E-Commerce's Impact on the Travel Agency Industry

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Special Note

The following note is in regard to the September 11, 2001 terrorist attacks.

The Travel Agency Industry is being forced by new online distribution channels to rapidly incorporate E-commerce in their business models. Because these new channels offer tangible efficiency benefits in distributing certain travel services such as airline ticketing, reductions in the number of agencies and agents required to serve existing customers was a normal response occurring in a free and open marketplace.

However, the over-acceleration of this process following September 11, 2001 will unfairly eliminate viable agencies and potentially result in reduced distribution capacity when travel markets return to normal. Likewise, the ability to disseminate and explain new travel policies will be more limited, and fewer agents will be available for promoting travel and offering personal reassurances to returning travelers.

While the forecasts cited in this report will be revised downward, the fundamental trends impacting the travel agency industry will remain the same. For this reason, the report remains useful for understanding how E-commerce is impacting the travel agency industry. The report may also be useful for differentiating between trends existing prior to September 11, 2001, and those trends artificially created following that date.

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April 9, 1997

Online Travel Agent Pioneer Shuts Down

The country's first online travel agency, PCTravel, has gone out of business just three years after it began as the pioneer in cyber-travel, according to Travel Management Daily.

George Newsom, Chairman of the company, said, "There was just no way we could stay in business with our revenue and expense figures." Several major airlines have recently capped commissions for online bookings and the Apollo CRS increased fees to PCTravel and others in mid-March.

"Consumers were treating us like a public library. They were using our site to look and then going offline or to the airlines directly to book," said Newsom. He added, "We're not sure where to go from here. One thing we know is the Internet isn't the way."

Sources: National Business Travel Association (NBTA), Travel Management Daily

Comparing the state of online travel in 1997 to the $15.4 billion in online travel sales during 2000 shows how quickly E-commerce business models and markets can change. Today, E-commerce is forcing the travel agency industry to rapidly adjust to new competitors who are reaching millions of travelers using new online travel distribution channels.

Online direct sales by travel providers represent the greatest potential challenge for offline and online travel agencies - both large and small. While online direct sales are still just a fraction of total travel sales, the ability of travel providers to sell direct diminishes the perceived value of intermediaries such as travel agencies.

As an example, airlines leveraging customer relationships cultivated in frequent flyer programs have reduced offline agency commissions by $2.8 billion since 1992. By relying on their own online direct sales capability, some airlines have eliminated online agency commissions altogether.

E-commerce and Internet technology successfully duplicate the key features of offline markets; good location, strong retail activity, secure payment, fast delivery, and readily available customer service. In 2000, 90.4 million travelers visited this new online travel marketplace with 24.7 million travelers eventually making an online travel purchase. Attracting these travelers are websites capable of delivering online equivalents of the five “R’s” of travel agency services - Recommendation, Research, Reservations, Reporting, and Relationship.

In response to direct sales and online agencies, small travel agencies are taking advantage of new ‘off the shelf’ software and technology solutions to provide similar features and services. Other small agency responses include refocusing on selling higher commission leisure travel packages, closing storefronts and moving to home offices, and charging customer service fees.

Reductions in the number of travel agency locations from 33,500 in 1995, to 29,018 in August 2001 are primarily due to airline commission cuts. Airline ticket sales generate 54 percent of total travel agency revenues, making agencies highly sensitive to any change in this travel category.

Comparatively, online travel sales represented only 7 percent of total travel sales in 2000, and growth estimates show online sales remaining less than 30 percent of total travel sales through at least 2005.

While E-commerce does not yet dominate travel sales, the future efficiencies promised by online distribution channels have already reduced the perceived value of traditional offline travel agencies. It is likely that other travel providers will follow the airlines’ lead of cutting agency commissions and developing online direct sales capabilities.

Given that offline travel agencies continue to distribute the majority of travel services, a premature reduction in the number of travel agencies would be undesirable. Understanding how E-commerce is impacting the travel agency industry will help differentiate between naturally occurring industry developments, and the developments resulting from anti-competitive or poorly conceived changes to travel distribution channels.

Section 2 : Introduction

Overview

This report describes the impact of E-commerce, new technologies, and related industry developments on the Travel Agency Industry. The combination of these developments is creating new channels for distributing travel information and services.

The travel agency industry was built on the pre-Internet assumption that suppliers were unable to maintain individual relationships with numerous and widespread customers. Like other industries faced with this 'few-to-many' business model, travel suppliers and customers relied on large numbers of middlemen (intermediaries) serving local geographical areas.

Successful intermediaries 'own' the customer relationship. The travel agency industry's ownership of the airline travel customer was reflected in the 10 percent agency commission rates following deregulation in 1978 and the introduction of variable pricing (yield management) systems. These developments resulted in confusing and dynamic fare structures which travelers relied on travel agencies to decipher. During this time, airlines rewarded agencies accordingly in order to protect their market share.

Using E-commerce and other technologies, travel providers can electronically reproduce the customer relationship formerly owned by travel agencies. This shift in ownership began with the introduction of frequent flyer reward programs in 1982 by American Airlines. The airline commission caps and rate reductions started by Delta in 1995 signaled that these programs were allowing airlines to develop direct contacts with customers and gain customer loyalty. Likewise, travelers were finding it possible to purchase directly from airlines using the Internet.

Report Scope

The study into E-commerce's impact on the travel agency industry revealed that other technologies and industry developments were key to E-commerce's success. The scope was expanded accordingly to include a broader overview of the entire travel industry, other related new technologies, and related market developments (specifically customer demographics).

Research Methodology

As the nation's third largest retail sales industry, research and coverage of the travel industry is extensive. This study drew on data produced by industry trade associations, suppliers, research firms, government reporting agencies, and universities. Phone conversations with travel agency owners, travel providers, and industry associations were used to verify or clarify findings. A list of sources useful for additional research on E-commerce and travel are listed in Appendix A.

Review of Sources and Data Used

E-commerce and Internet statistics are produced by monitoring Internet users and website traffic, or via surveys conducted online or by phone. Since a standard measurement system does not yet exist for measuring E-commerce and Internet activity, different methods and metrics are employed by different companies. As a result, E-commerce and Internet figures sometimes differ by wide margins between sources.

For example, online Christmas retail projections for the year 2000 ranged from $6 billion to $13.2 billion – partly because some included the entire fourth quarter, while others only included November and December as the Christmas shopping season. Likewise, projections for 2004 online business-to-business (B2B) sales ranged from $2.23 trillion to $7.9 trillion. These depended on the definition of B2B commerce and if both international and domestic volumes were included.

Similarly, online travel sale measurements and statistics also vary from source to source. Examples include the studies produced by two travel related trade associations.

According to their publications and website, the Travel Industry Association of America's (TIA) mission is to represent the entire U.S. travel industry. Consequently, TIA defines a traveler as "a person who took at least one trip 50+ miles away from home, one-way, in the past year (not including commuting to/from work or school)."[1] Since some number of these short-distance travelers would not require travel agency services to complete their trip, TIA's reports of 'online traveler' behavior are not limited to travel agency customers. However, because

[1] Travel Industry Association of America (TIA), "Travelers' Use of the Internet", 2000 Edition.

travel agency customers are a subset of the TIA survey and measurement population, major trends within the TIA results also indicate the trends of travel agency customers.

The American Society of Travel Agents (ASTA) stated mission is to represent travel agencies worldwide and meet the needs of the traveling public.[2] A majority of ASTA's 26,000 members have annual sales under $3 million, are focused on selling leisure travel, and have been in business for over eleven years. This makes ASTA surveys useful for studying smaller agencies.

Some E-commerce measurements require a comparison to the overall market. One example is the frequently published high growth rate of online travel sales. These sales still represent less than 10 percent of total travel purchases and are not expected to exceed 30 percent until 2005. Consequently, E-commerce's current ability to rapidly grow does not necessarily indicate that E-commerce will eventually gain, or hold, a majority share of the overall travel market.

Industry Specific Terminologies

Industry specific terminologies are compiled in the Glossary found in Appendix B.

Benefits of this Report

The travel agency industry's response to E-commerce offers insight into how other mature industries populated with small businesses will react to E-commerce developments. In particular, industries that can complete transactions electronically and are served by numerous small outlets share two key characteristics of the travel agency industry. One possible example of a similar industry would be the insurance industry.

The study of travel agencies and E-commerce also offers valuable insight for the following reasons. First is the continued success of online travel sites following the failure of many online business models during the 2000-2001 stock market correction. Secondly, the industry has large numbers of independently owned small businesses. Thirdly, the industry is mature and is adapting to E-commerce in the context of other changes experienced during the past 100 years of its history. Finally, travel agencies are part of the overall travel industry which is the third largest retail industry in the United States.

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[2] American Society of Travel Agents (ASTA), November 2000, http://www.astanet.com

Section 3 : Travel Agency Industry Overview

E-commerce combined with new communication technologies, changing market demographics, and ongoing travel industry developments, is reducing the need for intermediaries in the distribution of travel services. E-commerce enables travel providers to directly transact business with millions of individual travelers who are increasingly more experienced at using the Internet and other new communication technologies.

As a result, total online travel sales have risen from approximately $400 million in 1997 to $15.4 billion in 2000. These figures include sales by online travel agencies, online direct sales by travel providers, consolidators such as Priceline, and sales by traditional agencies through their individual websites (bricks and clicks). By comparison, in 1999 the total of online and offline travel agency sales was $143 billion.[3]

The traditional travel agency industry still accounts for the majority of total travel sales. Airlines continue to acknowledge this fact that most of their ticket revenues are generated through the travel agency channel.[4]

In addition to distributing travel services, travel agencies provide other value-added services such as making travel recommendations, managing corporate travel accounts, and in general, aiding customers with a variety of issues related to the purchase of travel services. These services are providing an increasingly important source of fee-based revenue to offset declining airline commission revenues.

However, technology advances have begun reducing travel agencies exclusive role in providing many of these value-added services. Online corporate travel management programs are now duplicating services previously provided by travel agencies. Similarly, the Internet's information exchange capabilities give travelers wide access to travel recommendations, reviews, travel guides, and even interactive multi-media promotions of travel destinations.

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[3] Travel Weekly, "Travel Weekly's U.S. Travel Agency Market Survey 2000"

[4] Selected SEC 10-K company filing, 2000

The introduction of online travel sites has led many travel agencies to acknowledge the need for developing an online presence. According to ASTA's 2000 Agency Automation Survey, 52 percent of 1999 respondents reported having a website compared to only 37 percent in 1998. Of the remaining offline agencies, 56 percent stated they planned to go online within a year.[5]

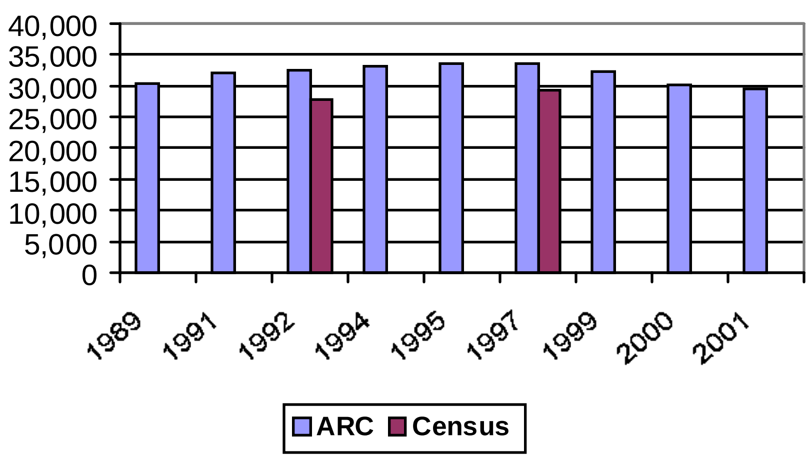
One key question for these agencies to consider is whether the cost of website development and advertising is a one time investment, or if these costs will remain a significant and ongoing cost of conducting business online.

Travel Agency Industry Size

The exact number of travel agencies varies between sources, but all show a decline in agency locations following the airline commission reductions initiated in 1995. The Airline Reporting Corporation (ARC) is the airline owned centralized clearinghouse responsible for reconciling airline ticket sales and commissions between agencies and the airlines. In August 2001, ARC reported there were 29,018 retail travel agency locations.

ARC figures for the number of agency locations are shown in Figure 1. Also included are U.S. Census Bureau figures that show the number of companies, not locations, operating in the travel agency industry.

Figure 1: Number of Travel Agencies from 1989 to Present



Source: Airline Reporting Corporation and United States Census Bureau

[5] American Society of Travel Agents (ASTA), "2000 Travel Agent Automation Survey"

Not included in the ARC figures above are agencies not ARC registered to directly sell airline tickets. Only agencies directly selling airline tickets need ARC accreditation. Thus, the declining ARC numbers may reflect to some degree those agencies dropping airline ticketing to focus on more lucrative cruise and tour packages. According to a 1999 ASTA press release, the number of non-ARC registered agencies could be as high as 10,000.[6]

Integra Information specializes in collecting data on privately held companies. Their data showed a total of 24,938 privately owned agencies in 1999. Of these, 11,078 had annual sales under $250,000, with some number of these being non-ARC accredited agencies.[7]

The decline in reported agency locations has been equally spread across the U.S., down 4 percent in the East and West, 5 percent in the South, and 2 percent in the Midwest.[8] In 1999, small to mid-sized agencies continued to represent the majority of agencies in the industry with only 18 percent achieving annual sales over $5 million.

Table 1: Percentage of Agencies by Annual Sales

	Percent of Agency Locations			
Annual Sales	**1999**	**1997**	**1995**	**1993**
Under $1 million	24%	19%	30%	29%
$1 - $1.9 million	26%	30%	29%	33%
$2 – $4.9 million	32%	34%	27%	25%
$5 million or more	18%	17%	14%	13%

Source: Travel Weekly's U.S. Travel Agency Market Survey 2000

These sales figures indicate nearly a quarter (24 percent) of travel agency locations can be described as small businesses. Similarly, 56 percent of ASTA members have annual sales under $1.9 million, and nearly three quarters (73 percent) have sales under $2.9 million.[9]

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[6] American Society of Travel Agents (ASTA), "ASTA Replies to Bear Stearns Study: ARC Figures No Longer Define the Travel Agency Industry", April 19, 2000. http://www.astanet.com/news/releasearc hive/04_19_00.html

[7] Integra Information, PrivateCo.com Industry Report. June 15, 2001

[8] Travel Weekly, "Travel Weekly's U. S. Travel Agency Market Survey 2000"

[9] American Society of Travel Agents (ASTA), "2001 Service Fee Study", April 2001

In terms of employment, the 1997 Census Bureau reported 183,178 workers were employed by 29,332 travel agencies generating an annual payroll of nearly $4.5 billion. Both Travel Weekly[10] and ASTA[11] surveys show the average number of employees per agency is six. Using these values, the average annual employee salary would be approximately $25,500.

