



ANTICIPATED ACQUISITION BY SABRE CORPORATION OF FARELOGIX INC (CASE ME/6806/19)

Response to the provisional findings

1. Introduction

- 1.1. Aviation and Competition Law Research ("**ACLR**") is a Vienna based private and independent research organisation that focuses on research and knowledge transfer in the field of Competition Law in the aviation industry.
- 1.2. ACLR welcomes both the thorough investigation by the Competition and Markets Authority ("**CMA**") into the *Sabre/Farelogix* merger and the responses and hearings of other market participants. ACLR's objective in the present case is to contribute to an improvement of the distribution policy in the aviation industry by providing assessments which ultimately benefit (i) consumers, (ii) airlines, (iii) travel agents, (iv) technology and software providers to the global travel industry and (v) other market participants.

2. Market environment

- 2.1. The distribution policy of the aviation industry is characterized by a multitude of different distribution forms which – due to technical, regulatory and economic restrictions of the global aviation market – have taken on unique forms over time. Indirect distribution through intermediaries, such as global distribution systems ("**GDS**"), still plays an important role in the distribution policy of airlines. Due to the dependencies between airlines and individual intermediaries, which are characteristic of the air transport industry, indirect distribution has grown organically over decades and has proven to be a reliable form of distribution. On the other hand, it can be noted that new types of distribution channels are emerging in the course of progressive digitalisation. Both direct sales by airlines ("**airlines.com**") and distribution via New Distribution Capability ("**NDC**") have led to innovations in the market for the distribution of airline tickets in recent years. ACLR believes that the following market parameters are important for the future distribution of airline tickets:
- 2.2. **(a) The role of standardisation of distribution processes in the aviation industry:**
As already mentioned by the CMA in its reference decision¹, NDC is to replace the old EDIFACT standard (and associated restrictions on distribution) with the new XML standard. The more flexible XML standard now also allows for differentiated travel service offerings in indirect sales, which means that airlines can now extend their tailor-made flight, seat, baggage or menu offerings ("**À-la-carte-pricing**") from their own direct sales to indirect sales, thus enabling a more diversified distribution policy. Standardization is generally viewed positively under Competition Law, especially if –

¹ CMA, decision on reference under section 33(1) of the Enterprise Act 2002 given on 16 August 2019, ME/6806/19, paras 39 & 61.



as in the case of NDC – the standard is open to third parties (such as intermediaries or IT providers) for implementation and use, which is why a market foreclosure effect cannot be assumed.²

- 2.3. **(b) Consumer benefits in connection with À-la-carte-pricing:** With the emergence of the business model of low-cost carriers, additional revenues have become increasingly important in recent years. Meanwhile, even large legacy carriers are increasingly introducing À-la-carte-pricing. However, the travel industry (mainly travel agents) takes a critical view of À-la-carte-pricing and argues that in future, due to differentiation, the travel services offered by an airline will be difficult to compare with those of competitors.³ This could – at least in theory – lead to a reduction in price transparency in the markets and ultimately to a reduction in competition. From an economic perspective, however, such price differentiation must be viewed in a differentiated manner. Thus, perfect price differentiation (first degree price discrimination) can, at least under certain conditions, also lead to a better supply of people with the goods and services they demand.⁴ Whether consumers show lower or higher price elasticity in an airline's À-la-carte-pricing vis-à-vis the GDSs, and whether consumers rate the benefits of À-la-carte-pricing as low or high, depends on the specific design of the respective pricing model.⁵ From our point of view, therefore, À-la-carte-pricing can in principle (also from the consumer's point of view) be an alternative to the one-dimensional distribution of airline tickets via GDSs. From a regulatory and Competition Law perspective, market conditions should therefore allow airlines (in cooperation with, for example, IT service providers) to develop and improve novel forms of distribution via NDC.
- 2.4. **(c) Imbalance in the aviation supply chain:** The distribution in the aviation industry still shows very strong imbalances between the various market players. In general, it is primarily the airlines that generate value for the supply chain. In this sense, the highest returns in the air transport supply chain are generated in the distribution sector. GDSs earn an average return on invested capital ("**ROIC**") of 20%, double their 10-11% cost

² For fundamentally positive effects of industry standards in Competition law, see in more detail: *Burgui/Enriquez* in *Wijckmans/Tuytschaever*, Horizontal Agreements and Cartels in EU Competition Law (2015) para 10.62-10.93; *Aitken/Chapman* in *Bellamy & Child*, European Union Law of Competition, Eighth Edition (2018) para 6.090-6.105; *Schellingerhout*, Standard-setting from a competition law perspective, Competition Policy Newsletter 2011, Number 1.

³ See ECTAA, Open letter: Airlines' surcharges and other discrimination against neutral independent distribution threaten transparency and consumer choice (19 June 2017).

⁴ OECD, Personalised Pricing in the Digital Era – Background Note by the Secretariat, 28 November 2018; *McSweeney/O'Dea*, The Implications of Algorithmic Pricing, Antitrust, Vol 32, No1, Fall 2017, 75; *Collins/Eatrides*, An Analysis of the Proposal to Decriminalize the Anti-competitive Pricing Practices Under the Competition Act, World Competition Law and Economics Review; *Niels/Jenkins/Kavanagh*, Economics for Competition Lawyers, 2nd Edition 2016, 4.80-4.94; *Locher*, Verschiedene Preise für gleiche Produkte? Personalisierte Preise und Scoring aus ökonomischer Sicht, ZWeR 2018, 292-316 (in German).

