

A Work Project, presented as part of the requirements for the Award of a Master Degree in Management from the NOVA – School of Business and Economics.

“The development of a Sales Channel Strategy Framework for Lufthansa German Airlines in the Portuguese Market”

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LIST OF ABBREVIATIONS

LH	Lufthansa German Airlines
OTA	Online Travel Agency
VFR	Visiting Family and Relatives
SME	Small and Medium Enterprise
SOD	Service Outputs Demanded
SOS	Service Outputs Supplied
Cpn	Coupon
Pax	Passenger
YQ	Fuel Surcharge
GDS	Global Distribution System
AIP	Agency Incentive Program
CIP	Corporate Incentive Program

**“The development of a Sales Channel Strategy Framework for Lufthansa German
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Abstract

This paper explores the sales channel strategy of a major European passenger airline in the Portuguese market and gives implications to optimize the channel structure. Research was conducted to segment the airline’s customers according to service outputs demanded of each channel, and to further outline potential demand-side gaps and supply-side gaps within the current channel design. Results imply that offering personalized fares that are directly linked to the customers via the airlines corporate website, supports the satisfaction of their needs, reduces costs for the airline and brings with it the possibility to provide them with ancillary products.

Keywords: Airline Sales Channel Strategy, Airline Distribution, Lufthansa, Portugal

1. Introduction

“Control of distribution channels is one of the most powerful drivers of profits in any industry, and this is especially the case in the airline business.” (Shaw 2011, 219)

Nowadays, it appears that none of the players connected to airline distribution is content with the current situation. On one side customers are frustrated with the difficulties, complications and a lack of transparency in the booking process. On the other side, airlines struggle to differentiate themselves to intermediaries and end-customers in order to not being perceived as substitutable products. Even the travel agents and retailers are afraid the airline could bypass them to directly target their end-customers through disintermediation.

The aim of the underlying work project is the development of a sales channel strategy framework for Lufthansa German Airlines (LH) in the Portuguese market and to provide recommendations for the airline in order to achieve the goal of maximizing the bookings value by eventually satisfying the end-customer.

This framework consists of four major parts. Firstly, the customer will be analyzed to segment the Portuguese market in regards to the customers' needs and demands. In the following, the channel analysis aims at evaluating the purpose of the sales organization of LH in Portugal, inspecting the current design of the channel including its members and performance. The third part further analyzes which of the customer demands are not satisfied and outlines the major supply-side gaps in LH's sales channels. In order to optimize the cooperation within the sales channel successfully the last part focuses on the adequate closing of the gaps that arise from the demand-side and the supply side. (Palmatier et al. 2015, 87).

In order to meet its customers' demands, LH has to connect travel agents and customers directly to the company. Due to the market conditions and the booking behavior of end-customers in Portugal this should be achieved through binding the the customer without going through the agent and binding the agent without going through the GDS

2. Methodology

With regard to generating a purposeful research and increasing the stability of the results the underlying analysis focuses on the passenger airline LH and its distribution strategy in the Portuguese market exclusively. In order to gain thorough insight on LH and its strategy in the Portuguese market, to detect current conflicts and gaps, as well as develop relevant recommendations the underlying research was based on three different methods: industry insights and primary research.

As part of the primary data collection, exploratory research¹ was used as the main source of information, including expert interviews, observations and data analyses.

The interviews with employees and management experts from LH provided the groundwork and the initial starting point from where further analysis tools were generated. Twelve in-depth interviews with travel agents, LH's customers and employees were conducted in order to get a holistic view on the current situation and to gather helpful insights on customer satisfaction, purchasing habits, and customer brand perception.

The first and second part of the work project draws from primary data collection and analysis and also intends to apply the theoretical frameworks, gathered through intensive external and internal data research, to the current retail and distribution environment as well as subsequent challenges faced by LH in Portugal. In the third part of the report, the findings generated through primary and secondary research are applied in order to give relevant and valuable recommendations to the company regarding its distribution strategy.

3. Segmentation of the Portuguese Market

As stated by Abacus Internationals divisions head of airline distribution, Hoong Mau, "(...) it is not about one channel that is right or wrong, but a mix of channels that airlines must be able to influence to succeed. The better airlines know their customers, the better they are able

¹ Research was conducted as part of the author's internship in the Sales and Distribution Organization of Lufthansa German Airlines in *Avenida da Liberdade*, Lisbon, in the time frame of February until June 2016

to make informed product and marketing decisions” (Gupta 2012, 73)

As part of the underlying analysis, segmentation is essential because the adjustment of a distribution channel strategy to a selected amount of potential end-customers is more effective and allows the generation of more profit than targeting a very broad group of customers.

The passenger airline market in Portugal is highly competitive, especially nowadays with the uprising threats of Low Cost Airlines and Gulf-based Airlines² that compete against LH. This is why targeting the right customers, through the right channels at the right time in Portugal is more important than ever. LH has to understand their customers in order to successfully meet their needs. Even though the product itself remains constant in the passenger airline market, the market can be divided into different segments, reflecting different needs and priorities that will respond differently to different marketing actions. Only if these segments are fully understood the design and implementation of the strategies will be most effective.

