn	~12 bn	~12 bn

1 Before adjustment of value sustainability in long-term (does not consider value being "competed away" over time)
2 From new demand/additional sales
3 Investment based on 5 year increase above existing IT spend as % of revenue for airlines investing in major IT architecture; assumes share of existing IT capex spend reallocated to retailing projects

Value creation is driven by 5 major sources and 4 enablers (1/2)



Value creation is driven by 5 major sources and 4 enablers (2/2)

⊕ Additional revenue per Pax Additional Pax $ Reduced cost

Sources of value creation	Drivers
I Develop new offers	⊕ • Upsell opportunities through new and richer content (incl. non-air products) • More dynamic bundling of products
II Enhance revenue management	⊕ • New revenue management solutions built on booking request context, microsegments and demand drivers • Total revenue management optimization (incl. core and ancillary products) across a dynamic offer
III Optimize distribution mix	$ • Content differentiation by channel and exclusive partnerships with a broader landscape of sales and channel partners to efficiently manage aggregation costs
IV Target & engagement	⊕ Pax • Stimulate of new demand through new content, more relevant offers and new itineraries (e.g. interlining with ticketless carriers)
V Optimize payment and fulfillment	$ • Optimize and simplification of servicing, revenue accounting and back end processes in real-time • Introduce of latest generation of payment types and reduction of payment costs
ENABLER: Organization	• Streamline and integrate organization across functional silos and focus on retailing flows, products or steps in the customer experience
ENABLER: Technology & architecture	• More modular architecture transitioning from PSS-based to offer and order management systems • Remove platform duplications and leverage of new data sources and advanced analytics applications
ENABLER: Talent & skills	• Develop new skills, capabilities and talent with functional retailing expertise (e.g. product and category managers) while retaining technical and functional airline knowledge (e.g. P&RM)
ENABLER: Data	• Aggregate data across customer touchpoints, elevate through meta data and data partnerships • Develop feedback loops to continuously enhance data sources and aggregation layers

Value creation across scenarios and sources

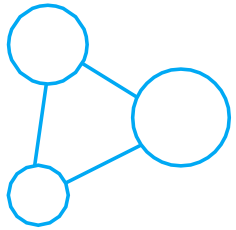
Total value captured (by airlines)

	A1 "Incremental NDC development"	A2 "Large airlines emerge into travel platforms"	Avg. % of 2030 revenue	Range depending on airline cluster	A3 "(Online) Intermediaries emerge as platforms"	A4 "Greenfield platforms for travel"
I Develop new offers	8.5 bn	22.1 bn	2.3%	0.2 - 3.5%	10.5 bn	7.3 bn
II Enhance revenue management	1.1 bn	3.6 bn	0.4%	0.3 - 0.5%	3.2 bn	3.2 bn
III Optimize distribution mix	2.0 bn	7.6 bn	0.8%	0.0 - 1.4%	4.0 bn	2.4 bn
IV Attract additional passengers	0.4 bn	0.5 bn	0.1%	0.0 - 0.1%	0.7 bn	0.7 bn
V Optimize payment and fulfillment	2.5 bn	4.9 bn	0.5%	0.3 - 1.0%	3.4 bn	3.4 bn
Total 2030 value captured	**15 bn**	**39 bn**	**4.0%**	**1.3 - 5.8%**	**22 bn**	**17 bn**

Speed and approach of retailing implementation will vary across airline clusters

GENERAL TENDENCIES

SCHEMATIC



Airline archetype

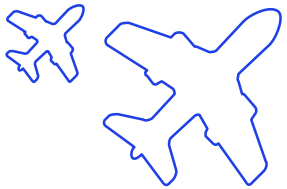
POINT-TO-POINT CARRIERS // MIDSIZED NETWORK CARRIERS // GLOBAL NETWORK CARRIERS // GLOBAL CONNECTORS

- **Global network carriers** and **Global connectors** assumed to have internal capabilities and scale necessary **to capture more opportunity**
- **Larger point-to-point carriers** (LCCs) already operate through a **more modular IT infrastructure** and are likely to **adapt quickly to capture benefits**

