Beware of the Middleman

How to deal with travel agents from an airline and customer perspective

When the scientific fathers of the new institutional economics developed the theories around the Principal-Agent Problem (Akerlof 1970), they focused more on markets such as fruits, cars and insurances rather than on the travel industry, though which they certainly would have looked at today if they had to reinvent those theories.

Even in today’s environment, with tools like Internet booking engines, metasearch engines and other tools to book airline fares, the majority of sales is still driven by the travel agency community. This applies to the more traditional network carriers in particular. The relationship between travel agents, their customers and the airlines is thus an important subject, from both a management and a scientific perspective.

This paper aims to illustrate the problems associated with the relationship between airlines, travel agents and customers, according to the Principal-Agent theory. Examples will be covered of real-life situations where elements of the Principal-Agent theory can be observed. In addition, airline professionals, students and other interested readers will gain a general understanding of the Principal-Agent theory. Finally, suggestions are given for coping with the general drawbacks of a principal, when dealing with (travel) agents.

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Assumptions

As a general assumption, the principal-agent relationship in this context is a two-sided one. One side is the relationship between the airline and the travel agent. The second side is the relationship between the travel agent and the individual customer. A travel agent in this context is an intermediate, regardless of its business. For the purpose of this paper, travel agents include brick-and-mortar agencies, online travel agencies, travel management companies, etc.

With the travel agent being the agent in both scenarios, it can be seen as a two-sided principal-agent-problem.

According to the traditional principal-agent theory, all parties focus on their own economic interests (Eisenhardt 1989). For simplification purposes, the scenario is presented based on the assumption that all airlines in figure 1 compete with each other in the same geographic market.

Asymmetric distribution of information

Travel agencies have a significant advantage when dealing with customers and airlines: they are the owners of information, as they know market trends, customer preferences, airline offers, availability etc. This advantage is particularly important in the relationship with each individual airline.

The airlines’ knowledge about the sales potential of the travel agency primarily relies in information provided by the agency. In contrast to previous years, airlines no longer have the same freedom to verify the travel agent’s information, due to the increasing barriers implemented by privacy laws like the EU Code of Conduct for Computerized Reservations Systems. Privacy laws have made it more difficult for airlines to access travel-agent information unless the travel agent agrees to the use thereof. Despite the freedoms a travel agent has to share all of its booking information with the airlines, the abovementioned privacy regulations are considerable firewalls that can protect travel-agent information and can work as a catalyst to strengthen the existing information asymmetry.
Apart from this, airlines also are unaware of the content of contracts between the travel agent and competitor airlines. When examining an incentive agreement, airlines are virtually incapable of determining whether the incentives offered are competitive in relation to those offered to its competitors. Again, having knowledge of all contracts, the travel agent knows far more than each individual airline.

Asymmetric information distribution in principle also applies to the relationship between a travel agent and its customer, as travel agents know the best offer for the customer in terms of price, service quality, travel time, time of arrival etc. With the evolution of travel websites, meta search engines and alike, the information advantage of the travel agent has shrunk. Customers today have more options to evaluate the offers available and are able to verify whether a travel agent indeed provided them with the best possible offer. However, customers need to be active themselves, and they need to act as a travel agent themselves to get this information, thereby reducing the benefit of hiring an agent and requiring a resource investment.

To summarize all of the above, a travel agent possesses all of the relevant information in the double-sided principal-agent relationship, while neither the customer nor the airline has sufficient power to accumulate the same amount of information without investing additional resources. Therefore, the asymmetric distribution of information is an irreversible fact in today’s relationship between airlines, travel agents and customers.

The contract between principal and agent
The contract relationship between the airline and travel agent, as well as between the customer and travel agent, can usually be divided into four steps:
- Pre-contract-signature
- Post-contract-signature
- Pre-action-decision
- Post-action-decision

Typically, this whole process stretches over a longer period in the relationship between airline and travel agent, compared to the relationship between travel agent and customer. Each of the four steps has its own hidden characteristics associated on the travel agent level, which will be further explained.

Hidden Intentions
The hidden intentions of a travel agent can usually be found before the contract is signed, and are particularly relevant to the airline-travel-agent relationship, as a travel agent in general does not have a significant amount of contact with its customer before the contract is ’signed’ and executed.

An obvious characteristic of a hidden intention is that it is hidden to the airline. The agent will therefore, in none of the steps, reveal it to its airline counterpart. However, the goal to gain as much reward as possible from the contract is not a hidden intention. Yet, exactly what the travel agent considers a reward can be a hidden intention. Airlines may act on the assumption that travel agents sign contracts to earn incentive payments. Although this is a logical and, in most cases, a correct assumption, money is not the only reward for a travel agent. In fact, it may not even be the most important reward at all.

