IBM Center for Applied Insights

Travel and Transportation

Capturing value from customer-centric sales and services

Deeper client understanding and more effective interaction in the airline industry

Introduction

For the past several years, airlines have been aggressively pursuing a dual strategy of cost reduction while increasing load factors, revenue and operating margins in their quest for profitability. This focus on operations has been very effective: from a global loss of US$16 billion in 2008, the industry realized US$16 billion in profits in 2010.[1] Yet, there are clear signs that these strategies are nearing the end of their usefulness. They have enabled the industry to cope with the highs and lows of economic cycles and increasing commoditization, but they are reaching the point of diminishing returns.

The reason is simple. Profitability has come at the expense of customer satisfaction. According to one survey, the air travel industry ranks 42nd out of 44 in customer satisfaction.[2] Moving forward, cost reductions will be harder to implement and are likely to have an even greater impact on customer satisfaction.

While this discouraging statistic highlights the impact of traditional approaches to achieving profitability, it also points to the way out of the dilemma. Clearly, airlines need to find a way to win back the favor of customers; those that do so sooner and more effectively will gain a clear competitive advantage in years to come. With few remaining areas of opportunity for operational savings and increased passenger density, airlines must find ways to compete based on quality. The ability to satisfy customers is now the key differentiator. Customers are saying "Know me, serve my needs and empower me with information. Don't just sell me."

Forward-thinking carriers are starting to act now to make the transition from emphasis on operational excellence to a strategy that is more focused on the customer. Future investments will be geared towards enabling airlines to play a greater role in the overall travel ecosystem and to deliver greater value to customers.

But what is the nature of those investments? More importantly, are they economically viable? To answer these questions, airlines need to both understand the necessary competencies and quantify the gains that investments in them can produce.

Research[3] suggests that the potential for return on investment (ROI) in this space is considerable. Moreover, these benefits scale readily across both carrier size and region. An illustrative top-20 carrier may realize annual benefits in the hundreds of millions in exchange for a remarkably small investment, with ROI topping 1000 percent in only a few years.

What's the overall potential?

Detailed modeling[3] of an illustrative global top-20 airline shows that over four years, a program of investment in multi-channel sales and services could yield:

- Total investment: US$34 million
- Total benefits: US$582 million
- Illustrative case four-year ROI: 1591%
- Payback: 16 months
- Discounted net cash flow: US$398 million in the fourth year

Figures based on financial modeling of an illustrative US$10 billion airline, assuming average operational maturity and investment in a full range of business competencies. Figures rounded for clarity.

Short-term success, long-term difficulties

In recent years, airlines have demonstrated great creativity in devising new ways to increase revenue. The unpopular baggage surcharge is one such move, as are change fees, cancellation fees and fuel surcharges. The list goes on and some airlines have taken the idea to an extreme: for example, one low-cost carrier made proposals in 2010 for standing-room tickets and pay toilets. While passengers may dislike them, surcharges have been very effective and accounted for 23 percent of global profits in 2010.[1]

Carriers have also aggressively pursued fundamental profit drivers such as load factors and operating costs. Consolidation and capacity rationalization have made the industry as a whole more efficient and in 2010, U.S. traffic increased 7.4 percent while capacity increased only 3.9 percent.[1] Revenue management and overbooking have kept load factors up, reaching an all-time high of 78.4 percent in 2010.[1] On the cost-reduction side, outsourcing, wage scale reduction, layoffs, pension obligation elimination and debt restructuring have been widely employed.

The focus has clearly been on operations – moving as many people, as inexpensively as possible. However, the limits are being reached. Collectively, these measures have had serious side effects, most notably in customer satisfaction. Surcharges erode customers' perception of value received for money spent. Not surprisingly, passengers tend to resent fees that cause inconvenience but do not provide any apparent benefit.

The travel experience, once valued, has become one that many passengers approach with a decidedly negative attitude. Crowding, overbooking and pervasive delays driven in large part by the airlines' own actions erode perceptions of service quality.

Customers are demanding to be treated better and respond well when they are. A company that can "make it right" when a problem occurs, for example, can actually increase loyalty. Some low-cost airlines have focused their corporate culture around this idea, training staff to be client-friendly and flexible. As a result, they have higher satisfaction rates and customer loyalty – a valuable and fast-disappearing asset – than traditional carriers.

Refocusing on the customer

The direction for the future is clear. Operational savings and increasing load factors are approaching their limits. Efforts to increase revenue are beginning to backfire and airlines need to shift the focus to making the trip better, not just more profitable. Carriers have to give customers reasons to want to fly with them.