Geography

LATIN AMERICA // EUROPE // AFRICA // MIDDLE EAST ASIA PACIFIC // NORTH AMERICA

- Market maturity in **North America** and **Europe** likely to result in larger airlines **moving first** and capturing value
- Other geographies catch up in **ancillaries** and **bundling** strategies. Also **motivated to invest due** to higher distribution costs

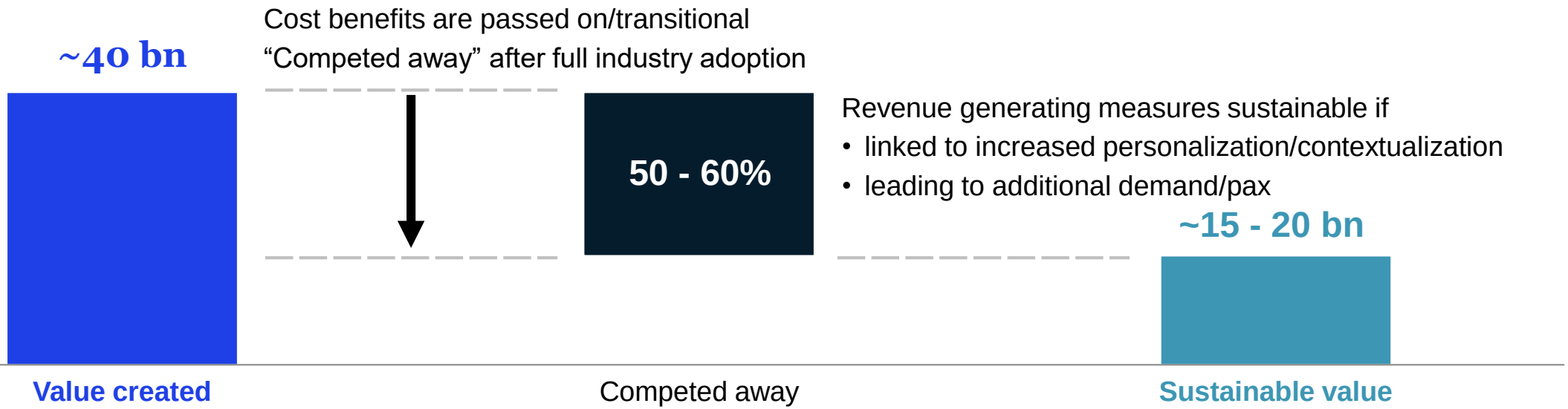


Airline size

<2BN USD REVENUE P.A. // 2 - 15BN USD REVENUE P.A. // >15BN USD REVENUE P.A.

- **Larger carriers** assumed to have internal capabilities and scale necessary to invest and **move faster** on NDC/One Order
- **Certain smaller players** in specific markets position themselves as innovators also **likely to capture more than peers**

~40-50% of the value created will likely be sustainable in the long term through broad adoption of retailing capabilities



Case example: adoption of Pricing & Revenue Management (PRM) techniques
Launched in the 1970/80s introducing perishable inventory concept

- Rapid growth and **wide adoption in the 1990s**
- Estimated effects **5 - 7% of revenue**, but never fully "visibly" punched through to bottom-line

→ PRM was a **transitional differentiator** (and value driver) for early adopters (vs lifting industry profitability sustainably across the board)

→ PRM made the **industry more competitive** inducing demand and gaining shares from other transportation modes

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Retailing provides value for customers and opportunities for all players along the value chain

