GOING PLACES

How leading companies are breaking the mould in travel, transport and logistics

OC&C Strategy Consultants

Times have been particularly tough for Travel, Transport and Logistics (TTL) operators, with the profits of leading brands such as Holiday Inn, Hertz and DHL all coming under pressure from recession and structural changes to their industries. But some TTL businesses are consistently outperforming the pack. Through work with clients across this sector, and from our proprietary analysis of approximately 300 TTL businesses worldwide, we have identified a portfolio of strategies – a 'TTL playbook' if you will – which can help your business succeed in a competitive market.

THE TTL SQUEEZE

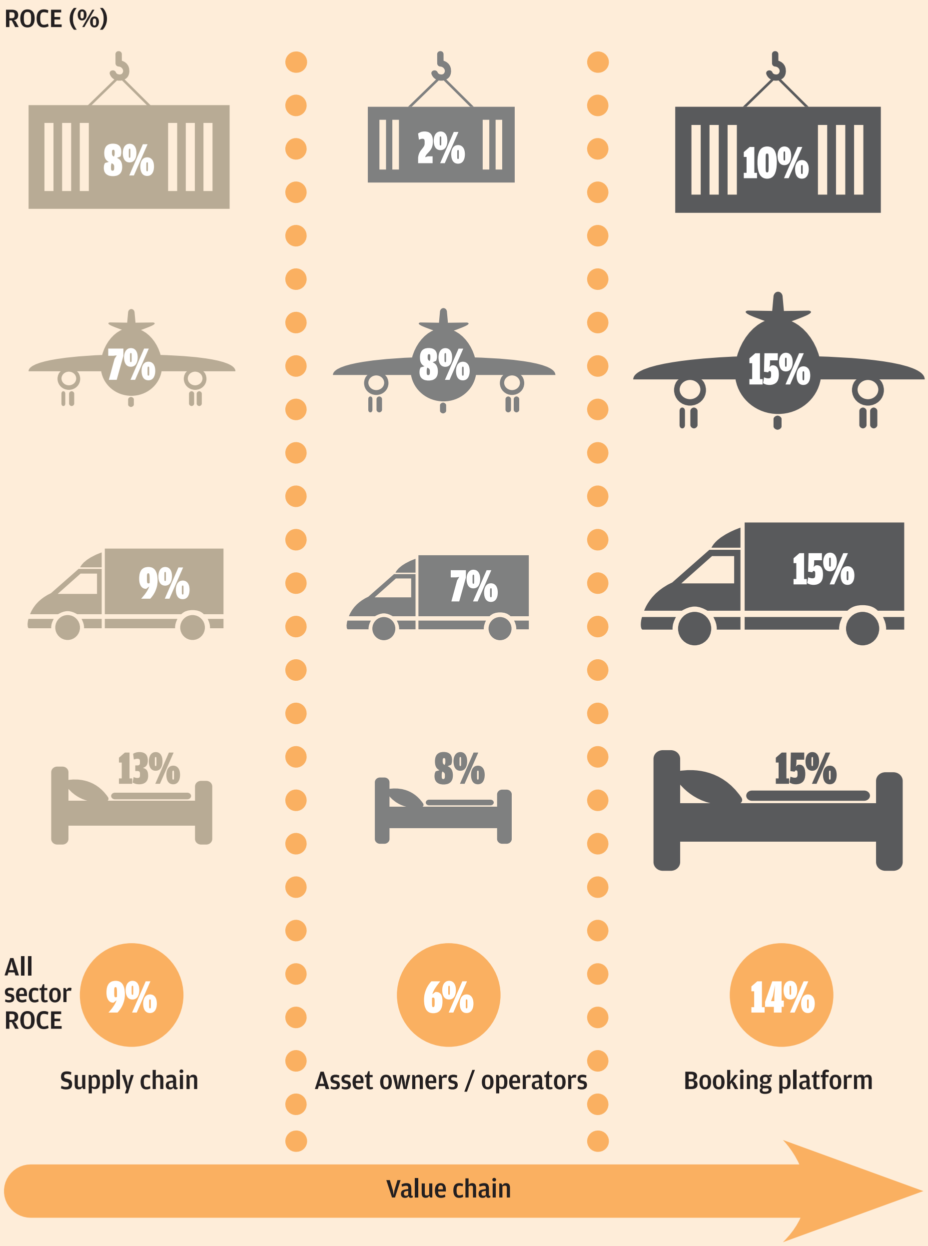
Although hotels, car hire and parcels may seem like very different businesses, they and other Travel, Transport and Logistics industries face common challenges:

- All have complex, capitally-intense inventory to manage: hotel bedrooms, rental cars and empty vans.
- All are being challenged by the digital revolution, as the shift of both consumer and business customers to digital booking channels increases transparency and service expectations.
- Most have seen the entry of 'low-cost' operators, which have pared back their cost base and invested in price.
- And many have difficult costs to manage, due to unionised staff and/or powerful and uncompromising suppliers.

These issues have had a significant impact on industry returns:

1. Average Return On Capital Employed (ROCE) for large businesses in the TTL sector is only 13%, vs. say 18% in Consumer Goods and 15% in Retail.
2. The asset owners at the heart of these sectors have ROCE on average a third lower than their upstream suppliers and make on average less than half the ROCE of the online aggregators which have inserted themselves between them and their customers (see Figure 1).
3. 'Traditional' operators make on average, 6-10% pts lower returns than their 'low-cost' competitors (e.g. traditional vs. low-cost airlines).

FIGURE 1: AVERAGE ROCE IN TTL – SUPPLY CHAIN VS OPERATORS VS BOOKING PLATFORM



Source: Annual reports, OC&C analysis

ESCAPING THE SQUEEZE: THE TTL PLAYBOOK

However, insights from our work in the sector – supplemented by a proprietary database, which we update each year – show that not all businesses are consigned to this fate. Some have deployed **strategies to tackle structural problems head on**, while others have succumbed, delivering sub-par returns and ceding profits to competitors and other players in their value chain.

The Transport, Travel and Logistics businesses that are doing well have responded with a range of strategies, which we call our 'TTL playbook':

Targeting specific customer groups... without sacrificing economies of scale

- They have identified and taken control of the elements of their propositions which their target customers care about, and focused investment there and nowhere else.
- They have created underlying infrastructure which can cost-effectively serve the needs of one or more target segments.

Harnessing local entrepreneurialism... without losing control

- They have increased on-the-ground productivity through local accountability or even franchising...
- ...and only exert control from the centre where it enables something that really matters to customers.

Responding smartly to online distribution channels

- They have re-engineered the whole business to win in the indirect online channels...
- ...or re-balanced their business to meet the needs of specific customer segments (e.g. B2B) where direct channels are sustainable.

Fundamental re-engineering of the cost base

- They have got rid of 'gold-plated' propositions (built for the days when travel was for the few, or that were designed to meet quality standards defined by regulators regardless of cost considerations).
- They have successfully worked *with* unionised workforces to increase efficiencies, unlocking their ability to compete with new, non-unionised entrants.
- They have made the tough decision to upgrade antiquated IT systems – and executed the implementation unusually well.

Tackling shift of profit to suppliers

- They have spotted emerging players in the supply chain which were starting to capture excess profits (e.g. ports) and either acquired them or diversified supply.

Learnings from specific industries

These strategies work in practice – as illustrated by the experience of our clients in specific TTL sub-sectors. However, the blend of strategies varies substantially by sub-sector and business.

WINNERS HAVE SUCCESSFULLY WORKED WITH UNIONISED WORKFORCES TO INCREASE EFFICIENCIES

Industry: pallet logistics

REAPING THE REWARDS OF LOCAL ENTREPRENEURIALISM

Palletised freight is a mature industry that grows and shrinks with economic activity, right? Not if you're a pallet network, where **business growth rates of 10-30% per annum** are common. They do it by harnessing the power of franchising.

A pallet network has a lot in common with other pallet freight businesses, especially groupage: pallets get picked up, cross-docked at a local depot to a larger truck, line-hauled, cross-docked back to a smaller truck, and then delivered. The difference is that a pallet network doesn't own trucks or local depots. They have c. 50-100 franchise partners per country, who each 'own' a local area, both in terms of local infrastructure but also – crucially – in terms of local sales.

