

IBM Institute for Business Value

Travel 2020: The distribution dilemma

*Enhancing collaboration to enrich the traveler experience
and improve profitability*



IBM Institute for Business Value

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By Steve Peterson

At the height of the Internet revolution, the travel industry was expected to be among the greatest beneficiaries of new, low-cost, information-rich distribution opportunities. More than a decade later, however, online channels have done little but focus travelers on price. But new technologies and business models finally offer the potential for online differentiation and the provision of value-added services and features for which travelers will pay a premium. To capitalize on these developments, enhance the consumer travel experience and create opportunities for improved financial performance, the travel ecosystem must learn to “play well” with others.

The travel industry has worked for decades to put the customer first. Unfortunately, the end result has often been unrealistic and unconnected traveler interaction and booking processes that frequently require customers to self-assemble itineraries from multiple sources. A customer interaction on an airline website, for example, often must be followed by similar attempts to engage with hotel, car rental or related sites.¹

To solve this problem, consolidated websites were created to provide customers with a single source to book multiple travel modes. But the resulting increase in customer convenience was counterbalanced by a loss of customer intimacy and personalized merchandising opportunities. As a result, travelers, frequently presented with conflicting incentives, dissimilar methods of interaction and competing business models, were largely left to fend for themselves in a confusing, time-consuming and often undifferentiated travel distribution landscape.

Traditional distribution model gives way to “always on”

Seventy percent of travelers in our survey shop for travel even when they are not planning a specific trip. In an online world in which travelers are constantly connected to the Internet and often receptive to information about travel, the linear travel-buying pattern many distributors have clung to is being overtaken by an “always-on” model of travel distribution. This model places the traveler at the center of a constant hive of information exchange across the entire travel ecosystem. Travel distributors that do not adjust their business models in response to this and fail to capture customer attention with personalized, meaningful content, will be poorly positioned to succeed.

Customer service has been further diminished by the economics-driven focus of many travel executives to lower distribution costs. Automated interactions have replaced labor-intensive call centers for both suppliers and travel agencies. Unfortunately, the purchasing services provided through these channels were also excised, which, again, left travelers to manage their own cross-mode travel portfolios. Perhaps the correlation between travel distribution cost reductions and decreasing rates of customer satisfaction is not coincidental.²

Travelers aren't the only ones "lost at sea" in today's distribution landscape. Providers also find themselves adrift by a distribution model that rarely casts their products and services in the perfect light. Consumers already have a well-documented tendency to focus on price, but many online channels make this outcome almost inevitable by displaying few, if any, of the features and benefits that distinguish competing options.³ Global distribution systems (GDS), such as Sabre Holdings and Amadeus, and the on- and off-line agencies that rely on their data, serve up only the most basic information – price, availability, and general category of service – about flight and hotel options. This suboptimal method of selling predictably produces less-than-desirable results.

Even travel distributors, which have fared much better than travel providers in the past decade, struggle to find their rightful place in the travel ecosystem. Financial returns are inconsistent among major distribution players. The competitive environment is awash with discord between distributors and major travel providers seeking to lower fees or bypass distribution systems altogether.

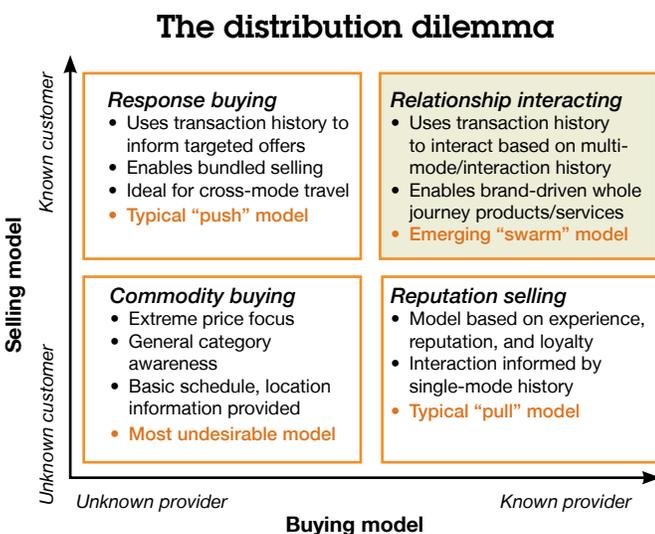
Fortunately, this morass of competing priorities, objectives, and technologies can be addressed by a dedicated commitment by the industry to put the customer first. The future of distribution will be defined by the success of the travel ecosystem in meeting unique customer needs. Much of that battle can be won with more coordination among competing travel providers and distributors. By sharing information about traveler preferences, the distribution community can formulate a collaborative, more complete view of customers, enhance online interactions and, ultimately, transform the customer experience. The net result promises to be an industry with happier customers and more solidly positioned for healthier financial returns.