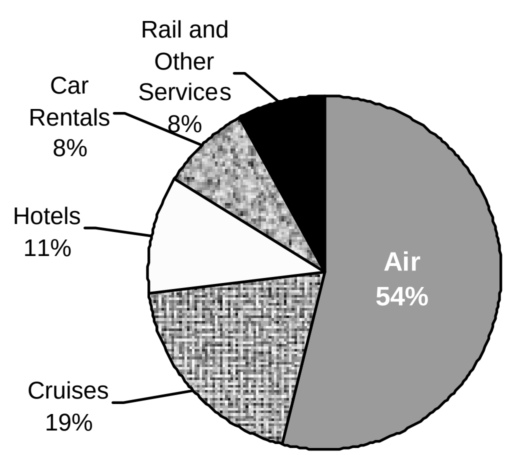
ASTA travel agencies workforces are predominately made up of women, with agencies employing on average 82 percent women, versus 18 percent mean.[12]

Categories of Travel Services

Airline ticketing generates 54 percent of total travel agency annual sales. The second largest contribution comes from cruise package sales at 19 percent, with the two remaining major categories of hotels and auto rentals contributing 11 and 8 percent respectively. Passenger rail, bus and other services make up the remaining 8 percent.

This explains why changes in airline ticket distribution and commission structures have the greatest impact on the travel agency industry.

Figure 2: Travel Agency Revenue Streams



Source: Travel Weekly's U.S. Travel Agency Market Survey 2000

[10] Travel Weekly, "Travel Weekly's U. S. Travel Agency Market Survey 2000"

[11] American Society of Travel Agency (ASTA), "2001 Service Fee Study", April 2001

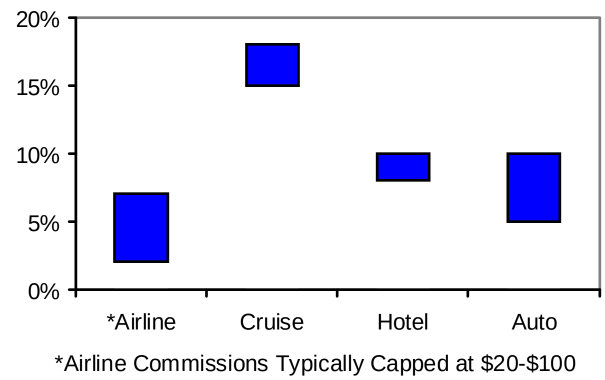
[12] *Ibid.*

Of the four major categories of travel services, cruise packages offer travel agencies the highest commissions - ranging between 15 and 18 percent. These higher commissions are refocusing many smaller agencies away from the typical 2 to 5 percent commissions, and the associated $25 to $50 commission limit (cap), found in the airline industry.

Gross profits from cruise sales are nearly equal to airline booking profits. Airline commissions paid to travel agencies in 1999 totaled $4.8 billion.[13] In comparison, the $26.5 billion in cruise sales would have generated approximately $3.97 billion in travel agency commissions.[14]

Figure 3 summarizes the commission ranges for the different travel service categories.

Figure 3: Commission Ranges by Travel Category



Source: Based on data by travel providers, September 2001

Distribution of Travel Services

Air distribution systems have greatly influenced the distribution of other categories of travel.

Prior to the emergence of E-commerce distribution channels, Global Reservation Distribution Systems (GDS's) were the primary resource used for researching travel options, finding the lowest pricing, checking availability and booking reservations. GDS's evolved from earlier Computer Reservation Systems (CRS's) developed by airlines to manage and distribute their airline seat inventory through travel agencies. Today, GDS vendors also offer worldwide reservation capabilities for non-airline categories such as hotels, auto rentals, and rail.

[13] Airline Reporting Corporation, Sales Summary Reports. Source http://arccorp.com

[14] Travel Weekly, "Travel Weekly's U. S. Travel Agency Market Survey 2000"

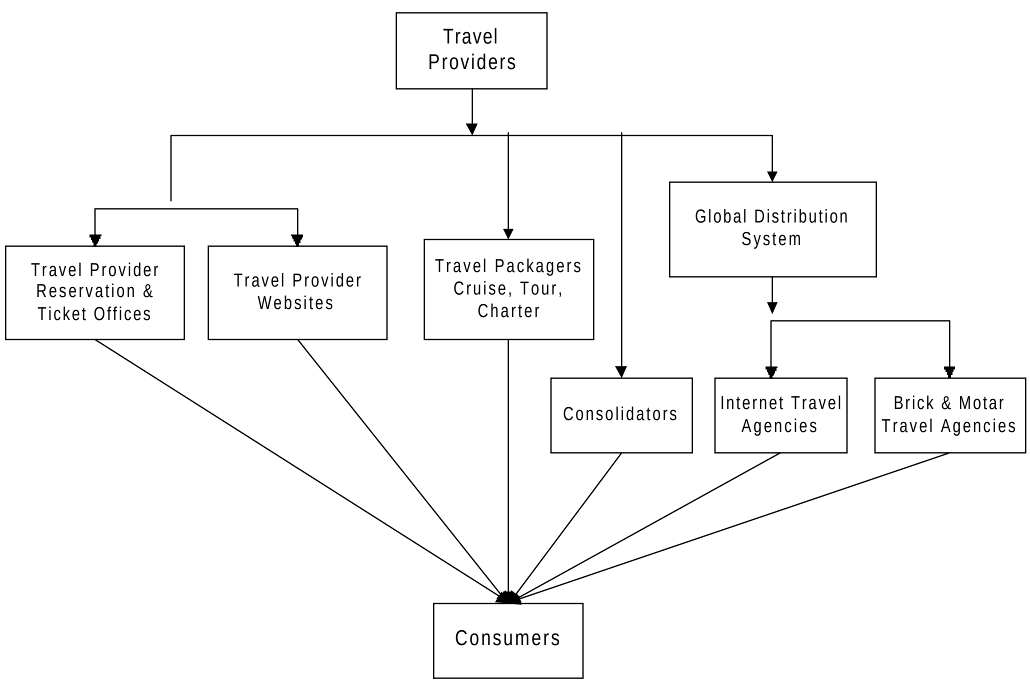
CRS's were an early form of E-commerce that allowed travel agencies to reserve seating electronically through dedicated computer terminals. Over 90 percent of all travel agencies still use their existing GDS systems for obtaining airline travel information. However, 75 percent now regularly use the Internet to find the best fares in addition to a GDS system.[15]

Sabre, the largest GDS vendor, estimated that in 2000 over $75 billion of travel-related products and services from over 990 providers were sold through its systems worldwide.[16] The other major GDS vendors include Worldspan, Amadeus, and Galileo.

Airlines and consolidators have used E-commerce to create online alternatives to GDS's. Airlines offer special fares and seat capacity through their own website reservation systems. Consolidators such as Priceline and Cheap Tickets purchase discounted blocks of seat capacity from airlines, and then resell these seats at fares lower than those found on GDS's.

A simplified depiction of this new distribution environment is shown in Figure 4.

Figure 4: Travel Service Distribution Channels



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[15] American Society of Travel Agents (ASTA), "2000 Travel Agent Automation Survey"

[16] Selected SEC 10-K company filing, 2000

GDS vendors have responded by purchasing or developing their own online travel agencies. Table 2 lists the major GDS's, their owners, and the online agencies they currently own. Also shown is Orbitz, a new online travel agency developed and owned by major airlines.

Table 2: Ownership of Major GDS's and Online Travel Sites

GDS	Online Agency Owned	Part-Owner(s)
Sabre[17]	Travelocity.com	*(American)*[18]
Worldspan		Northwest (33.7%) Delta (40.0%) TWA[19] (26.3%)
Galileo[20]	Trip.com	United (15%) Cendant
Amadeus	OneTravel.com	Air France (23%) Iberia (18%) Lufthansa (18%)
	Orbitz.com	American, Continental, Delta, Northwest, United.
	Expedia.com	USA Networks, Inc. (Purchased from Microsoft)
	Biztravel.com *(Discontinued operations September 21, 2001)*	Rosenbluth

Source: Company Websites and Company 2000 SEC 10-K Filings

In addition to developing direct online distribution channels, GDS vendors have also sought to maintain their traditional travel agency channel. According to ASTA's 2000 Agency

[17] Sabre also assumed responsibility for US Airways reservation system in December 5, 1998.

[18] In March 2000, American completed the spinoff of Sabre.

[19] Northwest acquired TWA Worldspan interest during the two companies merger in 2000.

[20] Galileo is also under contract with United Airlines to host their Apollo reservation system until 2004.

Automation Survey, agencies are being offered more favorable equipment lease and system training terms. GDS vendors are also developing Internet solutions for travel agencies as well.

GDS vendors still have a slight advantage retaining agencies because online airline ticket reservations do not earn agency commissions. However, Forrester Research predicted airline commissions for both offline and online agencies could drop to zero by the end of 2001. This would leave GDS vendors competing for agency bookings solely on the travel inventory they can offer, and the computer interfaces and E-commerce solutions they provide to agencies.

GDS vendors also face increasing competition from providers selling direct online. Jupiter Research predicted that sometime in 2001, direct airline ticket sales through provider websites could surpass online agency sales.[21]

While the major GDS vendors offer hotel, auto rental, and other travel services, travel agencies can book these services directly with providers. Cruise lines for example rely on travel agencies for over 95 percent of their bookings. Likewise, agencies typically deal directly with providers of packaged travel services such as tours and charters.

For bookings with small providers not listed on GDS's such as small hotels and resorts, travel agencies contact providers directly to determine pricing, availability and make reservations. Potentially, this ability to create highly customized travel packages with small travel providers may offer traditional agencies new niche market opportunities.

Competition

Examples of companies competing in the distribution of travel services include:

- Traditional Travel Agencies – American Express, Carlson, Independent Agencies.
- In-house Corporate Travel Office – Corporations booking their own travel
- Online Travel Agencies – Travelocity, Expedia.
- Consolidators and wholesalers – Priceline, Hotwire, Cheap Tickets
- Travel service provider direct sales – Airlines, Hotels, Auto Rental Companies

[21] Jupiter Media Metrix, Inc, April 4, 2001

- Partnerships formed between travel suppliers – Orbitz (airlines), Travelweb (hotels)
- Online Affiliates – AOL, MSN, Yahoo!, Sam's Club, Amazon

The last two represent new business models created by E-commerce. The most well known partnership between travel partners occurred when airlines joined together to form Orbitz. Affiliate programs allow companies ranging from America Online to Sam's Club to use online travel agencies booking systems to offer customers online travel services.

Travel Agency Distribution Channel Size

While direct online travel sales have experienced rapid growth, the travel agency industry distribution channel still accounts for 26 percent of all travel related expenditures according to Travel Weekly, a paid-subscription travel industry publication.[22]

As a percent of total sales within each travel service category, travel agencies book approximately 95 percent of cruise packages, 90 percent of tour packages, 52 percent of domestic airline tickets, 50 percent of auto rentals, 37 percent of rail tickets, 25 percent of domestic hotel reservations, and less than 10 percent of bus fares.[23]

In the air travel category, major airlines continue to acknowledge their dependence on travel agencies. Northwest stated that 74 percent of their 2000 ticket sales were through travel agencies, while TWA reported 84 percent. Other major airlines report similar percentages.[24]

In terms of annual revenues, the travel agency industry produced revenues of $143 billion in 1999. Over one third of these revenues came from the 50 largest travel agencies which generated $54 billion, or 38 percent of total travel agency revenues.[25]

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[22] Travel Weekly, "Travel Weekly's U. S. Travel Agency Market Survey 2000"

[23] Harold L. Vogel, *Travel Industry Economics – A Guide for Financial Analysis*, Cambridge University Press 2001

[24] Selected airlines SEC 10-K filings, 2000

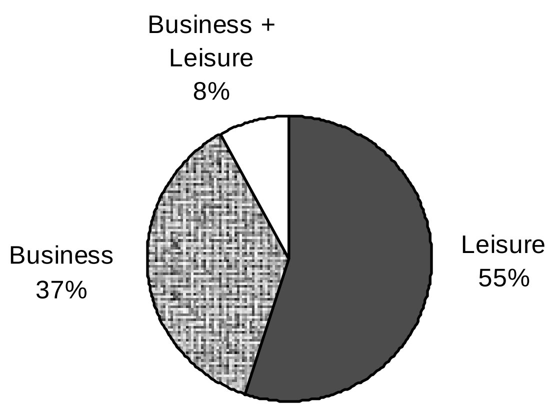
[25] Travel Weekly, "Travel Weekly's U. S. Travel Agency Market Survey 2000"

Market Segments

The travel agency market can be broadly divided into two market segments: business travelers and leisure travelers. In addition to these two segments, annual federal and state government travel expenditures are estimated to be in the neighborhood of $2.5 billion.

Leisure travelers outnumber business travelers according to a TIA study conducted in July 2000.[26] The number of business travelers numbered 36 million compared to 139.8 million leisure travelers. Figure 5 below shows the breakdown of total agency sales between leisure, business, and business combined with leisure travel.

Figure 5: Agency Sales by Market



Source: Travel Weekly's U.S. Travel Agency Market Survey 2000

Travel Agency Services

Travel agency services generally fall into one of the five general categories below:

- Recommendation
- Research
- Reservations
- Reporting
- Relationship

[26] Travel Industry Association of America, "Travel Statistics and Trends", Source http://www.tia.org/Travel/

Most of these categories are well suited for the interactive and automated nature of E-commerce and the Internet. One key advantage of the Internet is the ability to provide routine travel information and assistance anywhere, anytime.

The Society of Government Travel Professionals' (SGTP) categorization of travel agency services shown in Table 3 highlights the large number of services provided by Travel Agencies.

Table 3: Agency Services by Travel Category

Airline Related Services	Hotel Related Services	Car Rental Related Services	Other Support Services
• Unbiased comprehensive information on schedules, routing and fares • Reservations and standard tickets • Contract compliance management • Ticketless reservations • Automated search for best seat assignment • Processing of refunds • Voiding of tickets • Filing lost ticket applications • Frequent flyer enrollment • Priority waitlists • Special service requests (meals, wheelchairs, etc.) • Changes to itinerary • Scheduled ticket delivery	• Location information • Electronic reservation system • Non-automated hotel bookings requiring a call • Use of negotiated preferred rates • Access to blocked room program, last room availability • Request for early check-in and/or late check-out • Cancellations before arrival • Domestic and international faxes and phone calls	• Electronic reservation system bookings • Non-system bookings requiring a call • Use of upgrade certificates • Request for specialty cars • Use of negotiated preferred rate programs	• Toll free telephone number • 24-hour emergency services • International rate desk • Personal profiles • Passport and visa services • Management reporting

Airline Related Services	Hotel Related Services	Car Rental Related Services	Other Support Services
• Boarding passes (where permitted)			

Source: Society of Government Travel Professionals, "Government & Travel Agency Contracts White Paper" http://www.government-travel.org/sgtp3b.html

While online travel sites have certain advantages in providing these services, characteristics that may help traditional agencies differentiate from online travel agencies include:

- Travel agent's personal knowledge and expertise;
- Face-to-face customer service during trip planning;
- Personally monitoring & notifying customers of price or schedule changes;
- Personal follow-up after travel is completed; and
- Personal Relationship.