Apart from earning money from a contract, the contract alone can be rewarding enough for an agent if the goal is to utilize the marketing potential of having a contract relationship with a particular airline. Reasons behind this may include the opportunity to sell this airline’s special fares or using this airline’s marketing symbols. Regardless of the exact reasons for signing, the travel agent may have no intention of fulfilling the contract nor preferring this airline. It may not even be willing to focus on meeting the minimum contract requirements. Of course, the agent will still sell this airline’s tickets, if requested or otherwise necessary, as selling in accordance with the contract’s terms will never harm the agent. It might provide the agent with an additional revenue stream.

Clearly, this does not match the airline’s expectations. As a principal, the airline usually wants to profit from this relationship by increased ticket sales. Considering a worst-case scenario, where the agent has sold no tickets of the airline at all, the above situation means that the airline has invested resources in a contract that only benefited the agent’s hidden intentions without benefiting the airline at all.

Looking at the travel agent-customer relationship, the risk of hidden intentions from the agency is limited, as, in most cases, the relationship between individual customers and travel agents do not have a significant pre-contract-signature period. In contrast, corporate customers do in fact have a larger pre-contract signature period and might be exposed to the following hidden intention (which could be imaginably transferred to individual customers as well):

Travel agents may advertise services and prices to make people approach the travel agent based on the ads, but then find out later that those offers are no longer available, leaving customers to approach the travel agent based on the ads, but then find out later that those offers are no longer available, leaving customers to choose an alternative service or price offered by the travel agent. The agent’s intention of making customers start a contractual relationship with them is hidden by the ‘intentions’ mentioned in the advertisement. These tactics are not necessarily effective as the interactions with individual customers are usually based
on a single transaction and those tactics are likely to disappoint the customers, who might turn away forever. In addition, these tactics inherit the risk of breaking customer protection or fair trade laws.

**Hidden Information**

The next area of uncertainty is when the contract has been signed, but before individual transactions are performed. Again, it is the travel agent that can take advantage of the asymmetric distribution of information, as it knows what fares are in the market and what incentive it receives from each airline’s contract for sales. Looking at the relationship with the airlines, the travel agent knows what contract is the most profitable. In addition, it knows the true market and passenger potential it is able to sell. The airline itself only knows what is agreed upon between them and the travel agent, but has no knowledge whether the incentive is attractive enough to motivate the travel agent to sell the fares or whether the targets have been set too low.

However, these conditions alone do not mean the agent will not act in accordance with the contract, but it is likely that the agent will do just enough to get an incentive and put the focus on those airlines that give the greatest reward. If the agent contracts effectively on volume or growth-based contracts, he is able to fulfill all of his obligations with multiple airlines and receive incentives from all of them. In addition, the agent might also have the opportunity to participate in sales promotions with other airlines as well. Although this is not necessarily a bad thing, it is an example of missed opportunities from the perspective of a contracted airline.

For the airlines, these plans inherit the risk that they do not yield the airlines a better market position. In addition, volume-based contracts may result in the agent shifting its focus on other airlines, once the incentive threshold has been reached.

Looking at the relationship between travel agent and customer, hidden-information phenomena are present as the contractual relationship between airlines and travel agents are unknown to the customer. This may result in a situation, where a customer wants to fly on the cheapest fare possible and the agent tries to convince him to take an alternative airline, which is more expensive depending on the incentive benefits of the agent. In a face-to-face interaction, this may be achieved by telling the customer that the airline he wants to fly on has inferior service compared to the airline the agent would recommend instead. In an online world, this happens by not automatically presenting the cheapest offer at the top of the list of airlines, or by adding fees to that specific airline.

In reality, travel agents have various ways to benefit from the information advantage. The abovementioned example illustrates just one possibility and has revealed the underlying possibility of an agent maximizing its own profit and not necessarily acting in the principal’s best interest.

**Hidden Actions**

The last area of uncertainty is closely linked to the intended actions based on hidden information. Hidden actions are not necessarily a breach of contract. In fact, the contract is usually fulfilled, but the way it has been fulfilled may not have always been in the best interest of the principal. Looking at the airline-travel-agent relationship, the travel agent might just do enough to fulfill the contract and fill the airline’s plane with the easiest customers available instead of focusing on high-yield customers. Those passengers might be booked on competitor airlines, and the principal is simply unable to prohibit this.

Basically, airlines see the result, but have no knowledge whether the agent indeed devoted most of its resources into them. Another example would be a travel agency that is growing naturally, and more and more customers want to fly a particular airline without being influenced by the travel agent. In such a scenario, the travel agent would receive a growth incentive despite the fact there is no active influence on sales.