Study methodology

To understand the issues and the consumer dynamics that will shape the travel industry over the next ten years, the IBM Institute for Business Value, through its research partner Frost & Sullivan, surveyed a mix of 1,020 business and 1,030 leisure travelers from both developed and emerging economies. Once initial conclusions were derived, supplemental external research was conducted and in-depth interviews with subject-matter experts were completed to review and validate the main hypothesis and conclusions in the Travel 2020 study. Finally, IBM leveraged key findings about the travel sector from the Airline 2020 study and the Hotel 2020 study, which were completed in 2010 and 2011, respectively.

Distribution dissatisfaction: The true price of “low-cost channels”

From the perspective of every major party in the travel distribution ecosystem – providers, distributors, and, of course, customers – travel distribution is not working (see Figure 1). Travel buying models are out of sync with dominant selling models in the industry, which results in a patchwork of competing distribution channels that consistently fail to meet customer expectations.



Source: IBM Institute for Business Value analysis, eMarketer, March 2010, PhoCusWright, “Online Travel Overview, Ninth Edition,” November 2009, includes leisure travel, and both managed and unmanaged business travel.

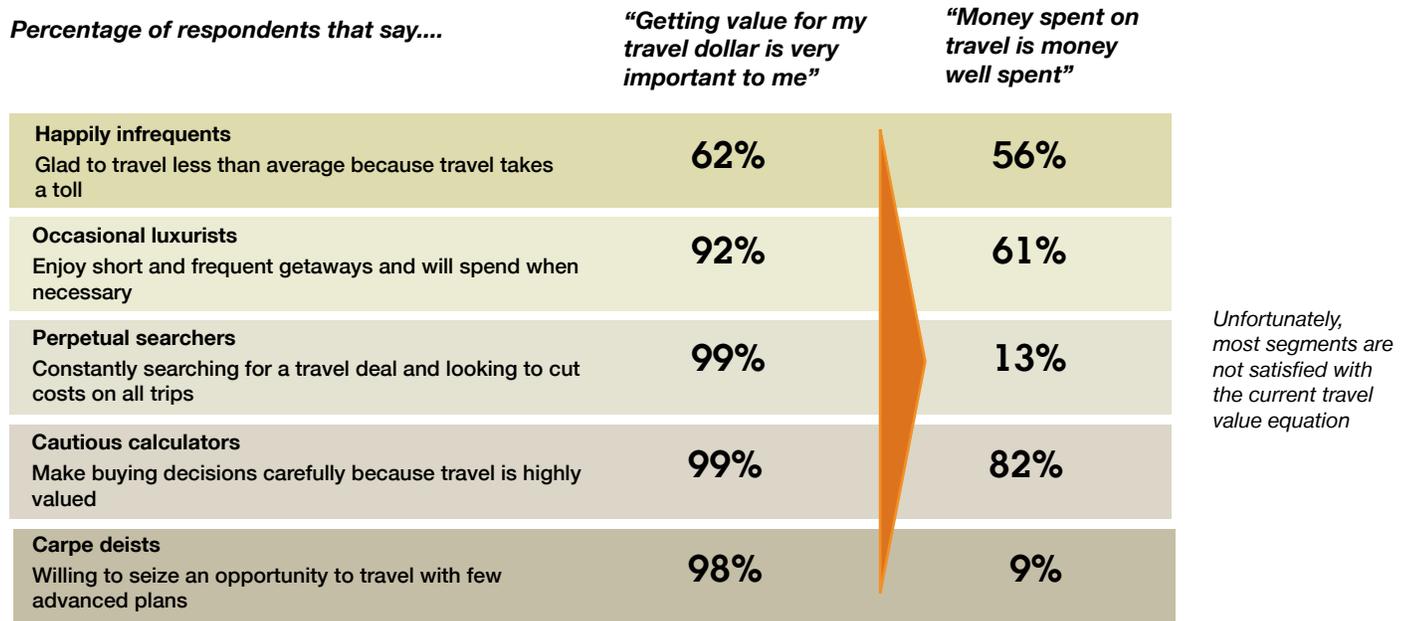
Figure 1: Travel distribution in its current state is not working for providers, distributors or travelers.