ILLUSTRATIVE

New retailing concepts: implications for different value chain participants

	Airlines	GDS/aggregators	Intermediaries
Opportunities	• Airline-generated offer for each request and channel • Closer customer relationship and insights, higher customer satisfaction • Ability to differentiate and create product transparency • Optimization of corporate sales/distribution contracts	• Interface between airlines and wide landscape of sales and channel partners • Possibility to monetize technology and software development and implementation experience • Customer and offers insights, analytics services and implementation needs	• Direct connections with (selected) airlines • Exclusive offers for customers • Deep customer knowledge/context and product breadth • UX design and customer service expertise
Risks	• Required investment and shift to retailing capabilities (technology, skills, fulfillment) • Lack of competitiveness due to risk of doing nothing	• Decreasing GDS volumes • Full content accessibility from suppliers • Competition in (parts of) the distribution technology stack • Lack of competitiveness due to risk of doing nothing	• Volume loss to suppliers and larger intermediaries • Full content accessibility from suppliers • Fragmentation of supplier interfaces and channels • Lack of competitiveness due to risk of doing nothing
Value capture actions	• Develop channel, product, pricing and distribution strategy • Drive rich content and UX adjustments • Strengthen customer analytics and retailing capability development • Build NDC, offer and order management capabilities	• Product and service offering for (transition to) airline retailing • Leverage deeper customer insights triggering more relevant offers from suppliers • Create offer insights and analytics service capabilities	• Push superior UX design, functionalities and customer service • Leverage deeper customer insights triggering more relevant offers from suppliers • Drive strategic suppliers/partnerships for exclusive content for own customers

Immediate opportunities to unlock the value of retailing

Strategic questions

- → Strategic objective of distribution?
- → Approach to channel, content and product development for offer creation strategy?
- → Business case for short and long-term value and required investment?
- → Actionable roadmap including trade, sales and channel partners?
- → Implications for organization, talent, culture and ways of working?

Implementation questions

- → Do I want to be a leader, early adopter or follower?
- → Which are the levers that bring the most value to me?
- → Where and how do I attract the right people?
- → How do I set up internally? (e.g., commercial department)
- → To what degree do I develop the systems/technology internally vs. work with external providers?
- → Who are the right technology partners for me?

Value capture steps to embark on the retailing journey

CUSTOMER VALUE PROPOSITION

Content & product elements	**Product offer and ancillary optimization**	• Modular product segmentation, attribute-based cataloging of ancillaries • Bundle introduction based on use cases and merchandise capabilities
	Customer experience and touchpoint design	• Customer experience design across journey steps • (Digital) marketing strategy across touchpoints, customer care strategy
Pricing	**New pricing and revenue management solutions**	• New approach to total revenue management and optimization across all offer components, introduction of dynamic pricing to prepare offer management
Channels & platforms	**Sales and channel strategy**	• Optimize content, trade and channel agreements to reflect richer and differentiated product strategy • Develop strategic distribution partnerships with differentiated content/bundles
	Distribution and ecosystem strategy	• Disaggregated approach to run distribution infrastructure for multiple channels • Platform, growth and ecosystem opportunities
Target & engagement	**Micro segmentation and customer analytics**	• Customer data lake and micro segmentation capability, understanding of demand drivers by micro segments, develop A/B testing capabilities for digital merchandising capability

Organization
Integration along offer flow
Customer-centricity
Product and channel view
Agile roadmap development

Technology & architecture
Modular architecture
Merchandise and retailing layers
Removal of platform duplications

Talent & skills
Digital, analytics and IT capabilities
(Digital) merchandise and retail experience
Product & category managers

Data
Data lake and meta data addition
Data partnerships
Aggregation and analytics layers

Detailed approaches, case examples available on request

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We distinguish (A) how the entire value chain and (B) how specific airline clusters will be affected

A **How will the industry value chain be affected?** (e.g., "growing pie" vs. re-distribution of value)

Looking at the future of travel distribution space, we **distinguish along key customer interactions:**

Shop (i.e., where do customers shop for their travel needs?)

Book (i.e., where do customers book their travel?)

Service (i.e., who services the booking after purchase up until completion of travel?)

Reflected in **4 industry scenarios** going forward (**A1** - **A4**)

B **How will specific airline clusters be affected?**

We **distinguish among different airline clusters,** often with a homogeneous approach to distribution:

- **B1** **Airline archetype** (i.e., point-to-point carriers, midsized network carriers, global network carriers, global connectors)
- **B2** **Airline size** (i.e., small <2bn USD revenue p.a., medium 2 - 15bn USD revenue p.a., large >15bn USD revenue p.a.)
- **B3** **Geography** (i.e., Latin America, Europe, Africa, Middle East, Asia Pacific, North America)