Overall Travel Industry Review

Travel agencies operate within the overall travel and tourism industry which is the nation's third largest retail sales industry behind the automotive and food industries. In 1999, this industry generated an estimated $541 billion in revenues from all travel related sales including entertainment, meals, and other incidentals such as gasoline for travelers using automobiles.[27]

From a trade perspective, the travel and tourism industry generated a favorable trade surplus of $14.2 billion in 1999 - with visitors to the U.S. outspending U.S. travelers abroad.

A summary of the travel industry's economic impact is shown in table 4 below.

Table 4: Economic Impact of Travel in U.S.

(1999, including both U.S. residents and international travelers)	
Travel Expenditures	$541.1 Billion

[27] Travel Industry Association of American, "Travel Statistics and Trends", Source http://www.tia.org/Travel

Travel-Generated Payroll	$157.8 Billion
Travel-Generated Tax Revenue	$ 86.7 Billion
Trade Surplus	$ 14.2 Billion
Travel-Generated Employment	7.8 Million jobs

Source: Travel Industry Association of America, Economic Impact of Travel and Tourism, September 2000 Tourism Industries / International Trade Administration

The travel industry is very large and highly fragmented between different types of modes of transportation, travel services, distribution channels, and customers. This fragmentation continues to drive the need for some form of intermediary, online or offline, to assist travelers with bringing together different components of their travel itinerary.

The large capital and operating investments required in some travel categories make economies of scale an important factor in the industry. For example, the airline industry is characterized by continuing consolidation resulting in an oligopoly environment. ARC data on the number of airline carriers reporting through the ARC declined from 143 in 1999 to 134 in June of 2001, while the number of major domestic airlines continued to drop with recent mergers.

Consolidation trends are not limited to travel providers. Large travel agencies have seen their market share increase to represent over one third of total travel agencies sales. Likewise, PhoCusWright reported in their 2001 Yearbook that 60 percent of all online travel bookings were through the two largest online agencies, Travelocity and Expedia.

Small Travel Agencies

One reason the travel agency industry attracted numerous small business owners were the relatively low barriers to entry. There are not any inventory investments or risks, accreditation costs are low, there are few special government regulations, and if airline ticketing is contracted to larger agencies, only minimal investments in equipment are required. For example, agencies limited to selling cruise packages avoid the ARC accreditation costs associated with airline ticket reporting requirements.

The industry's attractiveness resulted in roughly one quarter (24 percent) of all agencies being in the small business category with sales under $1 million. These agencies represent a variety of types ranging from home-based to being part of a large consortium or franchise system.

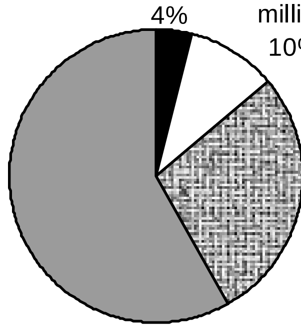
Table 5: Number of Agencies by Annual Sales Volume

Revenue	# of Agencies	Percent
Under $1 million	7,737	24%
$1 - $1.9 million	8,382	26%
$2 – $4.9 million	10,316	32%
> $5 million	5,803	18%

Source: Travel Weekly's U.S. Travel Agency Market Survey 2000

While agencies with revenues under $5 million represent 82 percent of all agencies, their market share declined from 46 percent of total revenues in 1997 to 42 percent in 1999. Agencies with revenues of $5 million or more on the other hand represent 18 percent of all agencies, but account for 58 percent of total revenues.

Figure 6: Contribution to Total Revenues by Size of Agency



Source: Travel Weekly's U.S. Travel Agency Market Survey 2000

This trend indicates larger agencies are becoming bigger revenue generators, while increasing numbers of agencies under $1 million reflect a growing population of home-based and part-time agents.[28]

[28] Travel Weekly, "Travel Weekly's U.S. Travel Agency Market Survey 2000"

Travel Agency Industry History of Change

The travel agency industry has successfully adapted to numerous technological, social and market changes in the past.

Technology advances produced the steamship industry which helped create the original travel agency industry in the early 1900's. With agencies ticketing 90 percent of all ship passengers, agencies had to adapt when new technology replaced ship travel with the first transatlantic passenger jet service in 1958. Likewise, the completion of the national highway system and popularity of automobiles caused railroad passengers to nearly disappear, and left the National Railroad Passenger Corporation (Amtrak) as the only remaining nationwide passenger rail line.

Social changes brought by the growth of the middle class market has created rising demand for more distant leisure and tourist travel. Leisure travel sales account for 55 percent of all travel agency revenues and are expected to increase as baby-boomers increase their travel spending.

Following government deregulation of the airline market and the subsequent introduction of variable pricing by airlines, the travel agency industry responded by doubling in agency numbers between 1977 and 1985 to 27,000 agencies. The number of agencies peaked in 1996 at 33,630 agencies. Travel agencies were in demand by air travelers searching for the best available fare/schedule combinations.

Following the airline commission cuts started by Delta in 1995, travel agencies continued to adapt by beginning to charge service fees and refocusing on more lucrative cruise and tour packages. Small agencies also began consolidating and replacing storefronts with home-offices.

E-commerce technology represents a transition similar to the introduction of the first Computerized Reservation Systems (CRS's), known today as GDS's. These systems were first created in the 1960's and were instrumental in handling the rapid growth of air travel during the 1970's. Agencies adapted as these systems replaced numerous clerical positions with computerized reservation and scheduling systems. Within seven years from 1978 to 1985, the percentage of agencies using the new CRS's rose from 2 percent to 90 percent.

A significant difference between the introduction of CRS's and E-commerce is that airlines funded the CRS's expensive development by forming consortia to raise the necessary capital. The cost to travel agencies CRS usage was a relatively low access and equipment leasing fee. CRS vendors also developed and provided the training resources for the new systems.

In contrast, E-commerce requires investments by the travel agency industry to develop new tools for competing online. According to TIA and ASTA surveys this has begun to happen. 52 percent of ASTA members report they have a website, and 56 percent of the remaining agencies were planning to have a website within one year. However, less than a third of these websites are capable of taking online orders according to Travel Weekly's survey data.

Agencies adding E-commerce to their business model are increasingly being aided by third party vendors, travel agency consortia, and GDS vendors. These companies offer travel agencies off-the-shelf E-commerce website solutions. This option gives agencies the ability to offer customers online information and reservation capabilities similar to large online agencies.

Section 4: E-commerce and Technology Developments

The benefits of E-Commerce and new technologies are not exclusive to large online agencies or providers. Many of these new technologies are also useful for enhancing existing travel agency customer relationships. Automated day of departure emails containing late breaking travel news is one example of a new technology being used by traditional and online agencies of all sizes.

Likewise, competitive threats presented by E-commerce and new technology are not the exclusive challenge of small travel agencies. By the end of 2001, direct sales by airline owned company websites are expected to surpass the total sales of Expedia, Travelocity, and other online travel agencies. Related to this development is the decision by Northwest Airlines and KLM Royal Dutch Airlines to eliminate commissions paid to online travel agencies. This negative development for online agencies highlights the uncertainty facing all players as E-commerce introduces new services and distribution channels.

The following sections describe the new online travel marketplace, the travel services it offers, the limitations of the technology supporting it, and the future technologies which may increase E-commerce's impact on the travel agency industry.

The Online Travel Marketplace

The two most significant developments supporting E-commerce growth are the Internet and new communication technologies. These technologies create an online travel marketplace that duplicates five key features of the traditional travel agency market.

1. Good location attracting enough travelers to justify agencies' presence,
2. Supports retail activity,
3. Has a secure and recognizable method of payment,
4. Delivers purchases, and
5. Provides customer service and support.

In terms of location, the online travel marketplace has obvious advantages over traditional storefront agency locations – unlimited geographical sales area, open 24 hours a day 7 days a week (24/7), large numbers of consumers, and relatively low staffing requirements.

The more common issues related to the online marketplace include the absence of personal contact, large numbers of competitors of all sizes, a sometimes inadequate organization of information and services, and continuing consumer concerns regarding online payment security and personal privacy.

Of these issues, concern over payment security would be the greatest obstacle to conducting retail activity online. According to surveys by TIA, concern over payment security still keeps 26 percent of online travel planners from completing their purchases. They also found that not having a credit card prevented another 5 percent from completing their purchases online.[29]

[29] Travel Industry Association of America (TIA), "Internet Use for Travel", Source http://www.tia.org/Travel/

There are signs that consumer concerns regarding online payment security are lessening, but these concerns do not necessarily translate into business for offline agencies. For example, all major online travel sites accept reservations over the phone through customer service centers.

Overall, the travel industry's use of credit cards offers a familiar and popular method of payment to both online and offline travelers. According to ARC sales reports, 80 percent of air and rail travel purchased through travel agencies is paid using credit cards.

Advancements in computer, credit reporting software, and Internet technology may also allow instant online credit approvals for qualified travelers. This feature combined with special offers would give online sites a slight advantage over smaller offline agencies. As an example, Carnival Cruise Lines promotes their 'Fun Finance Plan' which is linked to their Carnival MasterCard. This gives cruise travelers the option of paying for their cruise in 24 scheduled monthly payments versus one lump sum. While Carnival's program still uses offline applications, online credit applications are used by other online retail industries and will likely migrate to the online travel industry in the future.

The Internet has also encouraged the development of new methods of payments. Still primarily used to ensure payment between auction site buyers and sellers, these concepts may lead to other forms of online currency in the future. In particular, the growing popularity of online banking may make online purchases more convenient than offline purchases.

The online travel marketplace's ability to deliver travel documents instantly over the Internet is attractive to travelers. The widespread use of confirmation numbers to track travel purchases allows quick and convenient confirmation via emails and web page displays suitable for printing. Electronic ticketing (E-tickets) for airline travel eliminated the need to send paper tickets to most online buyers. Northwest Airlines now allows passengers to select their own seating and print their boarding passes through the Internet.

The introduction and customer acceptance of airline E-tickets was a key stepping stone towards future online ticket sales. Southwest Airlines was the first major airline to introduce a

'Ticketless' travel option in 1995.[30] Subsequently, the major airlines along with the ARC and GDS vendors developed an industry-wide E-ticket system. In November 2000, E-tickets accounted for 60.4 percent of all airline ticket volume reported by the ARC.[31]

Table 6: Percent of Tickets Sold as E-tickets by Airline

Airline	% of E-tickets
Southwest	80%
Continental	59%
Northwest	60%
US Airways	72%

Source: 2000 Annual 10K's filed by companies shown

For E-ticketing to expand beyond current levels, interline E-ticketing systems are needed to allow E-ticketing of itineraries including travel on multiple airlines and international trips. Continental and America West were the first major U.S. airlines to implement interline E-ticketing, and other airlines have already implemented, or are in the process of developing similar agreements.[32]

E-ticketing by itself has not represented a threat to existing agencies. In fact, ASTA reports that 69.6 percent of their member agencies actively promote E-tickets. Agency adoption of E-tickets was dramatic, with the number of agencies able to issue E-tickets rising from 53 percent in 1995, to 70 percent in 1996, to 93 percent in 1998, and 98.4 percent in 1999.[33]

This recent adjustment to new methods of airlines ticketing indicates that agencies will adapt to new technology and processes. Table 7 shows the relative satisfaction of ASTA member agencies with E-ticking, with over two-thirds satisfied with this new technology.

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[30] Southwest Airlines 10-K filing , October 26, 2001

[31] Airline Reporting Corporation (ARC), November 2000 Ticket Sales Report

[32] Continental Airlines SEC 10-K Filing, 2000

[33] American Society of Travel Agents (ASTA), "2000 Travel Agent Automation Survey"

Table 7: ASTA Agency Satisfaction with Distributing E-Tickets

Satisfaction Level	Percent
Very Satisfied	41.1
Somewhat satisfied	26.6
Neutral	21.4
Somewhat dissatisfied	7.2
Very Dissatisfied	3.6
Total	100.0

Source: The American Society of Travel Agents (ASTA), 2000 Agency Automation Report (with sample size of 303 ASTA agencies)

The use of email by online travel sites to automatically send confirmations is not a significant advantage for online agencies. Over three quarters (79.2 percent) of ASTA member agencies use email at least once a week to communicate with their customers.[34] Large online agencies' ability to send automated day of departure emails on flight status can now be duplicated by smaller agencies by using third party software solutions.

Online relationship building is supported by Internet website technology giving customers self-serve options such as Frequently Asked Question (FAQ) pages, online itinerary review, and checking flight status. If needed, most sites support email or live online chat rooms for help from customer service representatives. The need to meet in person with travel agents may decline as more travelers become comfortable with online chat rooms, or gain access to broadband streaming video capabilities.

Online Travel Services

The Internet and new technologies have provided online travel agencies the tools to duplicate the five "R's" of service provided by offline travel agencies.

Services Provided by Traditional Agencies

[34] *Ibid.*

Service	Online Features
Recommend	• Suggest type of travel • Promote travel providers
Research	• Travel planning • Price search
Reserve	• Reservations • Collect payment
Report (for Corporate Clients)	• Manage corporate travel programs • Produce management reports
Relationship	• Customer relationship management • Customer services

These Internet based tools have had a profound affect on how and when online leisure travel planners use travel agencies and other traditional sources to gather travel information. Table 8 shows that while travel agencies are used 71 percent less often for planning travel, personal sources of information are still used 73 percent of the time.

Table 8: Changing Usage of Offline Information by Leisure Travelers

Offline Information Sources	Less Often	More Often/ About as Often
Travel agent/agency	71%	29%
Call/visit chamber of commerce	69%	31%
Call/visit tourism office	68%	32%
Direct call to airline company	68%	32%
Direct call to lodging company	58%	42%
Travel brochures ordered by phone	57%	43%
Travel books, guides, magazines	49%	51%
Newspaper travel section	48%	52%
Friends, family, co-workers	27%	73%

Source: Travel Industry Association of America, E-Travel Consumers in the U.S: How They Plan and Buy Leisure Travel Online, 2001

The continued use of friends, family, and co-workers for obtaining travel information indicates that these sources may have more influence in recommending travel arrangements than do travel agencies.