Customers

The oft-cited axiom that you get what you pay for is aptly applied to travel distribution. In the years preceding the Internet revolution, travelers had little choice but to visit (by phone or in person) providers or travel agents to fulfill their travel needs. Today, the Internet provides the more common method of shopping and booking. In this new paradigm, travelers are forced to make selections, coordinate their travel plans across diverse travel modes and, ultimately, provide payment for each individual transaction on their own. While booking fees have declined over time, the disassembly of the travel agent model has also resulted in a decrease in customer services. For price-focused travelers, these changes may be a welcome development. But the extra work travelers have to do to compensate for the work travel agents once performed is exacting a toll on traveler satisfaction.

The intense focus on price among many consumers has been extensively reviewed and discussed. What gets slightly less attention is the deeper cause of this price fixation: a misalignment of value. In aggregate, 93 percent of respondents to our survey indicated that getting value for their travel expenditures is important to them. At a segment level, these findings are even more pronounced. The notion of value has a relationship to price, but the two concepts are distinct. Only 47 percent of respondents to our survey said their travel expenditures were well-spent. In three out of five traveler segments, more than 98 percent of respondents indicated getting value for travel investment is very important (see Figure 2).

The disassembly of the travel agent model has resulted in a decline in both services rendered and customer satisfaction.



Source: IBM Institute for Business Value analysis, IBM-Frost & Sullivan Travel Survey March 2011.

Figure 2: Diverse traveler segments share a desire to get value for their travel expenditures, but consumers are not satisfied with the prevailing value propositions in the market.

Only the “occasional luxurists” segment had a majority of respondents that felt that travel money is well spent. Across segments, our study shows customers feel the value equation is skewed and that they are not getting a fair deal.

Other trends in the industry make the level of customer dissatisfaction with value even more alarming. Exploding travel demand worldwide is expected to bring new travelers to the market from previously underserved populations. Though most acutely felt in growth markets in Asia and Eastern Europe, this transformational shift is certain to bring travelers to the entire global market. New consumers with unique

preferences may not be easily satisfied by travel products developed to please the more particular desires of travelers from developed markets.

Evidence of the difficulty customers have meeting their travel needs with the current systems, products, and services can be found in the exorbitant amount of time customers dedicate to travel search. Our survey of more than 2,000 global travelers revealed that 20 percent required more than five hours to search and book travel online. This affects travelers regardless of experience with the system. More than half of leisure travelers and nearly 40 percent of business travelers needed more than two hours to accomplish these tasks.⁴

While a portion of the excessive amount of time some travelers dedicate to travel search can be attributed to a simple inability to find what they are looking for, external assessments of travel websites suggest that few are designed for maximum efficiency. In its annual “Digital IQ” ranking, think-tank L2 determined that only 8 percent of travel websites qualified for the “genius” classification, and fully 60 percent of travel websites were in the “average,” “challenged” or “feeble” categories.⁵

After spending relatively large amounts of time shopping for and booking travel on websites that are not as good as they could be, many travelers become convinced they overpay for the services they purchase. In fact, across all segments in our survey, only 10 percent of respondents felt they received a good deal in shopping and booking their last trip.

Surveys confirm travelers are dissatisfied. The travel industry consistently ranks near the bottom of all industries in the American Customer Satisfaction Index’s annual cross-industry customer satisfaction comparison.⁶ In 2011, hotels were ranked 31st out of 47 industries, and airlines tied for last place for the second consecutive year.

In the eyes of many customers, travel has become a burden, not the relaxing, stimulating, rewarding experience to which many travel providers aspire. According to a 2010 survey of over 1,000 global travelers, four of the top eight words most associated with travel were negative – such as “frustrating,” “unreliable,” “infuriating” and “broken.”⁷

In a price-focused environment, some companies get price premiums by employing an innovative marketing model.

Providers

The efficiency of booking travel on the Internet has led over the past decade to a rapid decline in travel distribution costs. But this cost revolution has not been an unmitigated success for providers. Although online travel transaction costs are getting closer to what economists call “frictionless pricing,” travel distribution is failing to meet the needs of many travel providers.