Passengers today are sophisticated and demanding. They are aware that airlines can do a much better job. They expect convenient interactions at every level, anticipation of all their needs and, perhaps most importantly, for the airline to actually deliver on the promise of good service.

It's all about knowing and engaging with the customer, and being able to help passengers during the entire trip – even on the plane, or outside the airport boundary. Historically, airlines have been concerned only with the portion of the journey for which they are directly responsible. For the passenger, however, a trip starts with planning and doesn't end until they arrive at their final destination. A better overall travel experience can create a deeper emotional connection to the airline and drive long-term loyalty.

There are four ways in which airlines can refocus their strategy to serve customers better. These are key value drivers that can be used to gauge the effectiveness of investments in a customer-centric strategy:

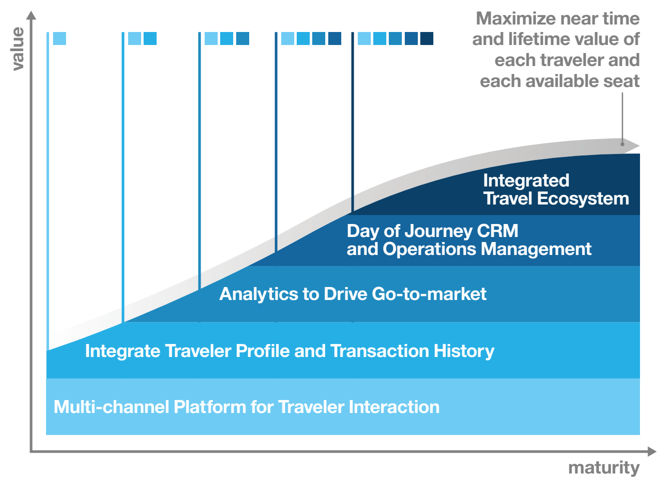
- **Create perceived value** with services that feel like perks, not penalties – for example, better meal choices based on preference, or seamless and convenient service via whatever channel the customer wishes including phone, email, text, web or personal interactions with agents.
- Use a deeper knowledge of the customer to **deliver a better overall experience**. By anticipating needs, understanding what passengers are going through and getting the basics right, airlines can impress their customers with a high level of attentiveness and care.
- **Expand the airline's role** and engagement with the customer and generate loyalty by helping to make the entire journey – not just the flight – more convenient and pleasant.
- Pursue technology-related **productivity improvements** such as self-service and mobile check-in systems that reduce staff workloads. Put measures in place that can improve perceptions of value while saving money.

When considering how to achieve these goals, it should be recognized that there is a high degree of leverage possible. Relatively small investments in technology can make big differences in customer perception. The key is to target competencies that drive a deeper understanding of customers and the airline's interaction with them.

Transforming the travel experience

The competencies needed to support a robust end-to-end customer-centric engagement strategy are clear, as shown in Figure 1. They mark a continuous and interconnected path of improvement in the ability to drive a better customer experience – and through it, increased satisfaction, loyalty and revenue. The first steps put the means in place to understand the customer and deliver services more effectively. Subsequent investments leverage real-time information and connectivity to transform the travel experience.

The path to customer-centric sales and services



Consistently capture the traveler's history and profile and deliver information and services to travelers using multiple channels

Make a single view of the traveler available to the entire enterprise across all processes

Personalize proactive marketing, promotions, and services, deepening the traveler's experience and increasing loyalty and wallet share

Empower the traveler with real-time updates, proactive communications and choices before, during and after the journey to minimize worry and enable positive experiences

Deliver continuous information to travelers to enable end-to-end, multi-modal journeys that are interconnected and seamless

Figure 1: The roadmap of competency development that enables the delivery of a better travel experience. With each step, the airline becomes more customer-focused.

Across the industry, efforts have been made to implement parts of the roadmap, often with several initiatives running in parallel at any given carrier. However, the goal of a fully realized, cohesive and integrated set of competencies has remained elusive. Many airlines, for example, have implemented new interaction channels, but struggle with information integration and are having difficulty creating a single view of the customer.

It is important to understand the interdependent nature of the journey towards creating a better travel experience. Putting new channels in place and making information available is critical, but by itself, it is not enough. Moving beyond investments in these first, foundational steps to leverage the information they produce can help maximize their value and accelerate the financial return.