Online Travel Recommendations

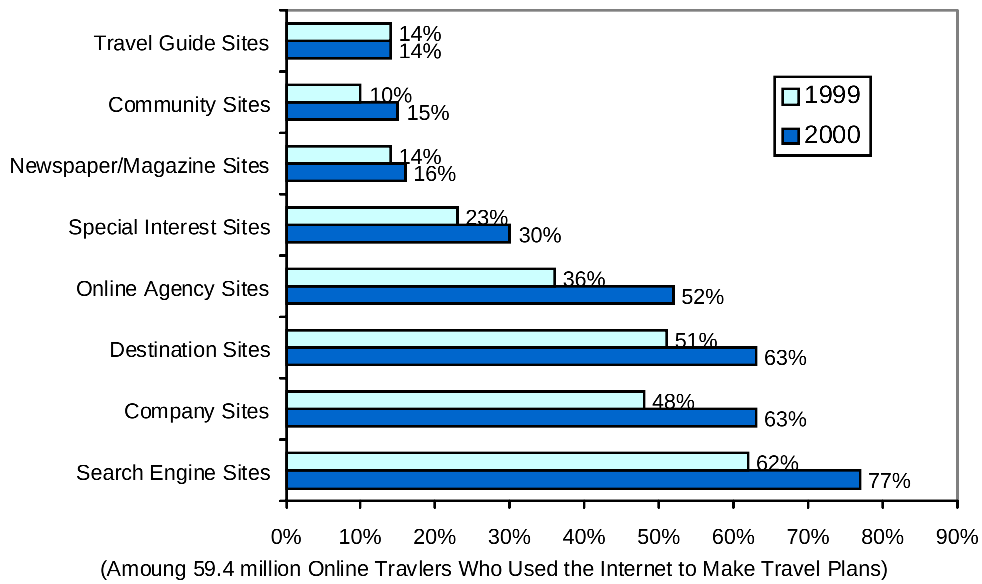
The Internet offers more opportunities for travel providers and agencies to promote their services using email, banner ads, and online multimedia programs. For example, Southwest Airlines emails customers updates on latest fares and specials, Cheap Tickets has banner ads on Yahoo!, Excite and other sites, and Princess Cruise Lines has links to live web cams mounted on their ships at sea.

Almost all of these online promotions bypass offline travel agencies and encourage travelers to buy direct online. The few exceptions involve travel agency consortia, franchises, and trade association websites. For example, Cruise Line International Association's website includes a Cruise Expert Locator to help consumers locate local travel agencies.

Online Travel Research

The Internet provides travelers with numerous locations to research their travel plan options. This includes websites by travel providers, search engines, travel agencies, online travel guides, tourist and convention bureaus, and personal websites maintained by private individuals.

Figure 7: Internet Sites Used for Travel Planning



Source: Travel Industry Association of America (TIA), Travelers' Use of the Internet, 2000 Edition

According to TIA surveys, online travel customers consider a website's ability to compare prices and save money as the most important travel-planning tool.[35] This ability is the same consideration behind travelers driving rapid travel agency growth in the 1980's in response to airline dynamic pricing models. The resulting myriad of fare/schedule combinations created demand for travel agencies to search for best available pricing and schedules.

The Internet provides travelers access to powerful airline travel search engines capable of searching millions of fare/schedule combinations in seconds, and then listing them in order of price, schedule, carrier, and other parameters such as number of segments. The pricing results

[35] Travel Industry Association of America (TIA), "E-Travel Consumers: How They Plan and Buy Leisure Travel Online", 2001

between online airfare search engines vary considerably, and lead to intense and ongoing competition between online travel providers.

For example, the results of a November 2000 airfare study found that Travelocity located the lowest fare 80 percent of the time when searching 300 different reservation requests, compared to 48 percent for Expedia.[36] This type of rating is likely to change as travel sites employ more sophisticated search capabilities.

For example, in January 2001, Expedia released its new Expert Searching and Pricing (ESP) platform to increase the number of priced itineraries presentable to customers from an industry standard of 8 to 12, to an average of 450 per inquiry.[37]

In addition to researching travel pricing and schedules, travelers can access information related to virtually any travel related topic. For example, OpenTable.com and Foodline.com offer travelers a way to make online dinner reservations in advance of their trip. Petswelcome.com is a travel guide for travelers with pets, and BestToilets.com displays lists of the best-maintained public restrooms in over one hundred cities.

Online Customer Relationship

Unlike traditional travel agencies where a human travel agent is the primary point of contact for travelers, the online travel customer relationship is maintained by online travel vendors, travel providers, destination websites, and numerous third party travel information providers.

The online travel marketplace has well-known tools to support communications between travelers and sources of information and assistance. These include online travel agency websites, websites owned by travel providers, search engines, chat rooms for travelers, email, FAQ sites, and independent online travel guides.

[36] Travel Trade, “Findings from the MIT Study”, 2000

[37] Expedia SEC 10-K filing, September 28, 2000

Other tools offered to build customer relationships include providing travelers with online access to their frequent flyer and other customer loyalty reward accounts. The use of Customer Relationship Management (CRM) and customer profiling tools allows online vendors to target market specific offerings to their customers.

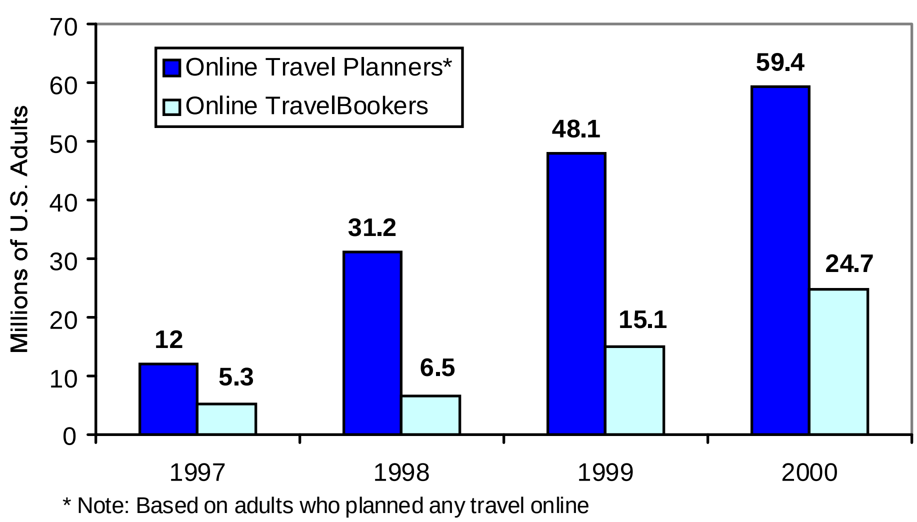
If the need for a live customer service representative develops, the Internet and new communication technologies provide multiple communication channels. Email, faxes, live on-line chat rooms, and call centers are all possible methods of obtaining live customer support.

Online Population

The overall online marketplace is attracting a large and growing population that is becoming more representative of the general population, and most importantly, contains millions of leisure and business travelers. This population combined with growing numbers of online travel sites are directly impacting the travel agency distribution channel.

In TIA's annual travel survey taken in July 2000, 149.4 million Americans were classified as travelers taking at least one trip over 50 miles unrelated to daily work or school commutes. 90.4 million of these travelers were Internet users. Of this total, 59.4 million travelers used the Internet for travel planning, and 24.7 million eventually made travel reservations online.

Figure 8: E-Travel Consumers in the U.S.



Source: Travel Industry Association of America (TIA), E-travel Consumers: How they plan and buy leisure on the Internet, 2001

Online business travelers numbered 27.3 million and pleasure travelers were 85.5 million. The travelers in both segments are increasing their use of the Internet for researching and booking their travel arrangements. Those travelers in either segment taking more than five trips during the past year were classified as frequent travelers and represented 44 percent of online travelers.

The potential for the Internet to attract more online travelers is high given the Internet's worldwide reach and flexibility. According to estimates, the worldwide number of all Internet users will reach 1.17 billion in 2005, up from 400 million in 2000. Mobile wireless Internet users, which numbered 40 million worldwide in 2000 will jump to 730 million in 2005, comprising 62.1 percent of all Internet users.[38]

The Internet is attracting all segments of the population, and many will become online consumers. As of March 2001, 48.2 percent of the U.S. adult population, or 100.2 million adults, had made a purchase online. Of all Internet users in the United States, 81.2 percent have made a purchase via the Internet.[39]

The availability of affordable PC's preloaded with free Internet access offers introduced the Internet to a many American households. By 2002, 68.2 million U.S. households will have computers and 66.9 million will have both a computer and Internet access. Today, just more than half (51 percent) of U.S. households have at least one computer and 43.5 percent have both a computer and Internet access. This figure is up from 1998, when 43.9 million households had a computer and just 26.6 million had Internet access.[40]

In the top 21 U.S. retail markets, at least half of the households were online as of October 2000. Seven months prior, only six of these markets had reached 50 percent penetration.[41]

[38] ETForecasts, "Internet Users Will Number More Than 1 Billion in 2005", February 8 2001

[39] Nielsen NetRatings, Press release April 26, 2001

[40] Employment Policy Foundation, "Computer Ownership and Internet Access: Opportunities for Workforce Development and Job Flexibility", January 11, 2001

[41] Nielsen NetRatings, "Internet Penetration Hits 50% in 21 U.S. Markets", October 17, 2000

Table 9: Household Internet Penetration by City

September and March 2000				
Rank	**City**	**% Sept.**	**% March**	**Growth**
1.	San Francisco	66	61	8.2%
2.	Seattle	64	56	14.3%
3.	San Diego	62	58	6.9%
4.	Portland	60	54	11.1%
5.	Washington DC	59	56	5.4%
6.	Boston	59	52	13.5%
7.	Denver	57	47	21.3%
8.	Kansas City	57	NA	NA
9.	Orlando	56	NA	NA
10.	Baltimore	55	NA	NA

Source: Employment Policy Foundation, January 18, 2001

Although ownership of computers does not necessarily equate to online access or online purchase of travel services, agencies in states with the highest levels of household computers may experience more online competition for travel services.

Table 10: Top Five States with Computers in the Household

State	% Ownership
Alaska	67.0%
Utah	66.8%
New Hampshire	64.3%
Colorado	63.2%
Oregon	61.2%

Source: Employment Policy Foundation

There are also signs the overall population of online users is becoming more representative of the general population. As of March 2001, households headed by blue-collar workers (defined as factory operators or laborers) were the fastest-growing occupational group on the Internet with 9.5 million users online. This was a 52 percent increase over March 2000's figure of 6.2 million users.[42]

The second fastest growing online user category in March 2001 was the homemaker category, which grew 49 percent from 1.6 million users in 2000 to 2.4 million users in 2001. Professionals were the largest overall occupational category which grew 23 percent from 15.0 million users in March 2000, to 18.5 million users in 2001.[43]

The Internet is attracting older generations as well. By December 2000, retired workers represented 8.6 million unique Internet visitors, and comprised 10.2 percent of the overall Internet population. Of these retired users, 63.3 percent were men and 36.7 percent were women. These retired users are not necessarily aged 65-and-over with 7.5 percent of the men under 49 years old. Retirees logged on an average of 15.9 days in December, which was higher than the average of all Internet users (11.9 days) and students (8.3 days).[44]

According to the Gartner Group, the average Internet user is now over 40. Another study conducted by the International Data Corporation predicts the number of U.S. Internet users aged 55 and up will triple from 11.1 million in 1999 to 34.1 million by 2004. This price conscious leisure focused travel group will be an important driver of future travel trends.

As more customers of traditional travel agencies become Internet users, 'opening' a location in the new online marketplace is becoming mandatory for agencies to meet client's customer service and support expectations. The likelihood that any segment of travelers will remain offline because they lack access or ability appears remote.

Online Travel Sales

The online environment is a proven and viable 'location' for retailing products and services including travel services. According to the Forrester Online Retail Index, online consumers

[42] Nielsen NetRatings, Press release April 17, 2001

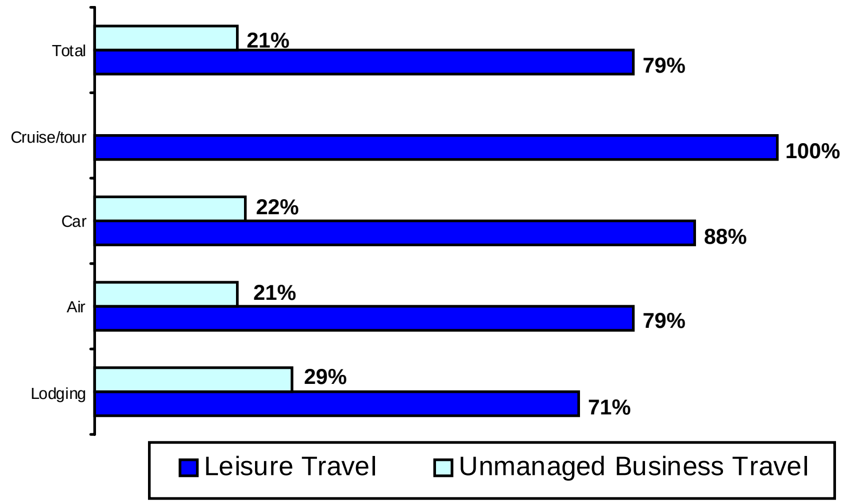
[43] *Ibid.*

[44] NetValue, "US and Europe Internet Usage", February 23, 2001

spent a total of $3.9 billion on retail goods and services during May 2001. Analysts estimate that over one third of this amount was directed towards travel services.

According to Jupiter Research reports, the majority of online travel spending is generated by leisure travelers compared to unmanaged business travel. Business travel is considered unmanaged when it is not booked via corporate internal travel offices or a contracted agency.

Figure 9: U.S. Online Travel Bookings Travel Segment in 2000



Source: Jupiter Research, 2000

Estimates for the growth of online leisure travel sales varies between sources as shown in Table 11, but none show online sales overtaking offline sales in the near future.

Table 11: Estimates for Online Leisure Sales for 2001-2005

Firm **In Billions**	**2001**	**2002**	**2003**	**2004**	**2005**
Forrester Research	$16.7	-	-	$28.9	-
Gomez Advisors	$20.0	-	-	-	-
Jupiter Research (Includes unmanaged business travel)	$14.8	$18.3	$21.7	$25.0	$28.2
PhoCusWright	$20.2	-	-	-	-

Source: Compiled by eMarketer, Inc, 'The eTravel Report™', April 2001

While online travel sales are significant in terms of dollars, Forrester Research's 2000 estimate of $12.2 billion for online leisure travel sales was less than 6 percent of the total estimated leisure travel market of $224 billion. [45] If the overall leisure travel market grows a modest 15 percent by 2005 to $257 billion, the estimated $32.7 billion in online leisure sales will account for 12 percent this market segment.

Online sales of business travel are expected to increase rapidly as companies begin using E-commerce to reduce their travel costs. According to Jupiter Research estimates, business travel purchased online through company travel contracts could rise to $32.8 billion in 2005.

Limitations of E-commerce and Technology

E-commerce and technology have limitations which need to be overcome for online distribution channels to become the primary method of distributing travel services.