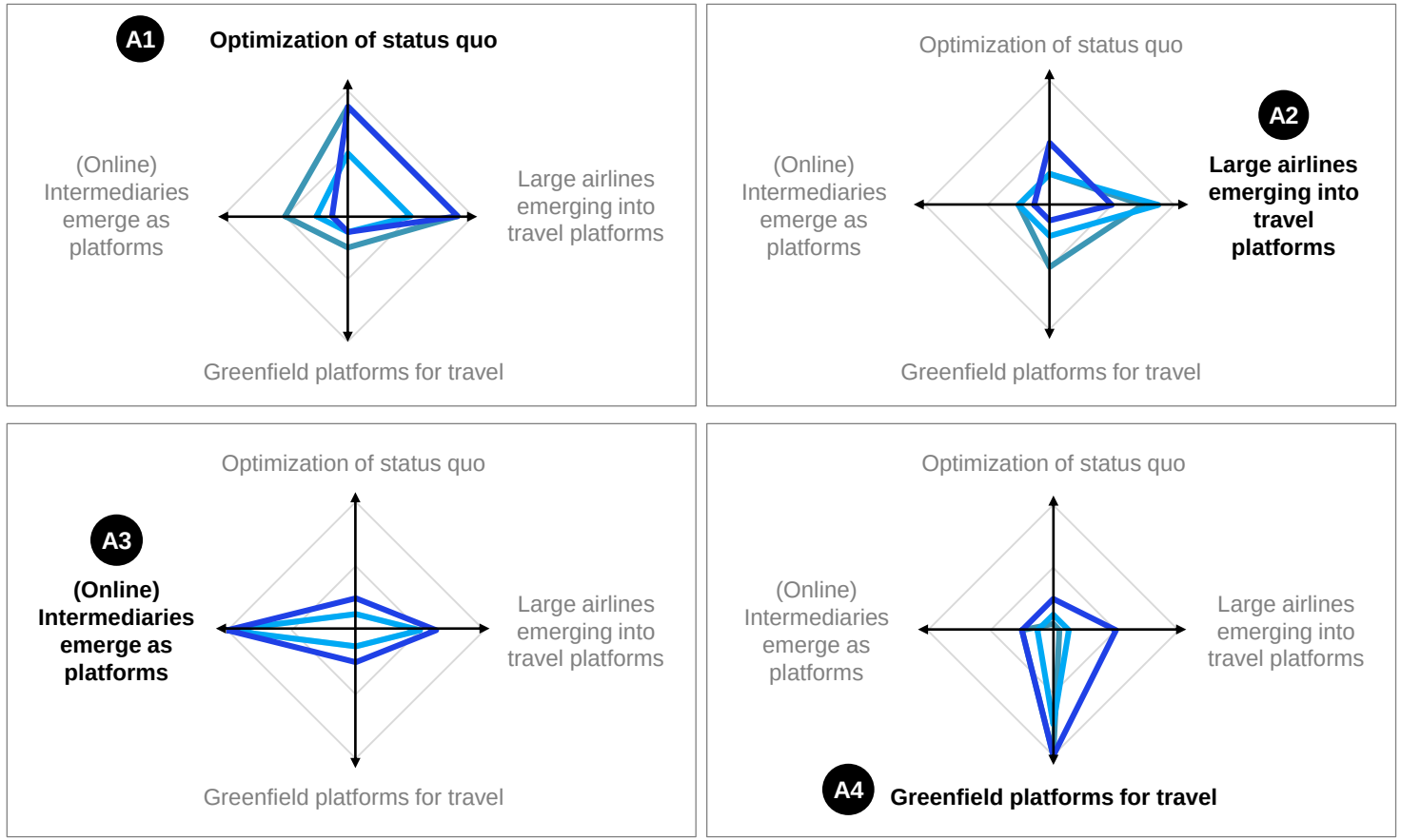
Focus of analysis and implications on **15 major airline clusters, accounting for >80% of total revenues**

A: We distinguish among 4 different industry scenarios

Three drivers of customer value …

- **Shop:** Shopping consists of customers researching possible travel options, e.g.,
  - checking possible connections
  - looking at reviews
  - asking friends and family
- **Book:** Booking is the actual purchase after shopping around for the best possible offer, e.g.,
  - booking flight on airline website
  - purchasing package holiday in travel agency
  - buy flight plus hotel combination
- **Service and delivery:** Servicing and delivery are the processes between booking and completion of booked services, e.g.,
  - processing the order
  - payment settlement
  - change of the order (e.g,. reschedule the flight, upgrade last minute)