The segmentation of a market can be achieved through a variety of forms. This work project will focus on the service outputs (Exhibit 1) that each customer expects out of the distribution channel. In addition, determining the service outputs will support the understanding of customer purchase preferences and needs besides the product and price characteristics. The detailed segmentation gives LH a broader understanding of its market and is able to support decisions concerning on where to put the focus of its strategy. In order to guarantee accurate segmentation and targeting, the identification of the customer is essential. In the analysis the *corporate customer* and the *leisure customer* will be differentiated including their subdivisions.

3.1. Corporate Customers

Corporate customers guarantee higher yield³, higher share on intercontinental routes and higher usage of First or Business class compartment. As we can examine in Exhibit 3 the total

² Euromonitor has identified the competition through low cost airlines in Europe and large international airlines like the Gulf-based airlines to be LH's most serious threats.

³ For detailed explanation of the importance of high-yield for LH see Exhibit 2

corporate revenue share for LH in Portugal is 26% and they book and buy their flight tickets via travel agents, online portals or directly with the airline. (Brighton, *Interview*)

Corporate Customers may show some typical characteristics which need to be considered when determining their demands: Firstly, a corporate customers' flight characteristic may follow a certain pattern, i.e.: periodical or seasonal activities or certain destinations. Secondly, corporate travel policy may stipulate the class of service to be used for booking flights for domestic, continental and intercontinental services.

Due to the high concentration of the business travel market, corporate customers in Portugal give high importance to comparing airlines and their offers. They represent a more loyal customer base, which is a great opportunity for LH. Once LH has attracted these customers they have a strong potential to maintain their loyalty over a long time. For LH in Portugal two types of corporate customers can be differentiated.

3.1.1. Small and Medium Enterprises

The small and medium enterprises (SMEs), are small companies under the threshold of 50.000 Euro generated revenue for LH per year. LH manages over six hundred SME's in their portfolio which consist of an average of two to three employees but very often represent one independent business traveler (Barboso, *Interview*). They have a higher price sensibility and are much more likely not to choose First or Business Class (Barboso, *Interview*). However, research has shown that additional services such as the use of fast lane, priority boarding or access to lounges are perceived as status symbols among Portuguese SME's⁴. These types of benefits concerning the **product variety** and ancillary products⁵ are often preferred over the 10% discount on the flight price that LH can offer them.⁶ When the journey purpose is to

⁴ They can only be accessed to Passengers with the status of Frequent Flyers or Senators.

⁵ Ancillary products represent additional non-seat related services such as special seat reservations, additional baggage, travel insurances, rental cars, hotel services, and access to lounges etc.

⁶ The 10% discount is granted on the price of the ticket without tax, i.e.: Lisbon – Frankfurt Economy Class ticket total price: 379 Eur. In this case the customer would have a discount on the price without tax: 325 Euro. The discount would be 32,5 Euro. (Interview, Campos)

attend trade fairs and at specific locations their demand of complete packaging⁷ and **customer service** is higher. In Portugal, SMEs are supported by the SME manager who is located in the sales and distribution office in Lisbon. In contrast to the contracted corporates, SMEs are not visited personally by LH's account managers but dealt with by phone. They can only participate in the online incentive programs such as *PartnerPlusBenefit* and *STAR Alliance Company Plus*, which represent a way to communicate with them and foster their loyalty. Since they are more independent and flexible in their choice of an airline LH is more likely to make special requests possible on short notice to not lose them as a customer.

3.1.2. Contracted Corporate Customers

When a corporate customer reaches the minimum annual turnover of 50.000 EUR, it is considered as a managed account with whom LH will engage a close contractual relationship. Contracted Corporates are national or multinational companies such as Bosch, Roche and Siemens. The contracts include *corporate incentive programs*⁸ depending on the customers generated revenue for LH in Portugal. In Portugal the contracts consist of upfront incentive deals with additional backend incentives in order to cover the business needs of the corporate. In addition, the contracts include regular personal service support of an account manager (**customer service, information provision**). One main characteristic of contracted corporate customers is that they do not place as much as importance to costs than to the high standard of the product service (**variety and assortment**). (Kettler, *Interview*). By many contracted Portuguese corporates LH is perceived to be a very reliable, accurate premium airline and therefore expect precise scheduling, competent flexibility and highly educated staff.

3.2. Leisure Customers

Customers in the leisure travel market, are family groups, couples or single travelers. Therefore, they include almost all ages. Especially young adults have a high affinity to fly

⁷ Including hotels and rental cars

⁸ Discussed in detail in section 4.1

once they benefit from constant incomes and have few commitments (Campos, *Interview*). Nonetheless, leisure customers are very price sensitive because unlike corporate customers they spend their own money on travel. For LH in Portugal two main subcategories need to be differentiated.

3.2.1. Visiting Family and Relatives

Visiting Family and Relatives (VFRs) are important for LH in situations where there is a strong tendency to specific travel destinations because of migration. In Portugal this is the case with the Brazilian, Angolan and Indian communities. VFRs in general have lower disposable incomes and care less about **spatial convenience** or **waiting and delivery time**. Their travel dates and destinations are generally not flexible and demand higher flexibility in terms of flight rebooking (**customer service**) and excessed luggage (**product variety**). (Campos, *Interview*)

3.2.2. Vacation Traveler

The journey of the vacation traveler is less flexible in terms of date and time because it has to match seasonal vacations and periods. **Information provision** is expected to be very high since he plans his vacation a long time ahead and wants to compare fares and offers of LH. In Portugal the holiday traveler demands individual but at the same time complete packaging including hotels and car rentals at the destination (**product variety and assortment**). Due to the time he spends on the aircraft the vacation traveler will often prefer hotels of good quality or better restaurants at the destination rather than a comfortable but expensive flight. In general, he has a higher disposable income and disposable time. Vacation traveler are not very experienced and destinations are much more flexible. Due to this fact, they can be highly influenced by the channel they use (influenced by agents) according to the network of LH.