⁵ *Granados/Kauffman/Lai/Lin*, À la carte pricing and price elasticity of demand in air travel, Decision Support Systems 2012, 381; *Robbert/Roth*, The importance of transparency signals in a la carte pricing, J Revenue Pricing Manag 2018, 32.



of capital ("WACC").⁶ In comparison, the airline sector with an ROIC of 4% earns the lowest return on capital, yet faces the second highest volatility of returns or risk.⁷ Although this uneven distribution of ROIC within the supply chain does not necessarily point to anti-competitive effects, we nevertheless believe that it would in any case be pro-competitive if there were a more balanced distribution of opportunities and risks within the supply chain. For this reason, both direct sales by the airlines and indirect sales via NDC can be a suitable way of minimising the imbalances in the long term.

- 2.5. **(d) Innovation in the field of novel distribution solutions:** The importance of GDSs for competition lies mainly in the indirect network effects resulting from the fact that the more airlines involved, the more attractive GDSs become for travel agents. As virtually all airlines (except a few low-cost carriers) subscribe to GDSs, GDS-operators create added value for their subscribers by enabling an effective allocation of travel services through positive network effects in terms of booking volumes.⁸ Despite this, in recent years there has been a growing debate as to whether GDSs are still an effective way of distributing airline tickets in times of increasing digitalisation and changing customer preferences.⁹ Compared to other industries, such as the book industry, disintermediation in airline ticket distribution has come relatively late, with the advent of Direct Connect in 2011 and IATA's NDC Resolution in 2012.¹⁰ Although it cannot be inferred that GDSs, by adhering to their business model, have inhibited innovation in this area, it is nevertheless evident that the major innovation cycles in the field of airline ticket distribution have been initiated by external factors (Direct Connect, NDC, One Order etc.) rather than by the GDSs themselves. This causality also corresponds to the prevailing view in the scientific literature on distribution in the aviation industry, because GDSs and airlines have fundamentally different interests with regard to their business models. While GDSs want to make the airline offers for the travel agents as comparable and simple as possible, the airlines want to differentiate their offers as much as possible. Although what has been said does not explicitly imply that GDSs have an incentive to inhibit innovation in the area of new types of distribution (such as NDCs), we believe that it cannot be denied that the cooperation between airlines and innovative IT service providers (such as Farelogix) has created competitive pressure on GDSs.

⁶ IATA Economic Briefing No 10 (conducted by McKinsey & Company), Profitability and the air transport value chain (Data from 2013; however, this trend was confirmed by more recent data from 2018, for which IATA will soon publish an updated report); IATA Economic, New study on airline investor returns, 7. February 2020.

⁷ Ibid.

⁸ European Commission, 21.8.2007, COMP/M.4523, paras 12-21 - *Travelport/Worldspan*.

⁹ *Bingemer*, Back to the future with IATA NDC? Critical turning points in the history of airline distribution, *Journal of Tourism Futures* 2018, 206; *Gnutzmann/Spiewanowski*, Did the Lufthansa group GDS surcharge stimulate direct online sales? A causal analysis, e-Review of Tourism Research 2016, pp 1-6.

¹⁰ *Bingemer*, Back to the future with IATA NDC? Critical turning points in the history of airline distribution, *Journal of Tourism Futures* 2018, 210-211.



3. **Implications for the Sabre/Farelogix merger**

- 3.1. ACLR does not wish to influence the final decision in the *Sabre/Farelogix* merger in any way, but merely sets out what criteria we consider to be important for effective competition in the distribution of airline tickets. In our opinion, the following two market parameters are particularly important:
- 3.2. **(a) Diversity of different distribution models:** With the expansion of direct distribution channels by the airlines, which has been made possible by progressive digitalisation, numerous new types of distribution models – as an alternative to traditional distribution via GDS – have emerged. In our opinion, this expansion of alternative distribution models (including, for example, NDC) has resulted in pro-competitive effects on the relevant markets. The oligopolistic market position of the GDSs has been (and is being) countered by strong competitive forces. Ultimately, this also benefits consumers, as they have a greater choice of booking options – according to their preferences – and (possibly) are exposed to lower distribution costs. From a competition policy perspective, we therefore believe that it should be ensured in future that the diversity of different distribution models can be maintained and further expanded. Within the framework of workable competition, efficient distribution models can thus prevail in the long term and possibly increase overall welfare as a result.
- 3.3. **(b) Innovation:** In recent years, there has been an increase in innovation in the market for the distribution of airline tickets, primarily driven by airlines and specialised IT companies (such as Farelogix). As part of these innovation processes, a large number of new types of distribution solutions have been developed, some of which have led to efficiency gains. Compared with other industries (such as traditional e-commerce), innovation processes in the distribution of air travel services started relatively late and in some cases lagged far behind their technical possibilities. From a competition policy perspective, we therefore believe that it is particularly important to ensure that optimal market conditions for innovation processes are also made possible in the future.

4. **Conclusion**

- 4.1. Distribution policy in the aviation industry is undergoing fundamental change. From distribution structures that have grown over decades to distribution channels shaped by the internet economy and business models linked to them. Consumers could benefit from these new and potentially more efficient distribution channels. Disintermediation can reduce distribution costs and these reductions can be passed on to consumers in the form of cheaper airline tickets. In particular, NDC's open source character allows more new companies to enter the market and spark innovation. From a competition policy perspective, we believe that care should be taken to keep market access open for further innovations.