The first step is to create a robust, **multi-channel platform for traveler interaction** that can both deliver services and capture information, seamlessly across all channels. Parts of this platform are in place, with varying degrees of sophistication, at most airlines; examples include web portals, smart phone apps, kiosks, technology-enabled roving agents, and text alerts. The goal is to provide anytime, anywhere access for passengers, making it both more convenient and natural to interact with the airline at every touchpoint.

For an airline to transform the way it deals with passengers, it is essential to **integrate traveler profiles and transaction histories** across the enterprise, remember all interactions and create a 360-degree view of the customer. This is the cornerstone of a better travel experience; gaining a complete view makes it possible for the airline to build stronger relationships with passengers and treat them as individuals. Yet, there are significant obstacles. Legacy systems tend to break the customer relationship into disconnected silos. At the same time, they continue to perform their functions well and serve fundamental business needs, so it makes little economic sense to incur the high cost of outright replacement. It is necessary to find ways to bridge this gap and integrate new competencies with existing systems.

How we put a value on "smart"

The information and projections contained in this paper are based on research conducted by the IBM Center for Applied Insights among airline leaders around the world. Case studies of 14 airlines were conducted to estimate potential benefits, along with one-on-one interviews with executives from the top 25 airlines around the world and 30 subject matter experts. The team supplemented this primary research with data from academic resources, industry publications and direct engagement with top researchers.

The model for smarter travel investment that emerged from this research, along with the hypothetical value projections, is designed to help airlines gauge their potential returns from their own, similar investments. The model can be scaled for different industry segments and maturity profiles to help produce individually tailored assessments and estimates applicable to your organization.

Once a comprehensive view of the customer has been achieved, the airline can begin to leverage that information to create value. Applying **analytics** to passenger and travel information marks the shift from data to actionable information, enabling greater personalization and relevancy. The airline can learn to anticipate customers' behaviour and their needs, using that insight to be proactive. For example, if a given flight is overbooked in coach, passengers whose profiles suggest they are most likely to be interested in paying for a business-class seat can be targeted for upsell.

Day-of-journey service can have a significant impact on the customer experience and marks the shift from being a travel provider to a true travel partner that assists the passenger during the trip. Customers want the airline to be there when and where they need assistance, with helpful answers to immediate needs. When faced with weather issues, for example, an airline can deliver immediate and detailed status updates instead of simply posting a "delayed" notice on the departure board. Or, should a long delay occur, the airline can rebook a flight in accordance with known preferences, without the customer having to ask. The key is action based on real-time awareness. When customers know what's happening, what to expect and feel cared for, they are much more satisfied.

Developing an **integrated travel ecosystem** leverages earlier investments and industry partnerships. This strategy positions the airline as a trusted companion and provider for every aspect of the trip, resulting in stronger customer connections and brand loyalty. The goal is to help manage the entire journey in every respect – before, during and after the flight. This requires a shift in focus from the specific leg of the trip to the whole travel experience. It's about service to the

Potential benefit across competencies

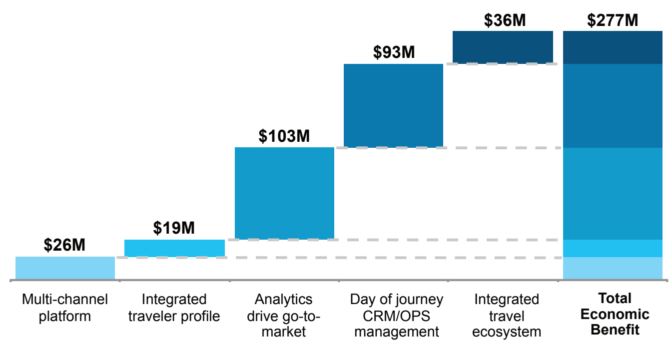


Figure 2: The aggregated benefit of investment, by competency. The potential for gain increases as more advanced competencies are put in place.

traveler at every step: from planning and booking, to ground transportation, to the experience at the airport, on the plane, all the way through to the final destination… and back. For example, an airline can work with parking providers to give its customers preferred lot spaces. Or it can partner with governments to streamline border passage by using technologies such as biometrics. The highly successful Privium program in use at Amsterdam's Schiphol Airport is one such system and is now being adapted for use in the U.S.

When considering how to develop these competencies, it should be understood that investments can be made in parallel while taking advantage of existing initiatives. As shown in Figure 2, however, significant benefit can be created as more advanced competencies start to build on those implemented earlier along the investment path.