... based on which we see four possible industry scenarios



B: We clustered the airline landscape around 3 key dimensions

B1 Airline archetype

We distinguish **4 main airline archetypes** – while each individual carrier may be different, the archetypes often have a rather homogeneous approach to distribution

Point-to-point carriers

Midsized network carriers

Global network carriers

Global connectors

B2 Airline size

We cluster **3 different airline sizes** (in terms of annual revenue) to account for differences in investment potential and distribution capabilities

Large (>15bn USD)

Medium (2-15bn USD)

Small (<2bn USD)

B3 Geography

We distinguish **7 geographic regions** to cater for local differences in distribution

Latin America

Europe

Africa

Middle East

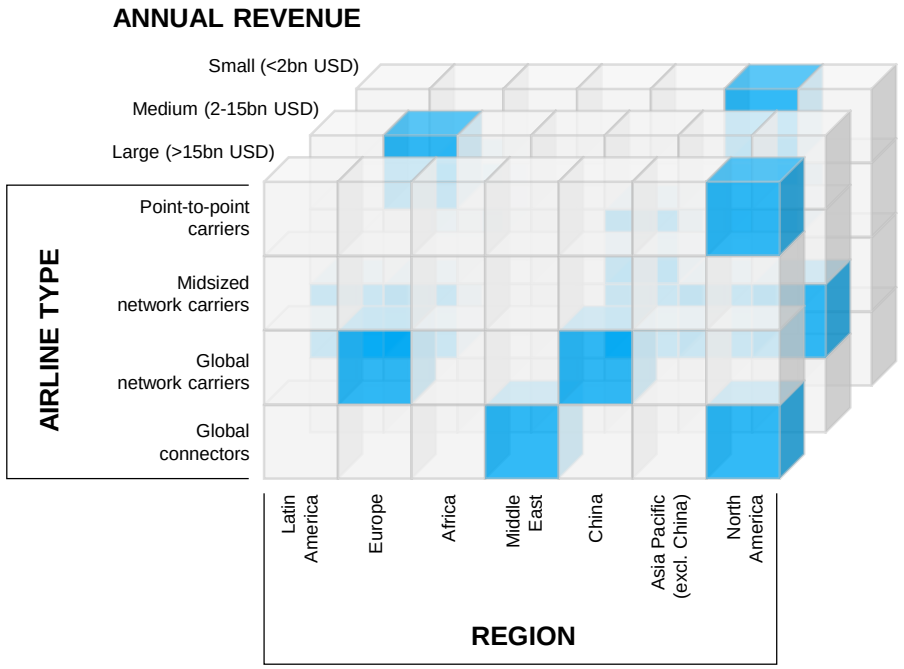
China

Asia Pacific (excl. China)

North America

B: The 15 major airline clusters account for ~80% of total revenues – we focus our quantification on these 15 airline clusters

Airline clustering approach



Airline revenues per cluster

Cluster	Revenues (2018, bn USD)	Share of total (%)	Cumulative share of total (%)
North America, Global network carriers, Large	102.2	15%	15%
Asia Pacific, Global network carriers, Medium	88.4	13%	29%
Europe, Global network carriers, Medium	67.8	10%	39%
Europe, Point-to-point carriers, Medium	36.4	5%	44%
China, Global network carriers, Large	32.2	5%	49%
Europe, Midsized network carriers, Small	25.6	4%	53%
China, Midsized network carriers, Medium	25.5	4%	57%
Asia Pacific, Point-to-point carriers, Small	23.1	3%	60%
North America, Point-to-point carriers, Large	17.8	3%	63%
Europe, Global network carriers, Large	17.6	3%	66%
Middle East, Global connectors, Large	17.6	3%	68%
Asia Pacific, Midsized network carriers, Small	17.5	3%	71%
North America, Global network carriers, Medium	14.9	2%	73%
China, Global network carriers, Medium	14.4	2%	76%
Latin America, Global network carriers, Medium	13.2	2%	78%
Other	149.1	22%	100%

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