4. Situation Analysis of LH Portugal

The aim of the following analysis is to provide a structured overview on the current situation

of LH'S sales organization located in Portugal in order to get important insights to refine the existing channel structure and provide recommendations for the company's distribution channel strategy in the Portuguese market.

4.1. LH's Sales and Distribution Organization in Portugal

Lufthansa German Airline's overall sales operations are arranged in a decentralized way and currently divided into five sales areas⁹ (Exhibit 4). LH's sales organization in Portugal, which is in the focus of this work project is located under the area management for Europe.

It manages all sales activities in Portugal and the overall purpose is to maximize revenue performance and enhance market positioning.¹⁰

It is of high importance to emphasize, that due to the fact that LH's sales organization in Portugal is responsible for the sales and distribution of passenger airline related products it accounts responsible for revenue generation only (not *profit*) within a given cost framework.

The added value the sales organization provides in terms of quantitative benefits is the delivery of unique selling propositions to a group of partners via the AIP and customers via the CIP. The qualitative benefits are the constant availability in the Portuguese market and therefore possibility of direct support (rebooking, rescheduling etc.) which is highly valued by customers and channel partners.

In order to achieve this goal, LH, as the service provider of air transportation needs to create bilateral agreements with travel agents and corporate customers.

Since LH cannot interfere in the market relation between corporate customers and their depicted fulfillment partner - the travel agent, it negotiates individual contracts separately with **corporate customers** and the **agents**.

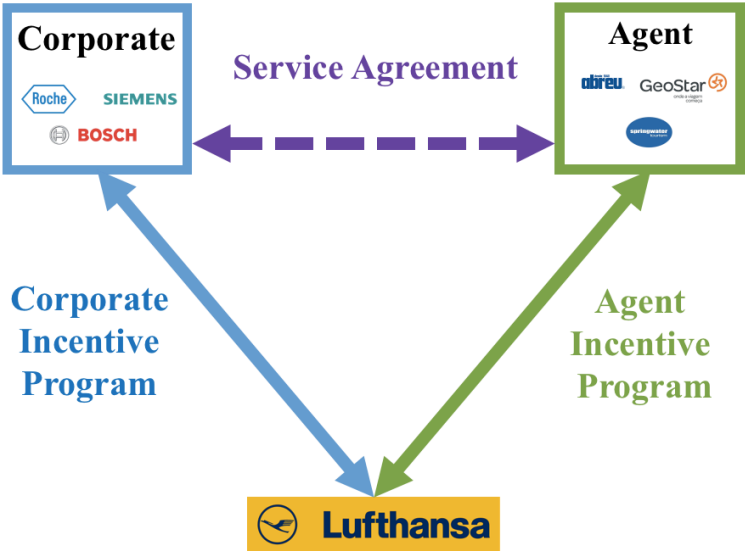
On one hand, LH's sales organization creates contracts (Corporate Incentive Program) for

⁹ The five area managements (FRA AC, DXB AM, NMC AW SIN AE, FRA AH) are top levels of the LH sales point hierarchy. The organization of the sales point hierarchy is defined solely by sales requirements of the LH headquarter and is independent of geographic conditions (Interview Hutzelmann).

¹⁰ See Exhibit 5 for LH's sales organization PT organizational chart

corporate customers such as *Roche*, *Siemens* and *Bosch* in order to incentivize them to **buy tickets**. On the other hand, it establishes contracts with business and leisure travel agents and online travel agencies (Agent Incentive Program) such as *Abreu*, *GeoStar*, *Springwater* and *eDreams* to effectively influence them to **sell tickets**.

In this relationship LH uses the purchasing power of the corporates and the selling power or steering capability of the agents to maximize sales.



As already mentioned in the segmentation, LH provides **Corporate Incentive Programs (CIP)** to corporates that exceed the threshold of 50.000 Euros revenue (per year) for LH in Portugal. These contracts are negotiated

Figure 1: LH's contracted Partnerships

every year between the LH account managers and the corporate customers (see Exhibit 5.5). They offer preferential treatments in form of upfront incentives¹¹ and backend incentives¹² to the **contracted corporates** according to their revenue significance and importance to LH. The special conditions are communicated to the GDSs and are only available to dedicated travel agencies allowed to issue such tickets for the respective corporate accounts. In the same contract four different types of targets are set that the customer has to achieve as presented in detail in Exhibit 6. (Campos, *Interview*)

In order to influence business as well as leisure customers through an intermediary, LH

¹¹ Upfront Incentive means that the incentive is essentially granted at the time of booking. There are two different kinds of upfront incentives: Percentage discount on flight price and absolute discount (rebate) on flight price.
¹² Backend incentive means that time and revenue is measured against a scale to determine if an incentive payment will indeed result. The payment will only be paid if the targets are reached as defined in the incentive scheme.

provides **Agent Incentive Programs (AIP)** to travel agents¹³. They also consist of backend incentives and upfront incentives. However, it is important to note that the aim of a backend incentive is to pay on the actual agent's performance and not additionally on their corporate revenue which is generated when the agency issues tickets for corporate travel. This business is already incentivized by the corresponding upfront CIP contract. (Campos, *Interview*)

It can be stated that in terms of the contracting approach, the main objective of LH's sales organization is to become the priority airline of its customers and the travel agents in Portugal. In the past, this represented the only possibility to offer specialized fares to significant customers outside of the GDS because of the full content agreement¹⁴. Constantly, LH has to monitor, control and if necessary adopt his contracts to ensure that no competitor offers better conditions and becomes the priority airline.