How a customer-centric strategy can pay off

To answer the question of which investments should be prioritized, it is useful to quantify exactly how each new competency can contribute to overall economic benefit. An airline may make an investment in a traveller interaction platform or analytics, for example, but how do those investments translate into impact on the business? What do they allow the airline to do for customers and more importantly, what's the potential financial gain?

Gauging economic return according to key value drivers provides an alternate view of potential benefits that can help the airline optimize its spending strategy. To this end, an illustrative top-20 global airline was modeled,[3] assuming investment across the complete range of competencies. The potential economic benefits were then mapped against the four core value drivers described earlier: **creating value, delivering a better experience, expanding the airline's role and improving productivity**.

The results are shown in Figure 3. Of particular note is that, for the expected steady-state annual financial benefit of US$277 million after four years, the majority of benefit– 87 percent– comes from investments that make life easier for the customer. This can result in increased preference to do business with the airline, as well as willingness to pay more for its services.

Potential benefit by value driver

US$277 million[4]

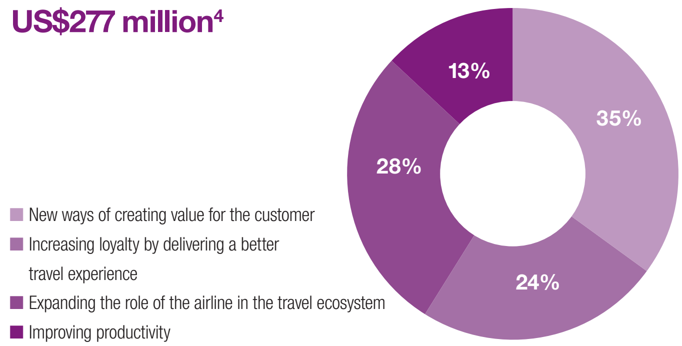


Figure 3: The contribution to overall economic benefit that can be expected according to core value drivers.

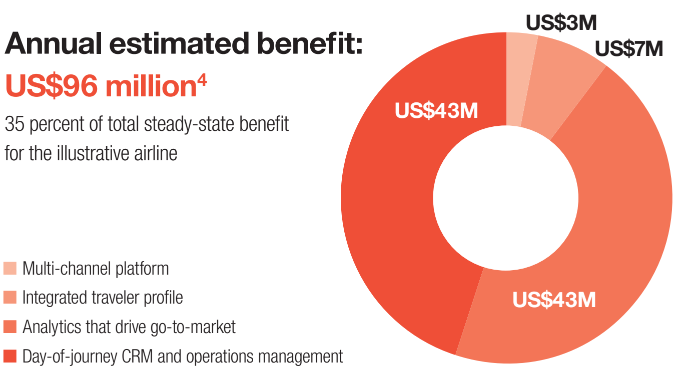
It is important to recognize that investment in any given competency can have a far-reaching impact and address more than one business need. For example, creating an integrated multi-channel traveller interaction platform can be a true differentiator. But why? Modeling of the illustrative airline shows that its benefit extends across multiple value drivers. It helps create new value for the customer, delivers a better travel experience and also drives productivity improvements.

New ways of creating value for the customer

This is where the greatest potential for economic benefit lies. Within this category, much of the gain comes from investments that leverage information to increase business agility. An airline that uses what it knows about customers and their circumstances is better able to act more quickly and effectively to meet their needs – offering services that both profit the airline and enhance the passenger's trip.

Annual estimated benefit: US$96 million[4]

35 percent of total steady-state benefit for the illustrative airline



Figures rounded for clarity.

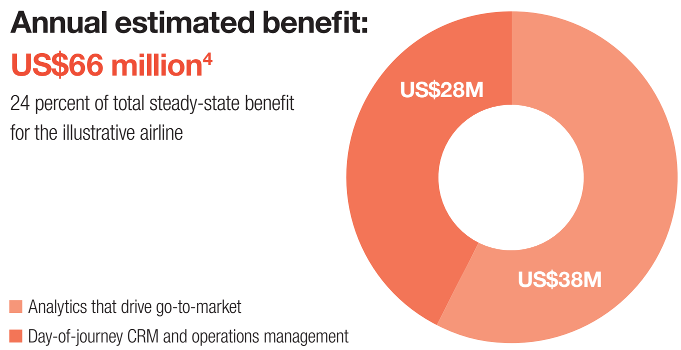
For example, British Airways has implemented a powerful business rules management system that allows it to offer customized ticket upgrade offers in real time. The system uses customer profile and booking information to automatically decide whether a particular ticket should be eligible for a special upgrade, and at what price. The system is so flexible that eligibility rules can be introduced as soon as the need arises, even allowing specific flights on specific days to be targeted. The result: 200,000 additional upgrades generated during the first year. The airline was able to both boost revenues and create greater value for customers by offering them better seats for less than they would normally have to pay.[5] It's a textbook example of a good deal, where both sides come out ahead.