Online Search Engine Limitations

An online travel search engine's ability to produce the lowest fares with acceptable schedules relies on sophisticated software, and more importantly, access to travel inventory.

Reduced inventory access may arise due to exclusive agreements between providers and other distributors, conflict of interests due to company ownership or controlling interest, providers desiring to reserve special discounts for their own company website, or providers deciding not to share data with certain companies for other business reasons.

Orbitz for example has exclusive rights to certain discounted fares from participating airlines. Likewise, consolidators such as Priceline buy exclusive blocks of discounted tickets and packages, and then resell them through their website.

Ownership and hosting issues may also become an access issue. For example, Sabre owns and hosts Travelocity, but also provides hosting services to competitors Cheap Tickets and Lowest Fares.

The software and hardware systems supporting online travel search engines is capital and time intensive to develop, and highly proprietary in nature. Expedia's development of their latest

[45] Forrester Research, "Online Retail's Ripple Effect", September 2000

search engine released in January 2001 began in 1996. The cost to achieve incremental improvements may become cost prohibitive in the future, and measurable differences between search engine results may become negligible.

Customer Service Limitations

The inability to meet in person with a travel agent may not be a significant issue according to a survey of online travelers. Only 5 percent rated having access to a live customer service representative as the most important feature of a website. Online users appear more comfortable resolving issues using email, or when needed, by telephone.

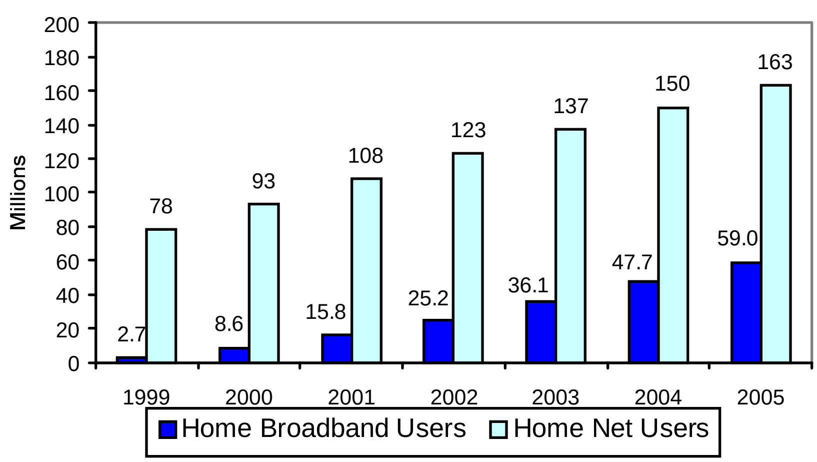
Speed of Online Connections

As travel sites become more graphically orientated and interactive to meet the needs of more complex travel arrangements, the so-called 'last-mile' between a user's modem and their Internet provider may become a factor.

Because online sites rely on travelers to perform much of their own research and planning, if slow connection speeds require lengthier online sessions, travelers may begin to view offline travel agency service fees as more cost effective than investing their own time online.

Figure 10 shows a comparison between total home internet users versus those with broadband.

Figure 10: Comparison of Total Home Internet Users versus Broadband



Source: Jupiter Research, December 2000

Future Technology Developments

Voice recognition, wireless Internet access, and other new technologies may compliment E-commerce and increase the impact on the travel agency industry.

While new technologies can be used by E-commerce based companies to reduce traveler's need for live customer support, they also can be used by existing agencies to improve productivity by reducing the number of routine customer contacts. This would allow agencies to spend more time generating new fee-based bookings using the Internet by finding the lowest possible cost travel options for customers.

Voice Recognition

Voice recognition is automating the customer relationship and further diminishing the frequency of human interaction in travel. AirTran Airways, an East Coast commuter airline implemented Automated Speech Recognition (ASR) technology in their customer service phone center. AirTran claims their customer call holding time has dropped from 7 minutes to 2 seconds, and questions previously taking an average of two and a half minutes now are handled in just over a minute. Other airlines are also using this new technology to answer common customer information requests such as flight information, itineraries, and delays.[46]

Online agencies are also adopting this new technology. Travelocity is implementing a new voice recognition system, [47] and Cheap Tickets uses an intelligent call routing and interactive voice system.[48]

Wireless Internet Access

Technology already allows travelers to use their wireless phones and Personal Data Assistants (PDA) for basic travel functions such as booking hotel and airline reservations. As more travelers obtain wireless Internet access and this technology matures, more sophisticated customer service tools will be developed. These tools may further reduce travelers' need to

[46] Ian Lamont, Network World, "Talk to me" , June 4, 2001.

[47] Travelocity 10-K Filing, April 2, 2001

[48] Cheap Tickets 10-K Filing, April 2, 2001

work directly with travel agents, preferring instead to make changes and obtain information from their portable devices.

Summary

In summary, the online travel market directly affects the traditional offline marketplace in a number of key areas.

- Brings new and physically distant competitors into markets previously served by travel agencies accustomed to competing within small geographical areas.
- The large size of some online competitors gives them economies of scale not easily duplicated by smaller independent agencies.
- The customer service features of online locations raise travel customers' expectations on the accessibility, availability, quality, and cost of customer service for existing agencies.

A positive aspect for existing agencies is that the new online marketplace does not exclude them from participating. Travel agencies can develop their own website, use third party solutions, and even use competing online travel sites to book customer travel arrangements. These and other online marketplace features may offer travel agencies new opportunities:

- Experienced travel agencies can use the combined power of their GDS and online search engines for locating the lowest cost travel options for service fee paying customers.
- Niche market travel agencies can use an online presence to attract more customers nationally and internationally than through a storefront.
- The remote access capabilities of the Internet can allow existing agencies to work from home offices or client locations.
- Information posted on websites can reduce the time spent answering routine customers questions.
- By adding links to their websites, agencies can offer customers an almost unlimited amount of free travel information and advice.

Section 5: Travel Industry Developments

There are five major industry developments changing the travel agency's role in the sales and distribution of travel services.

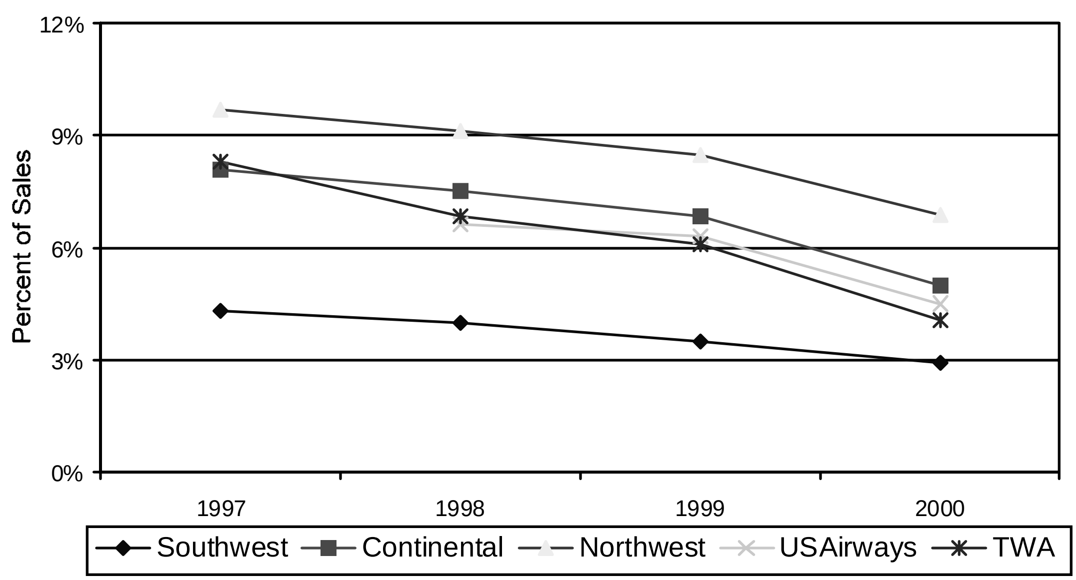
- Reductions in airline commissions,
- Direct sales efforts by travel providers,
- New online distribution channels,
- Travel customer trends, and
- Industry consolidation.

Airline Commission Reductions

The greatest economic impact felt by travel agencies continues to be reductions in airline commissions. According to ASTA surveys, 30 percent of member travel agencies see airline commission cuts as their main concern for staying in business.[49]

As a percentage of airline company passenger sales, agency commissions show a continuing decline due to reduced agency commissions, online agencies, and increased direct sales.

Figure 11: Agency Commissions as Percent of Airline Passenger Sales



Source: Select Companies SEC 10-K Filings

[49] American Society of Travel Agents, "Service Fees 2001", April 2001

Up until the most recent commission cut by American Airlines in 2001, most of the major airlines paid offline travel agencies 5 percent commissions up to a maximum of $50 for domestic tickets, and $100 for international tickets. Online agencies typically earned a maximum of $10 for either type of ticket, with both Northwest, KLM, and Southwest not paying any commissions for online sales.

David Swierenga, the chief economist for the Air Transport Association (ATA), stated in a Travel Weekly article that travel agency airline commissions dropped $2.8 billion from $7.6 billion in 1992, to $4.8 billion in 2000.[50] Further cuts are expected by the industry, with Forrester Research predicting that by the end of 2001, airline commissions for both online and offline travel agencies could drop to zero.

The trend towards lower commissions is also expected to affect the hotel, auto rental, cruise, and tour travel categories. For example, in November of 1999, Marriott adopted a variable commission structure that favors agencies successfully completing Marriott's hotel sales education program. While the program's goal is to develop educated and loyal partners, failing to participate reduces agency commissions from 10 percent to 8 percent.

In response to declining commissions, the percentage of ASTA agencies charging customer fees increased from only 20 percent in 1995 to 88 percent in 2000. Based on ASTA surveys the amount travel agencies charge for issuing airline tickets averages $13, with 47 percent of the agencies reporting they charge $10 or less for this service.[51]

ASTA found the highest percentage of members not charging customers service fees were smaller agencies with under $500,000 in annual revenues. These smaller agencies may be home-based with lower overhead expenses, feel less confident of keeping existing customers, or are already focusing on higher commission cruise and tour packages.

Table 12 shows the fees charged for selected service categories.

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[50] Travel Trade, "Agent Pay Drops to $3 Billion", May 21, 2001

[51] American Society of Travel Agents, "Service Fees 2001", April 2001

Table 12: ASTA Agency Service Fees

Service	% of Agencies Charging Fee	Mean
Refunds	71.9%	$17.09
Exchanges	83.9%	$17.88
Hotel only reservations	70.0%	$15.86
Car only reservations	59.2%	$16.37
Rail Tickets	84.4%	$14.84
Cruises	28.0%	$21.62
Tour packages	33.7%	$33.52
Trip planning or research	54.4%	$54.02
Special coupons and promotions	93.1%	$19.07

Source: The American Society of Travel Agents (ASTA), The 2001 Agency Service Fees Report

Online travel agencies may also start to charge service fees for airline tickets. Following Northwest Airlines elimination of online commissions in March 2001, Travelocity added an additional $10 per ticket charge on Northwest tickets. Expedia did not add an additional charge, but announced that they had negotiated other terms with Northwest to make it economically feasible for them to continue selling Northwest tickets.

Online agencies are also refocusing on more non-airline related travel sales. An example is the second largest online travel agency Expedia. During the first quarter of 2001, less than 25 percent of the company's revenues were generated from airline sales. Like other online agencies, Expedia is also using economies of scale to buy blocks of discounted travel services from travel providers and resell them for a profit. As a result of these steps, only 31 percent of Expedia's 2001 first quarter revenues came from traditional travel agency services.[52]

[52] Cheryl Rosen, Information Week, "Online Travel Industry Has A Big Week", April 16, 2001

Direct Sales

Commission cuts by travel providers partly reflect their ability to use E-commerce for reducing distribution costs and increasing profits by selling directly to travelers. Internet technology also gives customers access to travel information previously obtained through travel agencies As a result, the direct sales channel is becoming an attractive and viable option for travel providers.

A generalized comparison between the agency sales cycle and the direct sales cycle illustrates how technology allows providers and customers to replace travel agencies in the sales process.

Figure 12: Agency versus Direct Sales Process Comparison

	Promotion	Research	Reservations	Payment	Ticketing
Agency	Provider	*Travel Agent*	*Travel Agent*	*Travel Agent*	*Travel Agent*
Direct	Provider	**Customer**	Provider	Provider	Provider

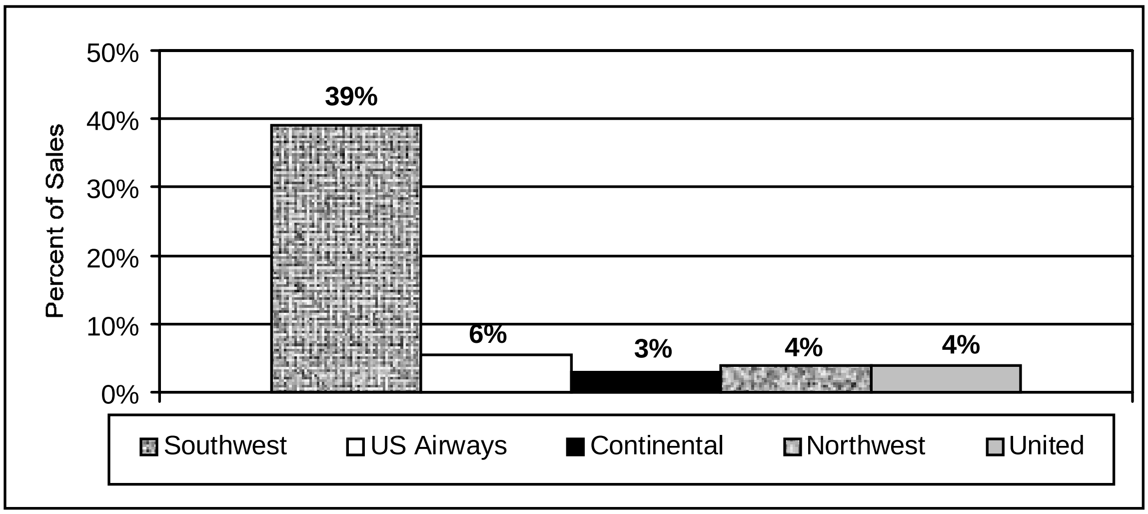
Promotion in both the direct and agency sales process is done largely by travel providers building brand recognition and market share. Except for local advertising which is sometimes co-sponsored by providers as part of a special travel offering, advertising costs for most small travel agencies are relatively minimal.

Travel research in the direct sales process relies on customers researching their own travel options using Internet based tools. If professional travel agencies can use online search tools to consistently find the same or lower cost travel options, customers may find agency service fees less expensive than the time-cost of performing their own research.