Previous IBM studies have revealed that while customers do perceive some differences in offerings, only a small number are willing to pay price premiums to purchase these “differentiated” products. In those studies, we chastened providers to address the challenges of undifferentiated products by altering the way they develop, market, and deliver products and services to consumers.⁸ We urged the entire process be organized around more narrowly defined customer segments and provided actionable suggestions for how providers can bring this new marketing model into view.

The challenge is that most non-provider-owned online channels make it all but impossible to effectively emphasize the differentiated features that make provider products and service unique in the market. Online travel agencies (OTAs) and other travel distribution intermediaries often depict price most prominently and display only the most basic information about provider services. This encourages a customer focus on price and is counterproductive for providers seeking to limit the bottom-line effects of further travel commoditization.

Of course, some industries that face similar challenges manage to get price premiums for their products and services by employing a completely different marketing model. Air New Zealand, for example, has been recognized by the industry for its innovative marketing efforts, in part because it effectively and consistently reinforces its differentiated services with multimedia tools and through its website.⁹ Too many travel providers view marketing expenditures as a mechanism to boost short-term sales, and too few see them as longer-term strategic investments that can consistently reinforce the differences among available products and services.

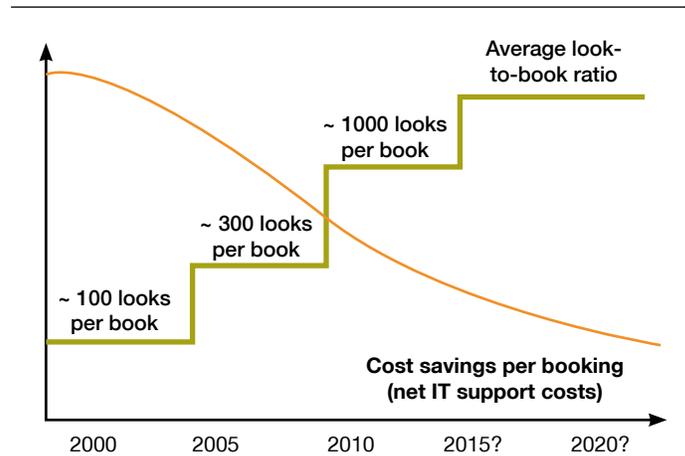
As providers begin to view marketing as a longer-term strategic investment, they will be challenged to decide which customer segments to “de-select” from their target investment list. Customers that place price above all other considerations will continue to be well served by comparison-based websites that enable them to see the products that fit their needs at the lowest possible price. It would be a poor investment to use marketing investment to pull them away from the lowest-cost options.

However, those travelers who value the differences offered by specific providers are ideal targets for investment. Customers with relatively high willingness to seek out the most convenient or most luxurious travel experience regardless of price offer the most promise for providers seeking to woo customers with differentiated messages.

Providers wrestle with increasing “look-to-book” costs

Provider websites remain an important tool for travel distribution. Well-developed sites help companies stand out from the crowded field of online travel distributors by presenting content in a meaningful, engaging manner. Unfortunately, while direct distribution has many distinct advantages, such as cost and content control, it also has frequently overlooked disadvantages.

As providers seek to promote their differentiated offerings, they must also contend with escalating costs – even in those channels they own. As they have become more successful in getting customers to book travel directly on their websites, they have seen a dramatic increase in the ratio of website “hits” to completed bookings. The ten-fold increase many providers have observed in the all-important “look-to-book ratio” is costly, however. Providers must scale websites to meet this dramatically higher level of traffic, even when the revenue generated through this channel is growing at a much slower rate.



Source: IBM Institute for Business Value analysis.

Figure 3: Over the past decade, direct distribution has been a boon for travel providers seeking to lower travel distribution costs. Increasingly, the cost associated with maintaining company websites is being driven up by a network of travel intermediaries, whose systems and solutions increase the volume of fruitless searches in online channels.

Ironically, one of the primary drivers of the rapid increase in look-to-book ratios is the proliferation of travel distribution intermediaries, whose sites are designed to look at inventory through provider websites, while bypassing GDSs. Travel providers who cannot control and limit such searches will continue to be exposed to the higher costs required to support increasing look-to-book ratios.

The proliferation of travel distribution intermediaries is a primary driver of increased “look-to-book” ratios.