Increasing loyalty by delivering a better travel experience

Airlines' low approval ratings are directly tied to the treatment passengers receive. An airline that "does the right thing" can recover and even improve loyalty in the face of adverse events. For example, seeing to it that passengers are compensated on the spot for damaged luggage can generate considerable goodwill.

Annual estimated benefit: US$66 million[4]

24 percent of total steady-state benefit for the illustrative airline



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Analytics-driven insight and real-time experience management represent major opportunities here. An airline that can get ahead of customers and know what they will need even before they do can do a great deal to bolster its reputation. A better travel experience is all about making it easier for the customer to get to where they're going.

Air Canada has delivered customer convenience, with a number of initiatives including access to real-time travel information via mobile devices, which the airline sees as always-on travel companions that can enable passengers to connect to the airline where and when they want. Its mobile application is a gateway to a broad array of information and services. Customers can book flights, download electronic boarding passes, check in, get flight status and book rental cars, as well as access other travel services. The application has proven wildly popular, with over 30,000 downloads from 47 countries in its first six days. This shows the high customer demand for offerings that increase convenience. Passengers naturally gravitate towards airlines that make the effort to facilitate easier travel.[6]

Improving productivity

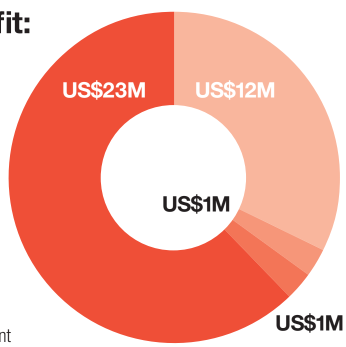
The greater the level of automation and passenger involvement in operations, the lower the operational cost for the airline. Having customers do more of the work associated with booking, ticketing and check-in can also have a fortunate side-effect: it can actually improve the customer experience by making interactions smoother, simpler and faster. After all, no passenger likes to wait in line.

Expanding the role of the airline in the travel ecosystem

The primary contributor to this value driver is the creation of an integrated travel ecosystem. By enabling airlines to expand their reach far beyond traditional boundaries, this new partnership model promises to become a key differentiator.

Annual estimated benefit: US$37 million[4]

13 percent of total steady-state benefit for the illustrative airline

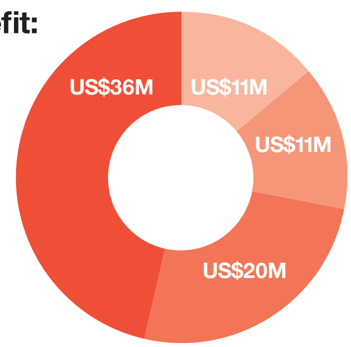


- Multi-channel platform
- Integrated traveler profile
- Analytics that drive go-to-market
- Day-of-journey CRM and operations management

Figures rounded for clarity.

Annual estimated benefit: US$78 million[4]

28 percent of total steady-state benefit for the illustrative airline



- Multi-channel platform
- Integrated traveler profile
- Analytics that drive go-to-market
- Integrated travel ecosystem

Figures rounded for clarity.

Here, too, Air Canada has taken a leadership position, achieving significant gains in productivity by making self-service innovation an important part of its strategy. Through a number of industry firsts such as off-airport kiosks, it has achieved an 80 percent reduction in check-in costs compared to the traditional counter process. The same investments have also paid off in other ways. New services and channels are now launched in half the time through the re-use of existing service assets. Customer service is now more efficient and of higher quality because agents can devote more attention to important issues instead of routine requests. And customer loyalty has increased through more compelling and engaging self-service options that make passengers want to help themselves.[6]

It should be understood that the integrated travel ecosystem complements earlier investments. The airline expands its role by leveraging the full range of interaction platforms, customer insight and analytics, in addition to integration of the value chain. Real-time information is gathered from across the value chain – for example from ground transport companies, or hotels or the web via intelligent agents. The airline has an understanding of the location of the customer throughout the trip and also can learn a great deal about his or her preferences. An integrated view of both the passenger and the entire journey can be created, constantly monitored and communicated to all travel partners.