The reservation, payment and ticketing steps of the direct sales process are completed by travel providers using E-commerce and other new technologies. These allow travel providers to take reservations, accept payment, and deliver travel documents automatically.

Airlines have significantly increased their direct sales. Northwest Airlines doubled their company website sales from $200 million in 1999, to $400 million, or 4 percent, of the total $9.65 billion in passenger sales during 2000.[53] Likewise, Continental's website volume grew from $165 million in 1999 to $320 million in 2000.[54] Figure 13 compares these sales to total sales.

Figure 13: Airline Website Sales as Percent of Total Sales



Source: Prepared by Heartland Information Research based on selected 2000 SEC 10-K filings

One strategy for travel providers to increase direct sales has been to develop websites offering other categories of services. For example, Hyatt and other chains are now offering agency like services to book airline tickets and auto rentals in addition to their hotel rooms. Delta Airlines introduced MYOBTravel.com as a one-stop online travel solution for small business travelers.

Non-Internet developments have also strengthened travel providers' ability to generate direct sales. Successful customer loyalty programs have significantly reduced the value of travel agencies to airlines. Prior to frequent flyer programs, travel agencies could more easily direct passengers to the airline offering the best overall compensation package.

The development of direct sales in the airline industry followed a series of steps that other travel categories are likely to duplicate. Frequent flyer programs dramatically changed

[53] Southwest and Northwest 10-K filings, 2000

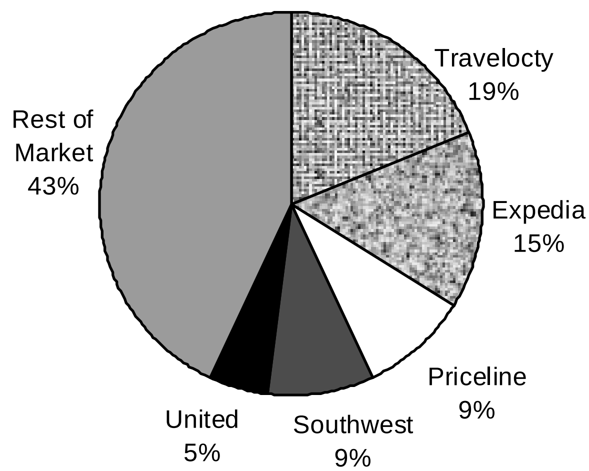
[54] Continental 10-K filings, 2000

passenger preference and reduced the travel agency role in selecting a carrier. Travel agencies' influence continued to erode as consolidation reduced the number of carrier choices. Finally, with the direct sales capabilities of E-commerce, airlines began bypassing both online and offline travel agencies to reduce their distribution costs and increase profits.

Online Distribution Channels

For ASTA agencies, online competition is the second greatest concern for losing business.[55] Five websites dominate the online market: two travel agencies Travelocity and Expedia, a consolidator Priceline, and two airlines Southwest and United.

Figure 14: Online Sales by Company



Source: PhoCusWright, 2000

Of these top online sites, PhoCusWright reported that in 2000 Travelocity, Expedia, and Priceline, accounted for 76 percent of online travel agency bookings.[56]

Table 13 shows the number of travel customers visiting the top online sites in March 2001. With millions of travelers visiting online travel agencies each month, fewer travelers may return to storefront agency locations for general information and travel planning.

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[55] American Society of Travel Agents (ASTA), "Service Fees 2001", April 2001

[56] PhoCusWright, "The Online Travel Marketplace 2001-2003"

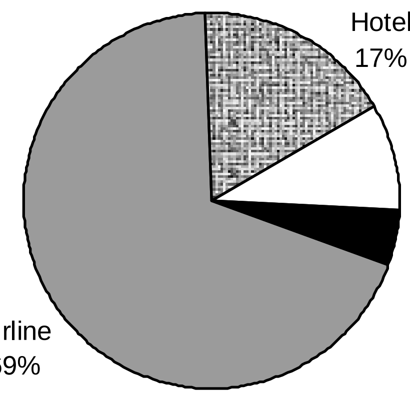
Table 13: Most Popular Online Travel Providers

Rank	Company	Unique Audience (000)
1	Travelocity	8,720
2	Southwest	4,109
3	Expedia	4,801
4	Priceline	3,409
5	United	1,887

Source: Nielsen//NetRatings and Harris Interactive
Reported March 2001 by CyberAtlas

Figure 15 shows the share each travel category represents in terms of total online travel sales.

Figure 15: Travel Categories as Percent of Total Online sales



Source: PhoCusWright, 2000

Only the cruise and tour service category remains almost completely dependent on travel agencies to book 95 percent of their sales.[57] This is attributed to the complexity of both the selling and planning steps for cruise and tour packages. As new Internet tools like video conferencing become more mainstream, the need to meet in person with a travel agent may become less important to customers.

The ability of online travel agencies to develop affiliate and partnership programs with storefront based businesses also presents a new competitive challenge for traditional travel agencies. For example, Amadeus and OneTravel provided Sam's Club with a private-labeled

[57] Cruise Line International Association (CLIA), "Cruise Industry Overview – Marketing Edition", March 2001

online travel site for Sam's Club members. This affiliate model may allow online based agencies to duplicate the successful 'bricks and click' model of online retailers.

Online agencies can also offer their online booking capabilities to other online retailers. For example, in September 2001 Amazon added an online travel store. This recent development uses Expedia for booking and travel information, Hotwire for discounted travel offerings, and The Vacation Store to provide vacation cruises.

Travel Customer Trends

E-commerce and the Internet have also impacted the travel agency industry by introducing travelers to new tools for planning and purchasing travel services.

Leisure customers who generate the majority of travel agency sales are becoming more experienced at using the Internet, and using it longer. An estimated 55 percent of online travelers have over two years of Internet experience, and 60 percent spend at least eleven hours a week online. As traditional agency customers spend more time online, the possibility of them exploring and possibly converting to online travel sites increases.

Consolidation and Ownership Trends

Consolidation of travel providers, GDS vendors, and online agencies are creating more complex relationships within the travel industry. Some of these new relationships also create new forms of competition for traditional travel agencies, with the lines between travel distribution roles becoming less clear.

As an example, Sabre which is the largest GDS vendor for travel agencies, acquired Travelocity in October 2000. Acquisitions of other online agencies make Travelocity the largest online travel agency on the Internet. As a result, travel agencies using Sabre now find themselves competing with their own GDS vendor for online travel sales.

Both offline and online travel agencies have protested the formation of Orbitz, the new online travel site launched jointly by United, Delta, Continental, Northwest and American airlines. In addition to competing against travel agencies, one of Orbitz's goals is to eliminate the need for GDS vendors.

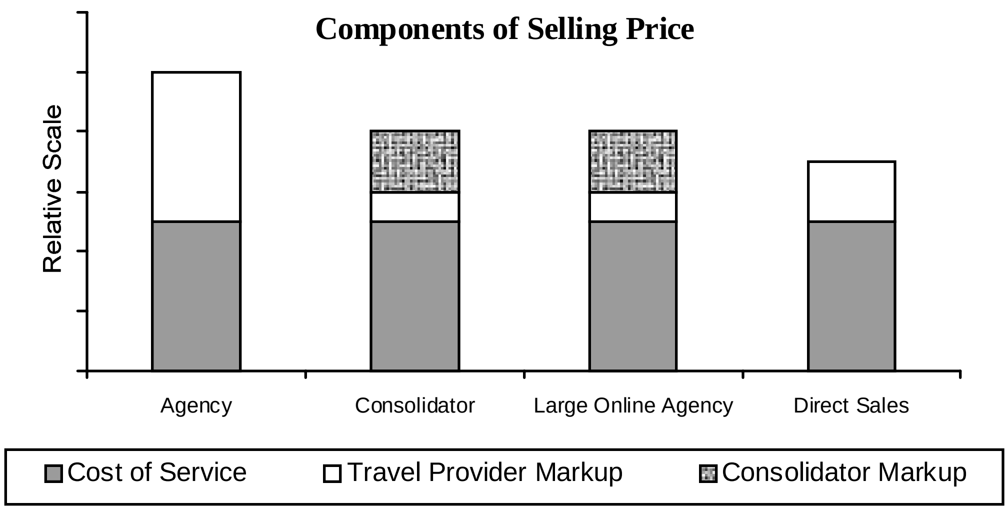
Consolidation is also helping online agencies develop economies of scale advantages. For example, by purchasing Travelscape, Expedia became a hotel consolidator offering discounts on hotel lodging. Expedia also purchased Vacationspot which gave it access to a vacation rental network. These purchases give Expedia increased ability to purchase large discounted blocks of travel services for later resale at a profit.

Section 6: Economics of Travel Service Distribution

Simplified Comparison between Channels

The economics of a traditional storefront travel agency differ from companies operating in the consolidator, direct sales, or online travel agency distribution channels

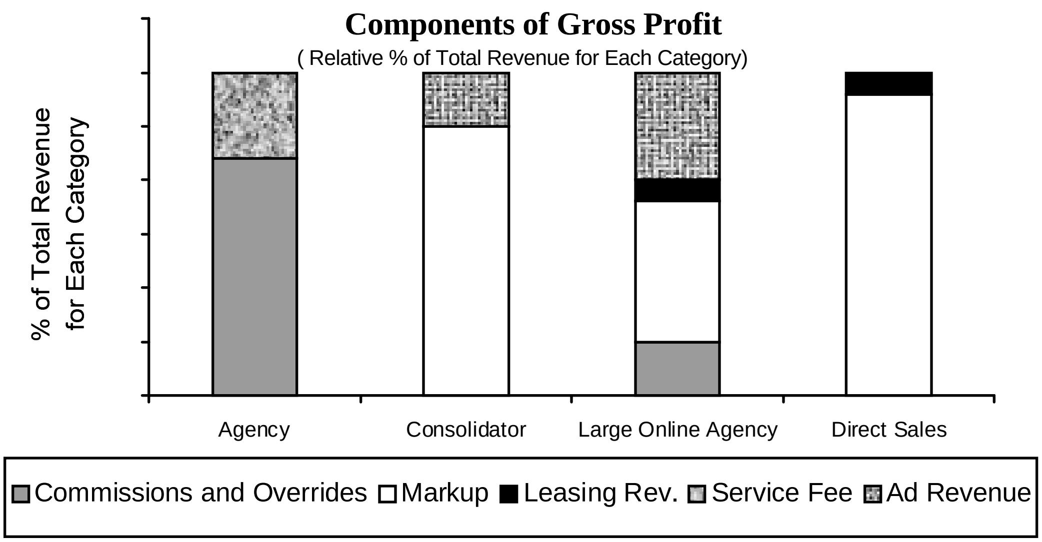
One key difference is that traditional travel agencies do not markup the services they sell. In the case of consolidators, a markup is added to their wholesale cost. For direct sales, a markup is added to the production cost of the service. Large online travel agencies also act as consolidators by buying some services at wholesale and then adding a markup.



The above comparison overlooks the fact that services sold at wholesale are usually only available on short notice, or have unpopular restrictions or schedules. However, this comparison does explain the perception that travel agencies are the highest cost option, and why direct sales by service providers are the lowest cost option. This explains the attractiveness of buying direct. Providers can sell unrestricted and popular services at prices lower than the other channels by avoiding distribution costs and adding smaller markups.

The sources available for generating gross profit, which is the difference between a service's selling and purchase price, also differs between channels. Travel agencies charge service fees and earn commissions. They can also earn performance-based incentive compensation (known as override commissions) from travel suppliers.

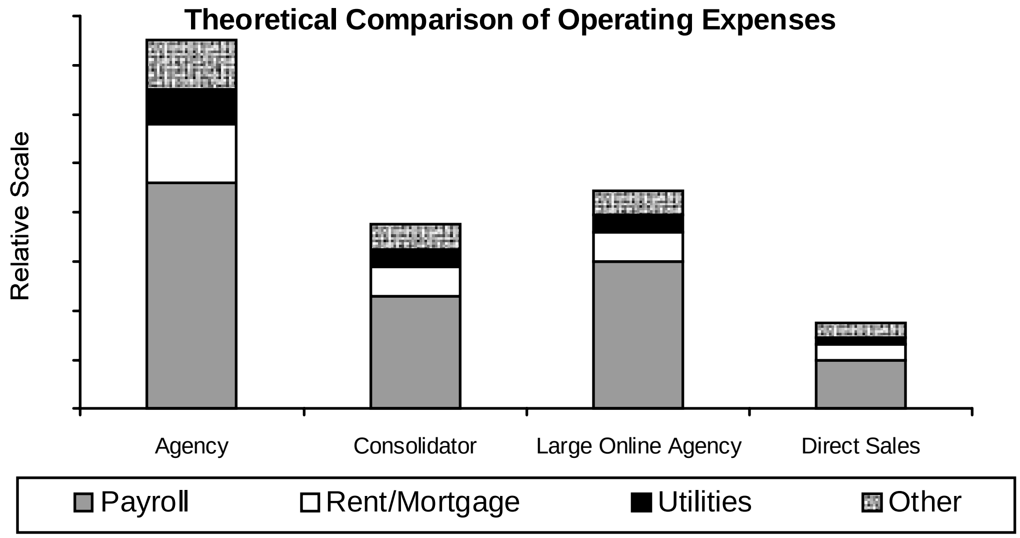
Online agencies also can earn regular and override commissions, but these are typically at lower commissions rates than those paid to offline agencies. Lastly, both large online agencies and service providers might generate revenue from leasing their proprietary information systems to third parties.



This simplified example reveals the revenue advantages online travel agencies have over their offline counterparts. Reduced or lost commission revenues can be offset with advertising and leasing revenues. Offline agencies on the other hand must rely solely on service fees charged directly to their customer.

The above examples offer simplified revenue comparisons between distribution channels. The next examples explain the differences between the expenses of each channel.

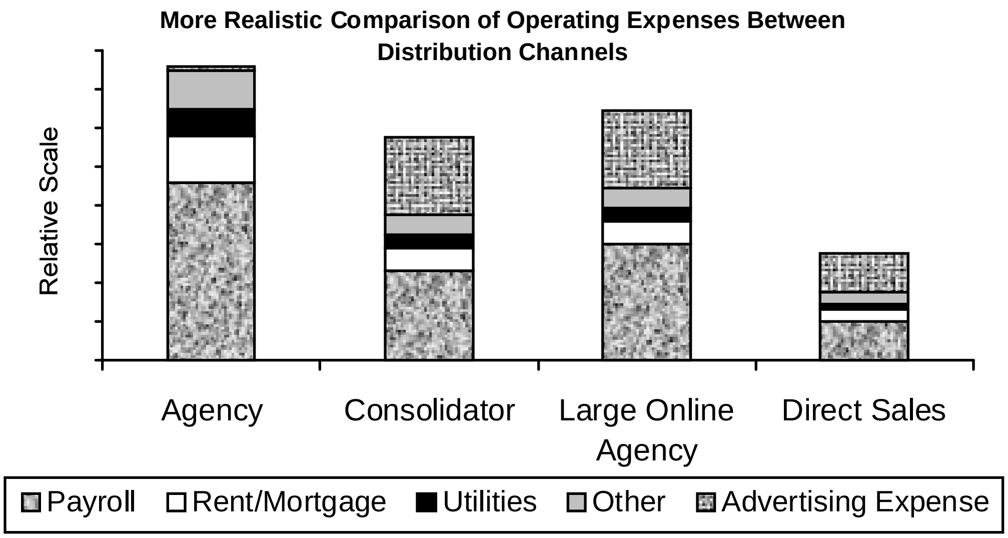
Theoretically, online distribution channels should enjoy significant expense benefits from the online environment. Centralized operations reduce payroll and overhead, and a large geographical market should create economies of scale in many expense categories.