The subsequent part provides a deeper understanding of the design of LH's different routes to market including the channel members as well as what customers expect out of the channels.

4.2. The Channel Design of LH Portugal

In order to reach their customers in the Portuguese market, LH uses direct and indirect channels. Customers can access the service and products of LH via four relevant channels that can be allocated to one of the two categories. In the following section the channel design of LH in Portugal will be analyzed according to each member, LH's relation to them and their service outputs demanded by end customers (Exhibit 1). To achieve the overall goal of the work project it is evident to note that "channels exist and remain viable by performing duties that reduce end-customer's search, waiting time, storage and other costs – These benefits are called the service outputs of the channel." (Palmatier et al. 2015). While other factors such as the product attributes or the price might be equal, the end-customers will choose the channel

¹³ Local agency chains and local retailer

¹⁴ By signing a so called full-content agreement with major GDS provider *Amadeus* and *Travelport* (Galileo) LH guarantees that they will not offer specialized or cheaper airline ticket fares through other channels but provide the GDS direct and full access to their ticket stock. The GDS agreed on the other hand to reduce booking fees and charge less on LH's domestic market. (Interview, Hutzelmann)

that provides a higher level of service outputs (Palmatier et al. 2015)

Clear distinctions have to be made when comparing the offline channels to the online channel of LH in Portugal (see Exhibit 7 for details). While offline channels score high in customer service, information provision and waiting time, the online channel is offering the customer spatial convenience in the form of purchasing the tickets from home, the office or even on-the-go. The following section aims at weighing these factors against each other according to the four identified channels.

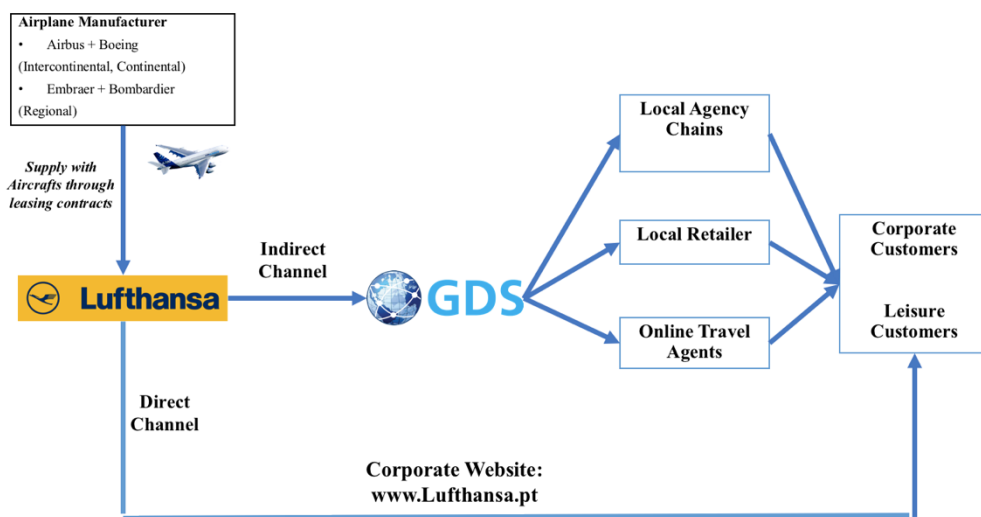


Figure 2: LH's Sales Channel Design in Portugal

4.2.1. The Direct Channel

Corporate website: Lufthansa.pt

LH's corporate website in Portugal *www.Lufthansa.pt* can be allocated to the direct distribution channel, since it is owned by the airline.¹⁵

For LH it offers lower costs of sale¹⁶, the total control over the distribution and provide the possibility to personalize the clients booking experience and engage them in a loyalty relationship (Seipke 2016). However, at the same time there is a shift of market power to the customer through the rapid and easy direct access to available fares and therefore commodity in comparing them with competitors (Doganis, 2006). At the same time this disintermediation

¹⁵ In 2016 the corporate website of LH is the only direct channel available in the Portuguese market since the call centers and sales counters at the airport are no longer available.