Bringing all of this information, connectivity, and ability to act together is what enables the airline to become much more than the company that provides a single part of the travel experience – the flight. By combining knowledge of the customer and the trip with the capabilities of the entire travel ecosystem, the airline can become a trusted, valued travel advisor and companion.

Large returns on small investments

What's striking for the airline industry is how cost-effective investments in smarter travel can be. As shown in Figure 4, for the illustrative airline a positive cash flow could be achieved after only two years. Once the ongoing cost is stabilized, the benefits can continue to accelerate quickly.

Assuming a two-year investment strategy, annual benefits for the illustrative airline could reach US$277 million after four years, with an ongoing cost of US$6 million. The total accumulated investment over the first four years could be US$34 million. That represents a four-year ROI of nearly 1,600 percent.

This potential for high return on investment is, perhaps, the most compelling reason to adopt a more customer-centric strategy. Not only is investment in new competencies highly differentiating for the airline, it can represent relatively low financial burden and business risk. The payoff could be considerable, both in direct financial terms and in positioning the business to be more competitive.

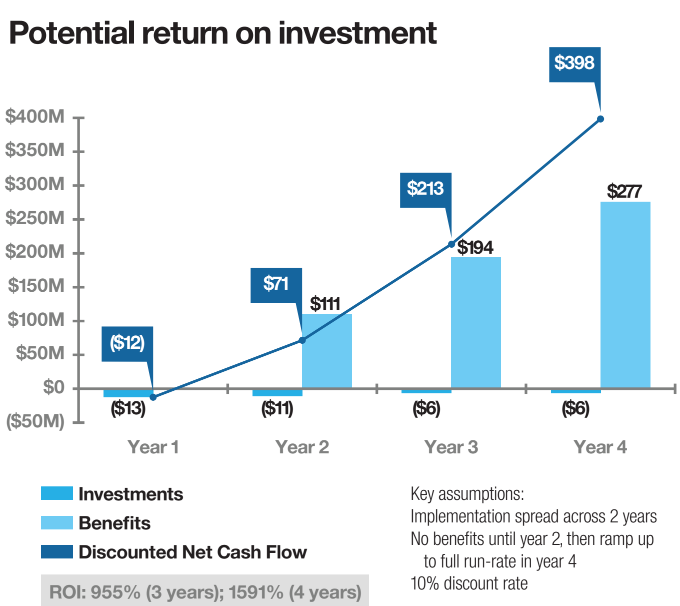


Figure 4: The potential ROI of smarter travel can be considerable, with benefit realization coinciding with the completion of investment.

Can we help you get started?

The kinds of transformational competencies discussed here represent a critical opportunity for the airline industry. With the unrelenting focus on operational savings yielding less and less competitive advantage, becoming an industry leader tomorrow depends on the actions taken today.

Airlines have widely differing needs and resources, and a number of initiatives to develop the competencies shown here are already under way across the industry. Your own situation is unique, and so are the investments you need to make and the benefits you can expect to achieve.

The same research methodology that lies behind this paper can be applied to your company, helping you to model potential benefits of transformation and helping you chart the course to get there. If you would like to continue the conversation about how and where you can start, we invite you to contact one of the authors.

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About the IBM Center for Applied Insights

The IBM Center for Applied Insights integrates deep industry and analytical expertise to help chart the course to new value for clients. The Center develops research and tools with pragmatic guidance and tangible outcomes to provoke organizations to action.

[1] International Air Transport Association Statistics. http://www.iata.org.

[2] The American Customer Satisfaction Index, University of Michigan, 2010.

[3] The model used for the financial results cited in this paper is highly dynamic and customizable, and makes a number of assumptions about the illustrative company including overall maturity and investments made. The modelling methodology is based on extensive primary and secondary research including interviews and data from more than 100 industry and academic sources. Individual results for other organization profiles will vary and the model can be tailored to accurately reflect individual circumstances.

[4] Results based on modelling of an illustrative US$10 billion global airline. Investment in the full range of competencies is assumed. Figures rounded for clarity.

[5] Buchanan, Richard, IBM Business Rules Lead Architect. Presentation notes from IBM ILOG® La Gaude "Smarter Decisions for a Smarter Planet" event. November 26, 2009.

[6] "Air Canada: Extending customer self-service beyond the airport." IBM smarter planet case study. http://www-01.ibm.com/software/success/cssdb.nsf/CS/GMMY-85CG9W.

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