In the simplified example above, the online agency payroll is shown larger than the consolidator payroll expense. The wider range and complexity of services offered by online agencies usually requires larger call center staffs.

The expenses for direct sales reflect the opposite point. Because providers support only one type of service, customer support expenses are typically lower than full service agencies. In addition, providers have existing call centers to support the customers buying their services through all channels. The overhead expense of these call centers is absorbed equally between customer support and direct sales activities. The above example only shows the portion of overhead charged to direct sales activity.

Unlike the theoretical operating expense example above, the real online marketplace has ongoing advertising expenses associated with building and maintaining brand recognition. Because economies of scale are important to the profitability of online agencies, attracting and retaining large numbers of customers is a key and ongoing concern. As a result, a comparison of operating expenses between channels is more accurately represented by the example below.



This again is a simplified example to point out key differences between expenses in each channel. Offline agencies have relatively low advertising expenses because they benefit from promotions by travel service providers. Both the online consolidator and large online travel agency have significant advertising and brand building expenses. Because service providers combine the promotion of their direct sales channel with other advertising activity, the amount of advertising expense charged to direct sales activities is less than the other two online channels.

Economics of Small Travel Agencies

According to ASTA surveys, salaries are travel agencies' largest expense followed by rent or mortgage payments.

The average travel agent salaries excluding bonuses is $24,641.[58] With ASTA agencies having an average of six employees, their average monthly payroll is approximately $12,320 excluding benefits and bonuses.

[58] Yahoo!, Source http://swz-yahoo.salary.com, August 27, 2001

In 2000, just over half of ASTA agencies paid agents a salary, with 39 percent paying a fixed amount in combination with commissions. Only 8 percent had a commission-only pay system for their agents. These ratios remain unchanged from 1999.

Table 14: ASTA Travel Agency Operating Expenses

Operating Expense Item	1999 (%)
Salaries	40.7
Rent / Mortgage	12.2
Telephone, Fax, Internet Access	6.9
Advertising / Promotion	5.9
Other Overhead	5.5
Employee Benefits	5.0
Office Supplies / Equipment	4.5
Outside Consultants	3.4
Travel & Entertainment	3.4
Dues/Subscriptions, professional fees	3.3
Other	3.0
Training & Development	2.9
CRS Fees	2.7
Postage	2.7

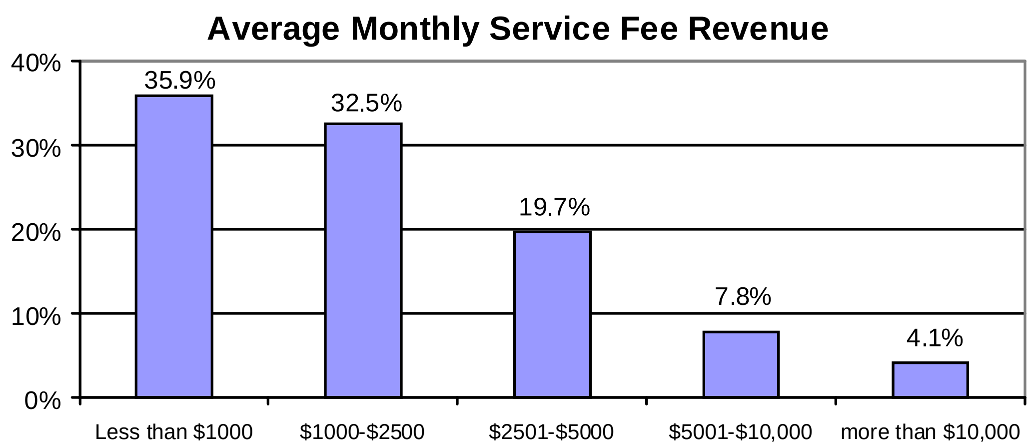
Source: The American Society of Travel Agents (ASTA),
The 2001 ASTA Agency Service Fees Report

Traditional offline agencies offset declining commission revenue and improve profitability by charging service fees, earning override commissions for higher volumes, focusing on higher commission travel services, or by reducing operating expenses. This approach has had limited success, with only 27 percent of travel agencies able to find ways to replace reduced commission revenue, and only 64 percent reporting a profit in 1999 versus 76 percent in 1997.[59]

[59] Travel Weekly, "Travel Weekly's U.S. Travel Agency Market Survey 2000"

According to ASTA's 2001 Service Fee Study, the number of agencies generating over $5,000 per month in service fees was less than 12 percent of all the agencies participating in the survey. 52 percent of ASTA agencies had monthly service fees between $1,000 and $5,000.

Figure 16: ASTA Agency Average Monthly Service Fee Revenue



Source: The American Society of Travel Agents (ASTA), The 2001 Agency Service Fees Report

Reasons cited by agencies for not charging fees included uncertainty on how to implement a fee program and the difficulty with processing the extra charge.

One key concern pointed out by ASTA's Service Fee Study was that 46.5 percent of survey respondents did not know the approximate cost to their agency for issuing a domestic airline ticket. One possibility is that non-owner agents who were unfamiliar with their agency's operating budget completed the survey.

The average cost given by those responding to the cost of ticketing question was approximately $25.50 for issuing a domestic ticket. Comparatively, the average service fee charged was $14. These figures suggest that service fees only cover half the cost of ticketing and are not yet contributing to the gross profit of small travel agencies. As commissions decline, travel agencies will need to increase service fees to cover costs and produce profits.

Service fees also lack the automatic inflation adjustment of rising ticket prices. With service fees, agencies will need to successfully negotiate higher customer fees as agency costs increase.

The various steps taken by ASTA agencies to reduce costs are shown in Table 13. This table also compares the difference between steps taken by unprofitable and profitable agencies.

Table 15 shows a trend towards replacing full-time staff with outside sales consultants by both profitable and unprofitable agencies.

Table 15: Cost Reductions Steps Taken by ASTA Member Agencies

	Increased (%)		Decreased (%)		Kept same (%)	
Category	**Profitable**	**Unprofit.**	**Profitable**	**Unprofit.**	**Profitable**	**Unprofit.**
# of full-time staff	16.6	7.5	23.1	36.3	60.3	43.8
# of part-time staff	18.5	19.0	13.5	19.0	67.7	62.0
# of outside sales consultants	27.1	23.0	12.4	15.1	60.5	61.9
Salaries	64.9	46.5	4.3	4.9	30.9	48.6
Employee benefits	25.1	19.3	3.5	4.3	71.4	76.4
Advertising/Promotion	30.3	32.4	15.5	27.6	54.2	40.0
Training for self/staff	27.8	30.2	7.1	12.2	65.1	57.6
Travel & Entertainment	19.0	11.3	17.5	34.5	63.5	54.2
General Overhead	33.2	32.4	22.3	37.9	44.5	29.7

Source: The American Society of Travel Agents (ASTA), The 2001 ASTA Agency Service Fees Report

Economics of Large Online Travel Agencies

This section briefly reviews the key profitability challenge facing online travel agencies - advertising. The challenge for online travel agencies is controlling advertisement and other brand building costs while attracting sufficient numbers of buyers to attain economies of scale. Expedia's sales and marketing expense was $95 million in 2000. As a percentage of revenue, this expense category was 34 percent or one third of Expedia's annual revenues. This was an improvement over 1999 when sales and marketing were 44 percent of revenues.

Travelocity reported a 307 percent increase in sales and marketing expense over 1999. This was largely due to expenses associated with mergers and strategic partnerships completed during 2000. Revenues for the year showed an increase of 158 percent.

Using 1999 data for Travelocity shows that as a percent of revenue, the $29.5 million spent in 1999 on sales and marketing was 46 percent.

Whether these large advertising and brand building expenses represent an initial startup investment, or an ongoing operating expense for online travel agencies is still uncertain.

At present, the two largest agencies Travelocity and Expedia are owned by well-established and financially healthy parent companies. Unlike other online companies funded primarily with venture capital, both agencies will benefit from longer performance horizons and the expertise gained from being owned by information technology companies.

Economics of Travel Providers

E-commerce offers travel providers opportunities to reduce expenses by reducing their distribution costs. Table 16 shows a typical breakdown of airline ticket distribution costs.

Table 16: Breakdown of Airline Ticket Distribution Costs

Component	Percentage
Commissions	6.5 %
CRS/GDS Fees	2.1%
Credit Card Fees	1.9%
Reservation Sales	1.8%
Total Distribution Costs	12.3%

Source: Richard Anderson, CEO Northwest Airlines. June 5, 2001 Merrill Lynch Global Transportation Leaders Conference presentation

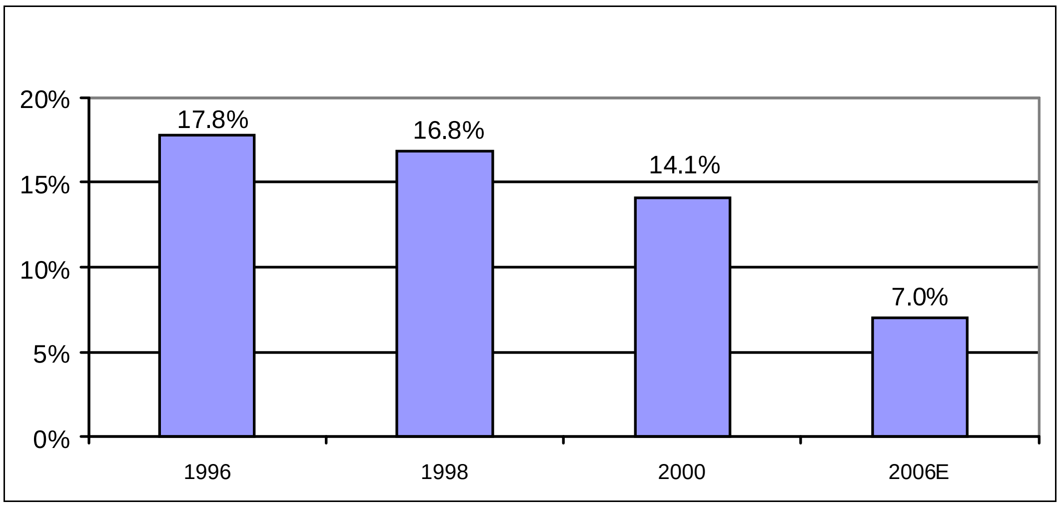
Using E-commerce, airlines are focusing on reducing the two largest components of their distribution cost – commissions at 6.5 percent, and GDS fees at 2.1 percent. Direct sales via company websites help airlines reduce commissions while also reducing their dependency on

GDS vendors to distribute seat inventory. Orbitz, an airline owned travel agency, is planned to eventually bypass GDS's by booking airline travel directly with individual airline systems.

Other distribution cost reductions attained using E-commerce and technology include E-tickets. E-ticketing cost airlines approximately $2 per ticket, versus $7-9 for paper tickets.

These reductions are having a measurable affect on airline distribution costs according to Continental Airlines' report shown in Figure 17.

Figure 17: Distribution Costs as Percent of Passenger Revenue



Source: Continental Airlines. Merrill Lynch Transportation Conference Presentation. June 5, 2001. www.continental.com/corporate

Summary of E-commerce and Technology's Economic Impact

E-commerce and new technology help reduce the value of agencies as intermediaries to travel providers. In some cases such as airline ticketing, E-commerce has recast travel agencies from being revenue generators for travel providers, to being seen as an unnecessary expense.

Section 7: Small Agency Strategies

This section briefly outlines possible strategies and tools that may help small travel agencies compete in the new environment created by E-commerce. The order shown does not indicate any order of importance, and more importantly, does not give any assurance that these will be successful. The purpose is to highlight the availability of new revenue sources for small agencies seeking to offset declining revenue due to commissions cuts and online competition.

Strategies in Use by Small Travel Agencies

1. **Home Office versus Storefront** - E-commerce and Internet technology allow travel agencies to work from lower cost home-based offices. Using software and Internet tools to duplicate the automated services provided by larger agencies, home-based agencies may realize significant cost advantages over larger competitors.
2. **Add Retail to Agency Storefronts** - Adding vacation apparel and travel related items to storefronts may generate revenues and attract potential travel customers.
3. **Invest in Technology -** Agencies can invest in technology that will signal them whenever an airfare drops in price.[60]
4. **Offer 24-hour Service** - Provide 24-hour service either through call-centers, forwarding calls to on-call agents, or online information websites. For on-call agents, laptop PC's can be configured to connect with GDS and other travel sites from home to access a client's records 24 hours a day, 7 days a week.
5. **Share Commissions with Leisure Customers** - Cash4Travel.com and atbm.com (A-Trip-By-Modem) are examples of websites attracting online customers by rebating customers part of their travel commission.
6. **Sell other Services** - In addition to traditional services such as passports and travel insurance, travel agencies may consider offering other services. These range from providing foreign currency through online sites such as Travelcurrency.com, to earning incentives for referring customers to Brinks Home Security for protecting empty homes during extended travel periods.

[60] Chuck Moozakis, Internet Weekly, "Help For the Middleman", December 1, 2000

7. **Niche Market –** Numerous specialty markets exist for interests ranging from overseas history tours to shopping spree tours in cities with famous retail districts.

E-commerce and Internet Tools

New E-commerce and office automation solutions are being developed and offered by GDS and third party vendors. These new tools may provide small travel agencies the opportunity to develop a professional and secure presence in the online travel marketplace.

Examples of E-commerce solutions for small agencies includes Sabre's 'Virtually There', Worldspan's 'My Trip and More', and Amadeus' 'NetTravel Complete'. Using these products, agencies can have their name and logo added to a website that gives their customers the ability to access itineraries online, download information to PDA's, receive updates on their flight status, make online bookings, and perform other common online travel activities.

Other offerings from GDS vendors can increase agency productivity and reduce costs. For example, Sabre's new 'Merchant Pay' system allows travel agencies to authorize and process payments through their existing Sabre GDS interface. Worldspan's 'World Ledger Powered by Unisys' processes, stores, retrieves, organizes, and produces reports on a travel agency's financial activity.