¹⁶ No commissions or incentives need to be paid to intermediaries (see 4.3 for details)

leads to LH bypassing the local travel agents or retailer and consequently threatens the delicate relationship between the channel partners in the Portuguese market (Frère, *Interview*). According to Jens Bischof, LH's Executive Vice President Sales and Chief Commercial Officer, the headquarter wants to keep fostering the direct connection to B2B Partners in the near future in order to present LH's "high-quality product" and provide additional information.¹⁷

The Service Outputs demanded in the direct channel (*Lufthansa.pt*) vary considerably compared to the agent's or retailer's routes to market employed by LH. **Spatial convenience** is usually the strongest argument in favor of the corporate website, since online ticket stores do not have regulated opening hours and tickets can be purchased 24/7. **Waiting and delivery time** is another key output demanded by the customers. Concerning ticket bookings **waiting and delivery time** is reduced to a minimum. In particular, due to the direct access to the ticket stock of LH through its website, strong **product variety** is expected to be given, representing the full assortment of ancillaries¹⁸, travel classes, dates, destinations and ancillary products. **Information provision** is demanded since LH's clients wish for details on their ticket purchase, on additional services provided during the journey and optimally even on special cultural or logistical circumstances at their destination.

4.2.2. The Indirect Channels

The indirect channel in Portugal involves a third party serving as an intermediary between the end-customer and LH and comprises of a broad variety of different and specialized local agency chains, local retailers and online travel agencies.¹⁹

It is important to note that the content for all indirect sales and airline related reservations is

¹⁷ Jens Bischof, Executive Vice President Sales and Chief Commercial Officer Hub Frankfurt: "The most significant factor of our strategy is a progressive presentation of the high-quality products in the B2B distribution channels, which now includes considerably more information, through direct booking interfaces like *Direct Connect*" (Seipke, 2016)

¹⁸ Ancillary products represent additional non-seat related services such as special seat reservations, onboard retail (duty free), additional baggage, travel insurances, rental cars, hotel services, and access to lounges etc.

¹⁹ See Exhibit 8 for detailed explanation of the IATA accreditation for agents.

provided by the Global Distribution System (GDS)²⁰. Nowadays, the two major GDSs Sabre and Amadeus are dominating the international market. In Portugal, however, agents mainly manage LH flights via the computer reservation system Galileo which is owned by the third biggest GDS provider Travelport (Euromonitor, 2013). As we will recognize also in the performance analysis, for LH in Portugal the local agency chains represent an important channel in order to reach high yield corporate customers²¹ (Brighton, *Interview*). Due to the high geographic reach in the country²² LH can reach a strong customer base. Nevertheless, commissions and fees paid to the GDS in combination with issues regarding transparency of the presentation or merchandising of LH's fares on the platform, embody a major point of concern of not only LH's executives (Hutzelmann, *Interview*).²³

Local Agency Chains

The agency chains and retailer with a local contract generally consist of several retailer locations. Through offices all over Portugal travel agency chains like *Abreu*, *Springwater*, *Go4Travel* get in direct touch with the customer. Local agency chains like *Geostar*, *Travelstore*, *Go4Travel* or *Springwater* are the first choice of LHs corporate customers. Even though LH's sales organization arranges direct contracts with the corporate customers, the agents serve as fulfillment centers (booking and issuing) of the tickets.

Due to the uprising importance of the corporate website (*Lufthansa.pt*), the relationship between the travel agent and the customer has changed fundamentally. Especially in the business travel market agents have become travel consultants rather than airline ticket sales agents. Concerning the Service Outputs demanded, **customer service** and **information**

²⁰ The Global Distribution System (GDS) is an international operating automatized reservation network which is managed by a company and represents the single point of access for reserving airline seats since it is directly linked to their availability stock.

²¹ In contrast to some low cost airlines, LH in Portugal cannot disregard or exclude indirect distribution channels since their target customers the corporates do not access them.

²² LH distributes its tickets through eleven major local agency chains (Abreu, Springwater, Go4Travel, Travel Store etc.) and a vast variety of independent local retailer in Portugal

²³ According to the IATA Atmosphere Research with regards to third-party distribution the GDS cost aspect is a major concern shared by a variety of airlines (See Exhibit 9).

provision are expected to be extraordinary high. Agents are required to not only be specialized in travel booking but also optimizing travel spending to ensure that the company gets the best value-for-money from its travel expenditure. The same is expected in terms of **product width and variety** since the possibility to compare a vast variety of airlines is seen as a huge benefit by the customers. However, the latter is more important to the inexperienced leisure passenger compared to the frequent flying business traveler. Moreover, they expect agents and retailers to arrange the entire travel in customized packages according to their individual needs and company travel policies. Regarding the local agency chains and retailers, **spatial convenience** is of less importance to customers since they are present in major locations around Lisbon. Additionally, leisure customers are often willing to overcome acceptable distances in order to receive good customer service, while business customers are in most of the times in direct contact via phone or their travel departments.

Local Retailers

The local retailers consist of single local travel agents all around Portugal, that do not belong to one of the bigger chains but have their own fulfillment and IATA accreditation. In terms of service outputs supplied they are much more basic in terms of **customer service** and **information provision**, compared to the local agency chains. Employees are not as educated in selling individualized packages and organizing every aspect of the journey like the agency chains. The local retailers in Portugal are much more leisure centered but still involved in the management of some corporate travel portfolios. They mostly sell and issue the tickets for customers that do not need further consultations or advice. or

Online Travel Agencies (OTAs)

OTAs like *Expedia*, *Ebookers*, *Opodo* and *eDreams* specialize in offering planning sources and the service of booking airplane tickets. OTAs are mainly accessed by Portuguese leisure passengers and SMEs who feel confident and secure in e-commerce. However, this segment

is still relatively small in Portugal. With only 4% of total channel share this channel is still not very established but is considered to grow in importance during the upcoming years.