Travel-agency customers do face a hidden-action problem in case of more complex travel bookings like around-the-world fares. For example, a customer wants to have around-the-world fares to visit cities A, B, C, D and E. Without the passenger particularly mentioning the carriers he wants to travel on, the travel agent has the freedom to choose those carriers that represent the highest yields to the agent and not necessarily the highest satisfaction to the customer.

**Summary and conclusion**

Put more concisely, the large information advantage of a travel agency in comparison to both airlines and customers is likely to result in a moral-hazard situation (also compare for other reasons: Hülsmann, 2006) as the agency is attracted to work purely towards its own incentives and not to the incentives of the principals.

Neither of the principals is able to fully control the behavior of the travel agency and therefore inherits the risk of paying too much for too little result. It is obvious that the travel agent does not need to actively trick each of the other parties. Usually, it can adhere to the contract, which is based on and fulfilled with the agent’s information advantage.

For both of the principals, it is essential to get as much information as possible before dealing with travel agents. For an airline, it is particular important to gain as much market intelligence as possible before entering negotiations. A way to address recent and proposed privacy changes in Europe during contract negotiations could be to require the travel agent to release their booking or ticketing data, enabling the airline to have access to it. Moving away from revenue-based and volume-based contract models to a share-based performance contract is an elegant way of doing it as it stimulates the agency for sharing information and surrendering part of the information advantage. However, given that agencies try to avoid those contract models, these models are difficult to negotiate.
Regardless of these technical aspects, airlines need to understand the real intention of an agency when beginning contract negotiations and need to work towards a contract that incorporates this, thereby removing some of the hidden intentions. For example, if the agency just wants to have access to the airlines fares for promotional purposes rather than for actual sales, the airline should be ready to offer deal models that just offers access to the fares and products instead of working on a performance contract that the agency is not going to fulfill anyway. Although the effects may not be as obvious from a sales perspective, even offering fares alone without receiving any counteroffer or money in return is economically viable, as these contracts do not require a tremendous amount of monitoring, which allows airlines to invest more time in monitoring the fewer contracts that are in place. Charging agents for access to the airline’s fares might still be a viable option of course, depending on the market power of the airline.

Another option would be to create a performance-driven contract with a clearly set goal by the airline that cannot be influenced by the agency itself. The goals could be volume-based and revenue-based or even triggered by fare classes, average price, etc. It is important that the goal be set by the airline according to its needs and desires. This is not largely different from the current contracts that are signed, but it is focused on incorporating the airlines’ needs instead of using generic terms, which could be influenced by the travel agent’s information advantage.

Like all performance-driven contracts, it is important to monitor them properly and to motivate the travel agents to follow them. To this end, airlines may consider incorporating agreements into the contract, which allows them to claim remedies or cancelling the contract right away for not reaching the agreed targets. This certainly may block agencies from contracting with a particular airline, but it ensures that those agencies that still pursue a contract do have a desire to shift the traffic towards the airline and this approach allows reducing the number of contracts in place, which saves cost for managing unsuccessful contracts.

Finally, airlines can avoid the principal-travel-agent dilemma by shifting more bookings to their own direct sales channels. However, this can be costly to initiate, as the airline must create a strong awareness in the customers’ minds to attract them to shop directly with the airline. But for larger and well-known airlines, the benefits of such a strategy will definitely outweigh the implementation costs as they already enjoy a strong awareness in the minds of the customers. However, certain customer groups, especially in the business travel arena, may still require an intermediate to facilitate their travel needs.

From a consumer perspective, it is even more difficult to address the issues of the principal-agent-problem. One option is to specify the travel needs as detailed as possible and let the agency expressively acknowledge them. This helps to claim damages if the customer at a later stage discovers that the travel agent did not follow the contract with the customer as agreed upon.

Another option for customers is the use of various internet tools to verify the offers of the airlines and book the flights directly with the airline to avoid the intermediate agency or to do a comparison of several travel agents to see, which fits the best to their needs. However, both alternatives are time-consuming, and, even for personal travel, it is useful to do a quick cost-benefit analysis as the invested resources could overweight the potential savings of a comparison. Other options to influence the travel agents based on the outline of the contract do not appear realistic, as the agent and the customer usually do not have such a long and deep business relationship compared to those between airlines and travel agents.

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Further theoretical background


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(Endnotes)
1. According to an American Express study, direct channels are considered to be responsible for slightly more than 40 per cent of all airline bookings in 2009, including low-cost carriers that sell an overwhelming majority of tickets via direct channels; American Express (2007).
2. E.g. expedia.com, opodo.com etc.
3. E.g. cheapflights.com, kayak.com etc.