Travel distributors

Over the past decade, despite the growth in the percentage of total travel purchases completed online, few distribution companies have met their expectations for financial return.

From the perspective of investors, only one major publicly traded online travel distribution company has met expectations over the past six years. And while that one distributor has indeed produced strong returns over that period, some analysts question whether its business model, which targets bargain hunters, will flourish in periods of economic growth.¹⁰ In any case, it is clear that competitors in this space have not been able to consistently deliver results that satisfy investors, as these stocks have not managed to beat returns generated by the S&P 500.¹¹

The relative under-performance in the travel distribution market continues to attract the attention of niche market players. While many new names in the travel distribution space, such as Hotwire, travel-ticker, and hotels.com, are actually sub-brands developed by larger OTAs (all of the aforementioned are from the Expedia family of brands), a host of new companies has entered the market the past several years.¹² Hotelpricer, Webjet, hipmunk, and dohop, for

example, are all companies that have emerged to fill specific markets perceived as underserved by the current set of market participants.¹³

Interestingly, new travel distribution entrants are not just confining their scope to the needs of narrowly defined segments. Several new players offer solutions they believe will appeal to unmet needs across broad swaths of the traveling public. Kayak.com, for example, hopes to continue its growth trajectory by providing more efficient and effective cross-site and cross-mode comparisons.¹⁴ Concierge.com hopes to revolutionize trip planning by re-introducing several travel agent-like services in an on-and off-line format.¹⁵

Of course, the largest and most disruptive development in travel distribution lies not with small entrants, but with the potentially disruptive effect of large players from other online domains. The full impact of Google's ITA Software acquisition to the travel distribution market is unknown. But the possibility exists for Google to combine its extensive marketing and customer information capabilities with a low-transaction-cost travel shopping and buying platform. If Google is also able to integrate such a travel offering with a mobile solution or device, the results could revolutionize travel distribution, fulfillment, and support.

The "swarm" model of distribution

Twenty-eight percent of travelers start their travel search with social media, travel opinion websites and general search engines. These provider-agnostic online properties could be the battleground of travel distribution in the years to come, as more and more providers and distributors vie to pull customers away from these sites to induce purchases on their own sites. This behavioral shift will challenge the sequential nature of both the "push" and "pull" models of travel distribution and give way to a "swarm" model whereby travelers engage in multiple, non-sequential interactions with many distributors across all aspects of the shopping, booking and travel process.

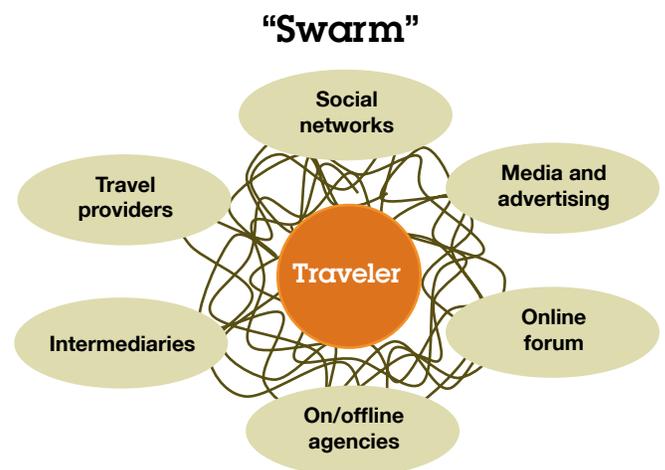
Finally the perennial pillar of the travel distribution ecosystem, the GDS, is also under pressure to change. In the next decade, GDSs may play a markedly different role in the travel distribution landscape. Shaped by the competitive pressures influencing other travel distribution companies, GDSs will continue to try to lock in long-term commitments with travel providers and offer difficult-to-replicate services to companies that want to improve their access to travel inventory via on- and off-line channels. GDSs will be pressured to bring innovative solutions to the presentation of enhanced provider content. However, going beyond simple search characteristics, such as price and availability, is counter to the simple search orientation that makes GDS systems so efficient. GDSs are not going away, but they will be reshaped over the next ten years to more affordably meet the needs of an increasingly demanding travel distribution community.