New GDS services, such as 'Galileo Wireless™', enable small travel agencies to offer their customers the latest emerging technology services such as wireless access to travel information.

Small Travel Agency Opportunities

Given the large number of travel agencies, it is likely that GDS vendors and other third party technology companies will continue developing E-commerce and other automation tools for the travel agency market. These off-the-shelf solutions may allow small travel agencies to provide customers the features needed to remain competitive against larger online competitors.

Likewise, agencies may be able to develop additional sources of travel related revenue to help offset declining revenues from commission cuts and lost volume to online travel sites.

Section 8: E-commerce Impact on Government Roles

This section is a brief introduction to how E-commerce is impacting government activity within the travel agency industry.

Rule Maker

E-commerce is creating requirements for new government rules within the travel agency industry. Small travel agencies offering E-commerce solutions must be aware of these rules and how they apply to them. Like small business exemptions from other government rules intended for larger businesses, small travel agency exemptions from new E-commerce rules may also be needed.

Market Issues

E-commerce has introduced new business models and competitive strategies requiring government involvement to maintain a free, open, and competitive market place.

The launching of Orbitz as a new online travel agency owned by major airlines required significant review by the U.S. Department of Transportation (DOT). This review will be ongoing, and Orbitz was required to report any changes made to its business model within the first six months of operations.[61] Travel providers in the lodging, auto rental, and leisure travel markets may develop similar E-commerce business models requiring government review.

Part of the DOT's decision allowing Orbitz to launch relied on existing plans to decide whether CRS rules regarding fairness of listing all carriers should also apply to online travel agencies – including Orbitz. The expiration date for the current rules was extended until March 31, 2002. If new rules are applied to online agencies, the impact on small agencies should be considered.

E-commerce's impact on the DOT was also illustrated by the department's repeated clarification that the full-fare advertising rule (14 CFR 399.84) also applies to Internet travel sites. This rule requires the total fare to be displayed onscreen except for certain governmentimposed taxes. In January 2001, DOT issued a letter clarifying this issue and informed online travel agencies how certain online search methods were producing non-compliant results.[62]

Since June 21, 2001, online travel agencies seeking Federal government travel contracts also must have websites complying with Section 508 of the American's with Disability Act. Section 508 requires that website designs accommodate Federal workers with disabilities. While currently only applicable to Federal contracts, travel agencies with an online presence should be aware of these requirements if and when they become mandatory for commercial markets.

Economic Issues

In addition to government agency rule making related to market issues, legislative government branches also have set rules regarding unique economic aspects of E-commerce.

At the Federal level, the Internet Tax Freedom Act enacted in 1998 exempts certain types of Internet sales transactions from state and local taxation through October 21, 2001. Senate legislation introduced October 2, 2001 proposes to extend this ban two more years. At the State level, nineteen states support the 'Streamlined Sales Tax Project' to develop a nationwide method of taxing online purchases. Taxing online purchases could reduce E-commerce's overall popularity and result in fewer visits to online agencies. If lifted, small online agencies would require E-commerce solutions capable of tracking any out-of-state tax liabilities.

At the State level, small travel agencies are encountering new bonding requirements intended to help reduce consumer losses from fraud and failed agencies.

As an example, a new Nevada law took affect October 1, 2001 requiring non-ARC registered agencies to post a $50,000 bond to help reduce consumer losses from bankrupt or unscrupulous

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[61] U.S. Department of Transportation (DOT), Press Release "DOT Decides Not To Prevent Orbitz's Launch", April 13, 2001. Source http://www.dot.gov/briefing.htm

[62] U.S. Department of Transportation (DOT), "Prohibition on Deceptive Practices In the Marketing of Airfare To the Public Using the Internet", Letter January 18, 2001.

agencies.[63] Small travel agencies focusing on leisure travel packages do not require ARC registration. While the Nevada Consumers Affairs Division which proposed the law is now working to get the bond lowered to $10,000 for small agencies, the potential for small online agencies being required to post bonds with multiple states could become a barrier to entry. Federal legislation similar to the Internet Tax Freedom Act may be needed to both protect travelers from losses, and to provide uniform markets nationwide for smaller online agencies.

Legal Issues

The steady reduction in airline commissions has resulted in a number of lawsuits claiming airlines acted in violation of anti-trust provisions in the Sherman Act. The central question is whether airlines conspired to reduce agency commissions together, or if airlines simply followed market trends when other airlines reduced their commissions. The scrutiny of these cases increases with E-commerce because of the ease with which prices can be changed to discourage new market entrants.

Government Security Issues

As the travel industry becomes more dependent on E-commerce and the underlying Internet technology, the travel agency industry will require a stable and secure Internet system.

In addition, E-commerce may require government rules to protect travelers from privacy and security issues. Potentially, some of these rules may impact both online and offline travel agencies. For example, personal data stored on a small agency's PC connected to the web must be secured against unauthorized access. E-commerce developments such as rebooking flights via wireless web enabled devices, and at-home printing of boarding passes, may impede security efforts to verify an air traveler's identify prior to boarding.

Small agencies entering the online arena must be aware of these issues to ensure their offline and online business systems comply with government privacy and security standards.

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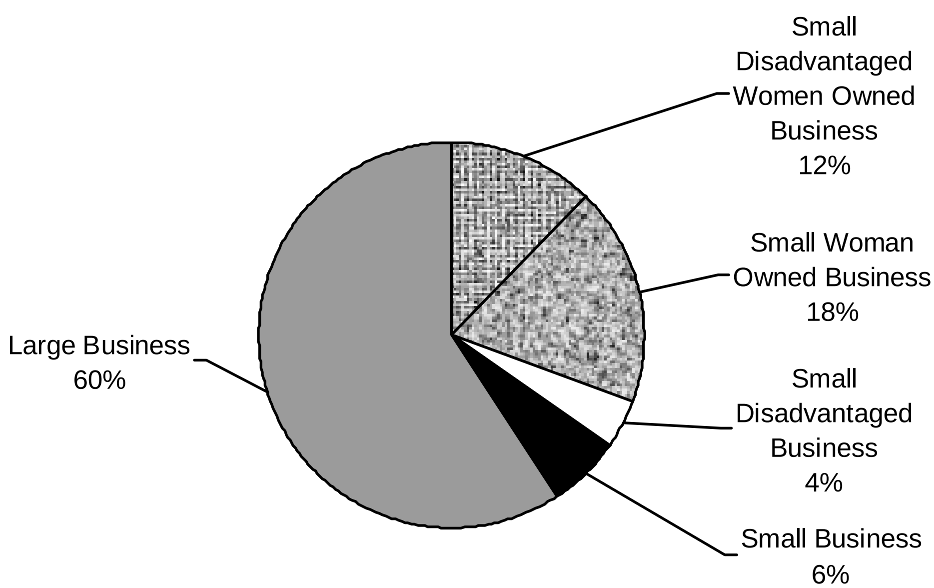
[63] Ed Vogel, Las Vegas Review-Journal, "Legislators Uphold Travel Agency Bond Law", September 7, 2001, Source: shttp://www.lvrj.com/lvrj_home/2001/Sep-07-Fri-2001/news/16946611.html

Government as a Travel Consumer

A 2000 survey by The Society of Government Travel Professionals (SGTP) estimated travel spending for U.S. and Canadian states and provinces at a combined $2.33 billion. As more of this government travel is purchased through online agencies, the ability of small travel agencies to compete in government markets must be considered.

As of June 2001, minority and small-business travel agencies represent 40 percent of the 55 approved agencies listed as approved GSA travel contractors. These and similar firms interested in competing for Federal travel contracts may need assistance to develop E-commerce capabilities, or update their existing websites to comply with Section 508 requirements

Figure 18: Mix of Agencies Awarded GSA Travel Contracts



Source: Compiled by Heartland Information Research from http://gsa.gov, June 2001

Section 9: Conclusion

E-commerce fundamentally altered the structure of travel service distribution by creating new online distribution channels accessible to travelers. So long as these new channels improve distribution efficiencies, some reduction in the number of intermediaries is an expected and normal behavior of a free and open marketplace.

Both large and small traditional travel agencies are impacted by E-commerce related developments. The new efficiencies offered by online distribution channels are widely seen as reducing the value of traditional offline travel agency services. Providers of lodging, auto rentals, cruises, and tours will imitate the current efforts by airlines to develop online direct sales capabilities and reduce agency commissions.

In response to these challenges, both small and large agencies are charging service fees and investing in custom or third party E-commerce solutions. Small travel agencies are refocusing on higher commission cruise and tour packages, and some are using E-commerce and Internet technology to reduce overhead by moving into home offices.

The number of storefront and ARC registered travel agencies will continue to decline through consolidation and forced exits. The majority of these will be due to airline commission reductions and the failure to develop alternative revenue streams such as service fees. The number of home-based agencies will proliferate as displaced travel agents from these agencies seek to continue their careers as independent agents.

The long-term structure of travel distribution remains uncertain. If the Department of Transportation decides large online agencies fall under CRS rules requiring unbiased displaying of travel offerings, the role of online travel agencies will change. These online agencies also depend on accessing travel inventory owned by travel providers. As travel providers increase their online direct sales volumes, they will have less incentive to sell desirable inventory to competing online agencies.

The majority of travel sales will continue to be made offline for the foreseeable future. Not until sometime after 2005 will online travel sales reach between 20 and 30 percent of total travel sales. In 2000, online travel sales accounted for less than 10 percent of total travel sales.

A new reporting method is needed to identify the total number of domestic travel agencies, including those that are not ARC registered and possibly home-based small agencies. The contribution by these small agencies will help determine what, if any, policies or programs are warranted to maintain free and competitive markets for consumers.

Traditional travel agencies need to consider the financial aspects of transitioning from commission-based representatives to fee-based service providers. One important difference is that commission revenues are automatically inflation adjusted by rising ticket prices. Fee-based revenues must be adjusted manually by negotiating higher fees with customers.

Likewise, as small travel agencies develop an online presence, how government rules for CRS and online travel agencies apply to small businesses becomes a concern. If compliance with these rules is cost prohibitive, larger agencies might use these rules to discourage smaller agencies from competing online.

E-commerce is challenging the travel agency industry to quantify the value agencies contribute to the distribution of travel services both online and offline. Based on the travel agency industry’s long history of successfully adapting to market and technological changes, the industry can be expected to find successful strategies for competing in the new age of E-commerce.

Because small businesses often provide the most innovation and creativity during these types of major transitions, the strategies of successful small travel agencies will likely influence the overall travel agency industry’s response to E-commerce’s challenges and opportunities.

Appendix A: Research Sources

Extensive resources exist for researching E-commerce and the travel industry. The sources listed below are representative of those available for additional research.

Associations, Research Firms, and Government Agencies

Organization Name	Address Information
Airline Reporting Corporation	1530 Wilson Blvd. Suite 800 Arlington, VA 22209 www.arccorp.com
American Society of Travel Agents	1101 King Street, Suite 200 Alexandria, VA 22314 www.astanet.com
Association of Retail Travel Agents	2692 Richmond Rd., Ste 202 Lexington, KY 40509 www.artaonline.com
U.S. Census Bureau	U.S. Census Bureau Washington DC 20233 www.census.gov
Bureau of Labor Statistics	Division of Information Services 2 Massachusetts Avenue, N.E. Room 2860 Washington, D. C. 20212 www.stats.bls.gov
Cruise Line International Association (CLIA)	500 Fifth Ave. Suite 1407 New York, NY 10110 www.cruising.org
Employment Policy Foundation	1015 Fifteenth St., NW, Suite 1200 Washington, DC 20005 www.epf.org
eTForecasts	926 Cambridge Drive Buffalo Grove, IL 60089 www.etforecasts.com
Forrester Research, Inc.	400 Technology Square Cambridge, MA 02139 www.forrester.com
Gartner Group	56 Top Gallant Road Stamford, CT 06904 www.gartner.com
Gomez	610 Lincoln Street Waltham MA 02451 www.gomez.com
Hospitality Sales and Marketing Association International	1300 L Street, N.W., Suite 1020 Washington, D.C. 20005 www.hsmai.org

Organization Name	**Address Information**
Integra Information, a division of Microbilt	1640 Airport Road, Suite 115 Kennesaw, GA 30144 www.integrainfo.com
Jupiter Media Metrix, Inc	21 Astor Place New York, NY 10003 www.mediametrix.com
National Bureau of Economic Research	1050 Massachusetts Avenue Cambridge, MA 02138 www.nber.org
National Business Travel Association (NBTA)	1650 King Street, Suite 401 Alexandria, VA 22314 www.nbta.org
NetValue Worldwide	427 Broadway - 4th Floor New York, NY 10013 www.netvalue.com
Nielsen NetRatings	890 Hillview Court Milpitas, CA 95035 www.neilsen-netratings.com
Office of Advocacy U.S. Small Business Administration	409 3rd St SW Suite 7800 Washington, DC 20416 www.sba.gov/advo
Official Airline Guide	2000 Clearwater Drive Oak Brook, IL 60523 www.oag.com
PhoCusWright	1 Route 37 East, Suite 200 Sherman, CT 06784-1430 USA www.phocuswright.com
Securities and Exchange Commission	450 Fifth Street, NW Washington, DC 20549 www.sec.gov
Society of Government Travel Professionals (SGTP)	6938 Wisconsin Ave, Suite 200 Bethesda, MD 20815 www.government-travel.org
Tourism Industries	www.tinet.ita.doc.gov
Travel Industry Association of America (TIA)	1100 New York Ave. NW, Suite 450 Washington DC 20005-3934 www.tia.org
U.S. Department of Commerce	1401 Constitution Avenue, NW Washington, DC 20230 www.doc.gov
U.S. Department of Justice	950 Pennsylvania Avenue, NW Washington, DC 20530-0001 www.usdoj.gov
U.S. Department of Transportation	400 Seventh St., S.W. Washington, D.C. 20590 www.dot.gov

Appendix B: Glossary

	Terms	Descriptions
1	5 ‘R’’s	Recommendation, Research, Reservation, Reporting, Relationship
2	ARC	Airline Reporting Corporation
3	ASR	Automated Speech Recognition
4	ASTA	American Society of Travel Agents
5	ATA	Air Transport Association
6	B2B	Business-to-business
7	Brick and clicks	Traditional travel agencies with websites
8	CRM	Customer Relationship Management
9	CRS	Computerized Reservation Systems
10	DOJ	Department of Justice
11	DOT	Department of transportation
12	E-commerce	Electronic commerce
13	ESP	Expert Searching and Pricing

	Terms	**Descriptions**
14	E-ticket	Electronic ticketing
15	FAQ	Frequently Asked Questions
16	GDS	Global Reservation Distribution Systems
17	NBTA	National Business Travel Association
18	NTS	National Travel Survey
19	OAG	Official Airline Guide
20	PDA	Personal Data Assistant
21	SGTP	Society of Government Travel Professionals
22	TIA	Travel Industry Association of America