Regarding the channel of OTAs, the service outputs demanded in Portugal are still mainly leisure-customer-focused. Similar to the direct online channel of LH, **spatial convenience** is of main importance. Concerning the **product width and variety** customers expect OTAs to offer further services beyond the airline travel, such as information on hotels, additional transports, restaurants or other convenient elements. Therefore, **information provision** is seen as a major benefit due to the perceived transparency and comparability of hundreds of suppliers presented on an efficient e-commerce platform. OTAs are often the first channel customers consult in order to get an overview of the variety of options offered. (Hahn-Raabe, Interview)

4.3. Channel Performance Analysis

In order to get a more detailed understanding about the importance of each channel in terms of customer booking behavior and to help determine potential gaps in relation to the channel members, the performance of each channel will be analyzed in the following. Therefore, firstly the revenue performance of each channel will be analyzed and secondly the major costs which arise through the sales via the two major indirect channels²⁴ in the form of commissions and fees are focused.

The channel performance analysis of LH's sales organization in Portugal, which is conducted in Exhibit 10 and Exhibit 11 demonstrate that not only in regards to the yield but also the revenue²⁵ generated by each channel, the **local agency chains** (59%) are LH's most important sales contributor followed by the **local retailers** (22%). It can be stated that even though there is a strong tendency in the increased usage of direct channels on a global basis in the airline

²⁴ Local agency chains and local retailer

²⁵ Net Net including YQ in the year 2015 (see Exhibit 10 for explanation)

industry²⁶, the indirect channel share of LH and especially LH in Portugal is still the major pillar of distribution (81% of revenue). This can be explained by the analysis in Exhibit 12, where the corporate customers are examined according to their purchasing preferences. The booking behavior of the high yield contracted corporates and SMEs who almost exclusively purchase their tickets via the local agency chains and retailers in Portugal disregard LH's corporate website (average 3%) and the OTAs (0%) almost completely.

In addition to that, a further investigation of the quality and type of flights booked as presented in Exhibit 14, revealed that there is an even stronger tendency of local agencies and retailers selling more intercontinental flights than are booked online. When undertaking a long distance journey, the customers (leisure and corporates) consult a local agency chain or local retailer to organize and book it. Only 28% of LH's customers undertake intercontinental journeys. Because of the high yield of intercontinental flights however, these 28% are responsible for 51% of the flown revenue. As a consequence, LH's sales organization has to steer the local agency chains to sell intercontinental flights. Moreover, the likelihood of booking first, business or premium economy class is much higher than on shorter continental flights (see Exhibit 15).

Concerning the **OTA channel**, in comparison to the international environment²⁷ it is important to note that OTA's have a revenue share of only 4% in the Portuguese market. This behavior could be traced back to the strong lack of e-trust, skeptical attitude towards credit card payments via the internet and the delayed adoption of e-commerce in the Portuguese airline market as stated by a General Manager of a major travel agency in Portugal (Frere, *Interview*). However, it is very important to note that there is not a lot of choice concerning OTAs in Portugal. The OTA *eDreams* is the last one, which provides its content not only in

²⁶ According to the Atmosphere Research Group on a global basis, network and flag airlines direct websites and mobile channels represent 35% of volume sold and are expected to grow up to 50% in 2017 (See Exhibit 13).

²⁷ See Exhibit 16

English but also in the Portuguese language and adopted to the market.²⁸

Similar to the OTAs **LH's corporate website**, *Lufthansa.pt* is also not accessed very intensively by the Portuguese clients. As the analysis in Exhibit 10 has shown, LH has not yet succeeded in attracting corporate customers to book directly via the website. The small percentage that use the site can be traced back to a small amount of leisure traveler purchasing low yield flights in Europe.

Each distribution channel, which is used by LH, results in different costs and fees for the company. An estimation of the total costs of LH's sales organization in Portugal can be seen in Exhibit 17. However, since this work project focuses on LH's sales organization in Portugal and in particular on the conflict potential within the sales channels, the costs of indirect distribution channels in form of commissions and fees paid to intermediaries are in focus. As we see in Exhibit 18, agency commissions and incentives paid to local agency chains (**1.037.718 Euros per year**) and local retailer (**350.327 Euros per year**) are a major cost issue for LH's sales organization in Portugal.

GDS fees are managed centrally from the headquarter in Germany and therefore not directly included in the cost structure of LH's sales organization in Portugal. Nevertheless, an estimation of GDS fees that occur through the indirect channels in Portugal has been undertaken in Exhibit 19. The result puts strong emphasis on the dimensions of these fees. With a total amount of **1.481.570 Euros** the GDS fees are almost equal to the total expenses of LH's sales organization in Portugal including the commissions for local travel agencies and local retailer, which represent **1.972.045 Euros**.

Concerning the overall performance of each channel in terms of yield management, it can be stated that even though no incentives or commissions have to be paid to third parties, the

²⁸ eDreams.pt includes the possibility to enter the "Número de Identificação Fiscal" and provides the content in Portuguese

corporate website of LH only reaches a yield of 111²⁹. This is much lower than the yield provided by the channel of local agency chains (165) or local retailer (142) in Portugal.

5. Gap Analysis

In the following section the channel gaps between LH and its customers (demand side) and the channel gaps in regards to LH's intermediaries (supply side) will be further analyzed. (Palmatier et al. 2015, 27) Therefore, the four main distribution channels of LH in Portugal need to be considered accordingly.