Rudimentary remedies: The travel ecosystem must learn to “play well with others”

With a new approach to the travel distribution landscape, members of the travel ecosystem have a unique opportunity to lead change across the industry. No segment can operate on its own and be successful over the next several years. Three initiatives, in particular, promise to deliver lasting benefits to the industry and its customers. Members of the travel ecosystem must align their selling models to match buyer behaviors, share data to form a more complete view of customers and collaborate in the delivery of travel services across the entire travel value chain. Implementing these initiatives will create the potential to fulfill the unmet needs of travelers for more integrated and seamless journeys.

Alignment – customers are becoming the center of the swarming travel “hive”

While customer buying behaviors have changed significantly in the past few years, travel distribution companies have not kept pace. In the pre-Internet era, travel distribution was largely guided by a push model of customer interaction whereby travel providers and travel agents would sell their offers to individual consumers. Then, the Internet empowered the most connected travelers and the push model gave way to a pull model of travel distribution. Over the next several years, the travel distribution model will change again, and only companies that more closely align themselves to customer’s needs and preferences are likely to succeed.



Source: IBM Institute for Business Value analysis.

Figure 4: The “swarm” distribution model places the customer in the center of a number of potential provider and distributor interactions.

The continued proliferation of social media and the rise of the “permanently connected” consumer are creating a buying model that places customers at the center of a hive of interactions – all of which have the potential to lead to a travel impression, decision or purchase. This new form of customer interaction breaks down the traditional boundaries that define the travel shopping and booking process and provides an environment in which customers can be influenced at almost any time by offers, ads, and suggestions about how to spend their precious travel dollars.

Traveler interactions must also be personalized. In our Hotels 2020 study, we uncovered a strong preference for personalized interaction.¹⁶ More important, we found that the companies that do not facilitate a personalized interaction are more likely to be punished with harsh reviews, lower customer satisfaction and limited customer loyalty.

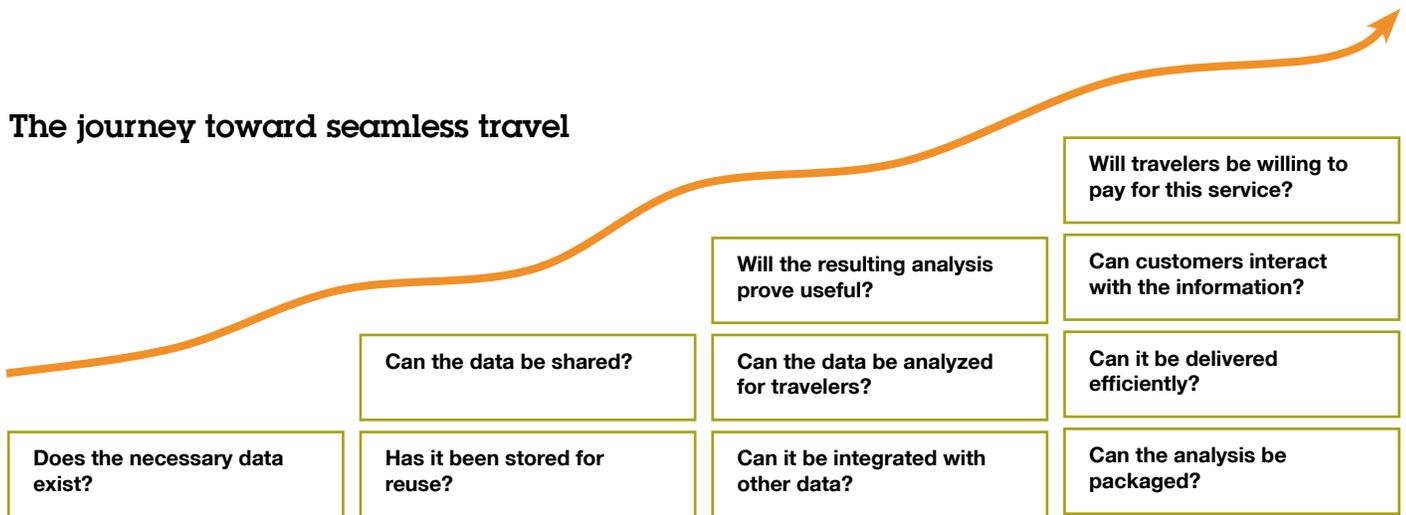
Effective personalization starts with the traveler experience online; it is not limited to interactions at the property or on the airplane. Online shoppers have come to expect that companies speed the process of selecting products and services that meet their needs based on their previous shopping and buying patterns. They also expect that interactions with companies will occur according to terms they accept and on devices they most prefer. Customers should be empowered to extensively customize their communication preferences and opt into and out of marketing and follow-on sales efforts.¹⁷ Customers could benefit, as well, from a provider that leverages booking pattern data and search history to distribute only flight options departing from their home city or deliver hotel promotions for destinations included in their future itineraries.