5.1. Demand Side Gaps

Channel gaps occur in case the service outputs demanded (SOD) by customers are not matching the service outputs supplied (SOS) by LH. The gap analysis intends to identify where LH has more potential to meet customer demands.

Local Agency Chains and Local Retailer

Concerning customer service outputs local agency chains and retailer score very high in **customer service** and **information provision** in the Portuguese market. They are perceived to provide strong benefits for leisure and business customers in terms of comparability, organizing every aspect of the travel (complete packaging: including hotels and car rentals) according to their individual needs or in regards to corporate customers, to travel policies of the company. However, the identified gap consists of the already biased form of which the fares are offered to the customers. Unless the customer does not specify the airline, travel agents prioritize the airlines that pay higher commissions. Furthermore, customers are often told about the airline **variety** but not well enough educated about the **product depth** in terms of specific fares which are bounded to or included in the offer LH. (Exhibit 20)

LH's Corporate Website

Concerning the SOS, it can be stated that **waiting and delivery time** as well as **spatial**

²⁹ The yield describes the revenue per passenger per mile and is calculated by dividing passenger revenue with revenue passenger miles.

convenience matches the end-customers' expectations for the corporate website. However, **Information provision** and **customer service** are perceived as ambivalent factors. On one hand customers value the **product variety** through fares and offers that they can easily access at any time via LH's corporate website³⁰. (Hahn-Raabe, *Interview*) On the other hand they are confronted with a vast amount of information and perceived lack of comparability.

However, the major gap that has been identified is that LH has not yet succeeded in effectively attach business customers with the corporate website since it is not optimized for them or meet their demanded service outputs such as the management and transparent presentation of personalized fares. This can be explained by the shift in integration of corporate travel policies or travel management departments in Portuguese companies that prefer the use of globalized systems or further ways of perceived objective comparability (PhoCusWright 2009, 34). Nevertheless, the SMEs and leisure passengers are more flexible in the booking process and can be more easily convinced to access the corporate website since their demand for specialized fares and ancillary products are higher. Even if e-commerce is not as quickly adopted by the Portuguese population in comparison to other European markets, LH should try to close this channel gap in the near future to attract more SMEs and leisure passengers to book online (Exhibit 21).

Online Travel Agents

The two major demand-side gaps identified in the OTA channel are **customer service** and the lack of **product variety** in terms of individualized fares (Hahn-Raabe, *Interview*). Due to the fact that there are only few providers that offer their services in Portuguese the channel is not used for undertaking major ticket bookings. (Exhibit 22)

5.2. Supply Side Gaps

In order to achieve a successful and efficient channel for LH in Portugal, it is evident to not

³⁰ Offers including lower prices and extra services: There is no 16-euro fee for bookings through the LH corporate website.

only meet the customers' demands but also to coordinate the existing power relations of each channel partner as well as the conflicts that arise between the members of the channel. If not managed correctly, they can result in high costs for LH. Exhibit 23 and Exhibit 24 consist of the detailed analysis of the power relations (Exhibit 23) and conflicts (Exhibit 24) between LH and its channel members.

Conflicts with intermediaries

In the analyzed channel of LH Portugal we find agents and retailers who want to maximize their profits and margins and LH who strives for increasing the passenger income. The conflicts manifests in negotiations of LH with the agents and retailers for being the prioritized airline in their offer or the ticket prices³¹. In addition, LH wants to be positioned and promoted adequately and more effectively than their competitors. Due to the high price sensitivity of the end-customer they do not totally commit to the LH brand and see competitor airlines as acceptable substitutes. In general, the power relations seem to be more or less equal but LH's dependence on the local agency chains and local retailers is higher as they account for over 80% of the sales organization's overall sales.

GDS Fees

However, the major gap that has been identified is LH's conflict potential with intermediaries and especially the GDS Galileo³², which results in high distribution costs (**1.481.570 Euros per year**) for LH's sales organization (see Exhibit 19). In comparison to other GDSs like Amadeus, Galileo installs the necessary access tools like hard- and software without additional costs in offices of local agency chains and local retailers in Portugal. In the beginning they charge a service fee to the agents who use the system. As soon as a small standard amount of bookings via the system is exceeded Galileo starts paying out commissions to travel agents and retailers for each ticket reservations over their system. In

³¹ Local agency chains and retailer claim that especially after the implementation of the 16 Euros GDS fee LH is always perceived to be more expensive

³² Galileo belongs to the third biggest provider of GDS, Travelport.

this way travel agents in Portugal are highly incentivized to use the system. LH on the other hand has to pay 5 Euros³³ per person and per segment to Galileo for bookings. This fee is charged even if the reservation does not result in the issuing of a ticket but is cancelled in the end. Exhibit 19 shows an estimation of GDS fees in Portugal paid by LH. GDS fees paid. In the beginning of 2015 LH has imposed an additional 16 Euros fee on top of every ticket booked via the GDS on a global basis. This was an attempt to disincentive customers to purchase tickets over the indirect channel but has not yet resulted in a strong shift in bookings via the corporate website. It can be stated that in 2015 the GDS fees of **1.481.570 Euros** occurring due to transactions in Portugal, were a major cost driver of LH.