Shared perspective – cooperation provides complete view of the customer

In this new travel distribution model, companies will recognize that untargeted customer interactions, or interactions not informed by rich information about customers, their preferences and their context will be not only wasted, but will be potentially damaging. Interactions with travelers should be informed by the full complement of available data about their previous travel experiences, search objectives and shopping preferences. Of course, the full set of necessary customer data that will be used to facilitate this more robust and informed customer interaction is not currently contained in one company or travel provider network, so individual elements of the travel distribution ecosystem must learn to cooperate.

Travel providers typically have an opportunity to harvest traveler data that can be used to improve the delivery of service on the plane, at the property, on the way to the airport, etc., but they are generally not well positioned to understand the full set of services customer seek during an online travel search. OTAs and traditional travel agents, on the other hand, know what the customer’s full travel needs are, but are consistently ill-equipped to know about customer preferences as the travel experience unfolds. In other words, while each member of the travel ecosystem has unique and important data about how to best serve the customer, no one party can assemble a complete view on its own.

No single party in the travel distribution ecosystem can assemble a complete view of the customer on its own.



Source: IBM Institute for Business Value analysis.

Figure 5: To enable seamless travel, information aggregation and partner coordination must become top priorities in the travel industry.

Sharing data across the travel ecosystem will enable both providers and distributors to improve traveler interactions. This is not only an essential advancement for travelers, but it will position the travel ecosystem to reverse the negativity and outrage many travelers express about the current travel experience.

Collaboration – leveraging the wisdom of the crowd

Future travel distribution success turns on the ability of the ecosystem to unite forces on behalf of the customers to deliver not just better marketing and sales interactions, but also a better end-to-end experience. Customers value a more seamless travel experience and show a willingness to compensate any entity that can provide it. With technological advances, travel agents have been removed from the travel process for many travelers. However, the valuable post-booking services agents provided must be reinserted into the travel experience for the customers who most value such services.

Through collaboration across the travel ecosystem, the travel shopping and booking process can be integrated and made more efficient for the traveler. With shared data about customer patterns, purchases and preferences, providers and distributors can work to deliver more coordinated journeys. Finally, by coming together in the assessment and evaluation of the customers they serve, travel companies can leverage the wisdom of the crowd to develop more precisely targeted products, promotions and offers to attract and retain customers.

Figure 6 offers just a taste of the world to come. Travelers will seek the services of travel providers and distribution intermediaries who can deliver the end-to-end experiences they most desire.



Source: IBM Institute for Business Value analysis.

Figure 6: Even if seamless travel did not directly increase revenue, it is highly likely that the improved travel experience it affords would be a lasting source of brand strength.

Collectively, these changes amount to a revolution in the travel experience. With better more meaningful interactions with travelers and with journeys that are managed across the travel ecosystem, customers will enjoy an improved all-around service experience. Confederated networks of travel players can then begin to differentiate on the basis of the quality of journeys they collectively provide. At last, price premiums will flow from the features customers care most about, not from the easily replicable physical factors that garner so much attention today.

“Upgrade” financial performance by teaming with current rivals

In an industry defined by perceptions of commoditization among customers and intense competitive rivalry between market participants, the opportunity exists for antagonists to reach common ground. They can give customers what they have been longing for: travel distribution solutions that cater to their unique patterns and current position in the travel process. For those travel companies that wish to define the future of the industry and bring an innovative seamless experience to a weary population of travelers, the future is rich with opportunity. The main obstacles to success are sharing data with partners and cooperating with rivals to augment capabilities. To assess and address gaps in capabilities and begin charting a path to future success, travel executives can ask themselves the following questions:

Question to get started

- Which distribution channels are most/least effective?
- How does your travel distribution website compare to best-in-class websites?
- How do customers view travel distribution and fulfillment?
- Do current segmentation schemes match current and future needs?
- How can partner data be used to formulate a more robust view of customers?
- What capability gaps can partners fulfill more effectively?

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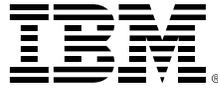
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