6. Recommendations for LH's Sales Channel Strategy in Portugal

LH encompasses a world-class brand that is still perceived by the Portuguese customer to be efficient, secure and offering a premium service. Therefore, LH's key power source is referent power since Portuguese travel agents want to be identified with selling LH's services. On the other hand, the local agency chains and retailers have huge expert power in retailing and knowledge of the local market.

LH has to exploit the opportunities provided by the expiration of the full-content-agreement with the GDSs. If the company would like to avoid the high commissions paid to Galileo, they have to figure out alternative ways to distribute the product. In order to meet its customers' demands, LH has to bind agents (B2B) and customers (B2C) directly to the company. On a long-term basis this should be achieved through binding the the customer without going through the agent and binding the agent without going through the GDS.

LH has to foster the use of *Lufthansa.pt* to enable customers to book directly and support the technological development of a *Direct Connect* platform that provides travel agents the possibility to make reservations outside the GDS. In the following this will be explained in

³³ Estimation according to industry insights and interviews.

further detail.

6.1. Closing Demand Side Gaps

Local Agency Chains and Local Retailer

In order to meet the customer demands in terms of **product depth** and ancillary services connected to LH's flights via the local agency chains and retailer, LH should further promote *Direct Connect* solutions to intermediaries. Since the full content agreement between LH and the major GDS provider Amadeus and Travelport (Galileo) ended in 2015, LH needs to focus on offering more and personalized fares outside the GDS. According to their end-customers the agency chains and retailers will be provided with flexible package offerings that can be accessed via the platform and directly purchased from LH. Especially leisure passengers who often demand to be provided with the whole travel experience will be offered bundled journey components³⁴.

LH's Corporate Website

The company has to optimize the technical capabilities of Lufthansa.pt for corporate customer purposes. Therefore, LH has to exploit technical solutions for this direct connection and then incentivize corporates to use Lufthansa.pt.

In a first step LH's sales organization in Portugal should focus on the SMEs. They are already managed and reported in the data base of LH, represent 11% of total revenue and are more flexible in booking procedures than the multinational contracted corporates. By offering them the choice between the ancillary products such as the access to lounges and priority boarding **or** the 10% reduction on the fare, they incentivize them to purchase the ticket via the corporate website and in addition meet their demand of **product depth**. In order to access the online fare that is shaped according to their individual needs each SME will receive an account number, which they will have to enter on the website. The fares provided will be

³⁴ Incl. hotels, tours at the destinations, excursions, airport transportation, car rentals, events at the destination etc.

more personalized, more flexible in terms of upgrades and including more rewards than the indirect channels. The analysis in Exhibit 25 demonstrates that taken into account that there is no major change in the amount of ticket bookings undertaken by SMEs, LH can reduce its commission costs and fees for the GDS. The total amount saved through the direct connection and therefore purchasing via Lufthansa.pt will be: **333.020 Euros** per year.

6.2. Closing Supply Side Gaps

Conflicts with intermediaries

In order to not further complicate their relationship, LH has to enhance and optimize the commercial relations with the local agency chains and retailers in Portugal, also on the conservative commercial basis including the GDS. Even if they represent high costs LH must not lose them as partners and retailers for their services.

However, LH has to further promote *Direct Connect* interfaces with travel agents. Solutions like SPARK already exist but are not yet adopted by the agents. Therefore, LH has to incentivize the implementation and usage of them in the mid and long-term future in order to enable local agency chains and retailer to offer tickets without the 16 Euros service charge.

These incentives should include providing dedicated products and special access of LH fares to selected and prioritized agents. Depending on the agency chain or the retailer, special availabilities, to e.g. leisure destinations for leisure focused agents such as **Abreu** and additional ancillary services for corporate focused agents such as **Go4Travel** have to be provided. In this way LH is not obliged to offer the same fare to all travel agents in Portugal at the same time.

GDS Fees

The expiration of the full content agreement allows LH not to provide the GDS with the whole availability of products, fares, timetables and services directly from its ticket stock. This leads to two major aspects of which LH has to take advantage of:

Major Cost savings with Lufthansa.pt: The calculation of cost savings in Exhibit 16 has shown that there is the possibility to reduce GDS costs of **162.320 Euros** per year, through SMEs purchasing on Lufthansa.pt. However, as mentioned before, on a long term basis LH also has to target the contracted corporates.

Comparability: As stated before LH should offer specialized fares outside the GDS to targeted customers and agents. Nevertheless, LH should also provide some offers and fares still via the GDS but only to selected agents. End-costumers will recognize an increasing lack of comparability and transparency within the indirect channel via the GDS and therefore might choose other channels (Lufthansa.pt) instead.

7. Conclusion

The goal of the underlying paper was to closely examine LH's sales channel strategy in Portugal with regards to customer demands and relations to intermediaries in order to reveal opportunities for the passenger airline to optimize its bookings value and satisfy the end-customer. The sales channel framework which was developed in this paper identified that LH's multiple channel strategy is crucial to obtain brand awareness and sales performance in Portugal. However, the company should take advantage of the possibilities offered through the expiration of the full-content-agreement with the GDS. LH is already creating direct contracts for travel agents and corporate customers but further coordination is needed in terms of provided individualized fares via the corporate website and *Direct connect* interfaces to meet customer demands effectively, to differentiate themselves in the market and reduce costs.

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