All the pallet network does is own a national depot, which breaks the line haul stage: pallets are cross-docked between the inbound and returning trucks from local franchisees. But the costs of this extra cross-dock in the middle of the journey are hugely outweighed by the high productivity of local franchisees. Put simply, the 50-100 local freight businesses which are members of each pallet network are hungrier for local sales than a national freight business and are much better at maximising the utilisation of their trucks.

The very best pallet networks further enhance this by wrapping a great IT system around the operations of the local franchisees, so end customers get all the benefits of quality control and consignment tracking that they would get from a scale national provider, while benefitting from the entrepreneurialism and lean costs of the local franchisee.

50-100 LOCAL FREIGHT BUSINESSES WHICH ARE MEMBERS OF EACH PALLET NETWORK ARE HUNGRIER FOR LOCAL SALES THAN A NATIONAL FREIGHT BUSINESS

CASE STUDY

PREMIER INN AVOID ONLINE DISTRIBUTION, SAVING AROUND £100 MILLION IN FEES

Industry: budget hotels

OWNING THE EXPERIENCE IN BUDGET HOTELS

A bed is a bed is a bed. Or is it?

The growth of the global hotel industry in the 1980s and '90s was driven by multinational goliaths such as Hilton Worldwide, Intercontinental Hotel Group (IHG) and Starwood, which were engaged in a major global land grab. The prize on offer was extensive national and international networks, powerful relationships with distribution platforms and agents, and captive loyalty programmes. In pursuit of this prize, the 'Asset Light' mantra, where the less glamorous elements of hotel construction and operation are delegated to third-party franchisees, enabled rapid growth. The result was superior returns, as leading brands such as Hilton and Holiday Inn were able to leverage their scale to deliver profits while limiting capital investment. The largest chains developed into powerful distribution systems in their own right, able to offer franchisees guaranteed volume thanks to strong brand recognition, third-party distribution relationships, largely captive members of rewards programmes, and call centres and websites, with capital returns more aligned to those of global travel distribution systems than hotel operators (e.g. Priceline Return on Capital is c. 23% vs. c. 35% for IHG but only c. 8% for LRG, a leading IHG franchisee).

However, rapid growth and high returns did not come without a cost. Through delegating control of many key elements of the proposition to franchisees, these chains became dependent on investments by others. The centre focused on marketing and distribution, while investment in quality and innovation was given lower priority, and control of revenue management was delegated. As propositions have become tired, consumer enthusiasm has waned and revenue growth has slowed.

A contrast to this is Premier Inn – a smaller hotel chain in global terms, although clearly the market leader in the UK in terms of number of rooms. They have taken a fundamentally different approach, which has enabled them to deliver superior consistency of experience and through that sustained, market-leading growth. Premier Inn has actively eschewed the franchise model, directly operating its entire UK hotel portfolio in order to retain control of the guest experience.

This has enabled them to invest in the proposition where it matters most to their target customers, such as a quality hot breakfast at every site and their Good Night Guarantee, supported by a King-size pocket sprung mattress in every room. They have also engineered their cost base to support the value-for-money proposition by only adding cost where it is valued by guests. They avoid online distribution, saving around £100 million in fees and the vast majority of their c. 60,000 rooms in the UK are booked through their own website; a proportion of these savings are re-invested in brand building, marketing and pricing promotions, which have much more tangible customer impact.

Tired mid-market hotels across the UK contrast starkly with the well-invested Premier Inns, creating an easy value-for-money trade-off for customers. The equation works for shareholders too; Premier Inn's focus on site ownership and operational control results in a capitally intensive business model and yet they are still able to deliver well-above average returns (c. 14-15%) and market-leading revenue growth (15% per annum).

Industry: parcels

POSITIONING TO WIN IN THE NEXT BIG THING

Citysprint operates in the highly competitive parcels market. **Yet growth and returns have been far above those of industry peers. How?**

Citysprint focuses on the same-day delivery niche, and has invested heavily to build economies of scale in major cities and nationally. So far, so normal for a logistics business. But Citysprint is also a great example of customising its proposition for specific customer groups without compromising on economies of scale.

Their legacy customers were B2B users – think lawyers sending urgent contracts around the country. Customers such as these supported the creation of Citysprint's national network by providing baseload volumes.

CITYSPRINT HAS CUSTOMISED FOR SPECIFIC CUSTOMER GROUPS WITH A SINGLE COMMON PLATFORM

But Citysprint soon realised two things: their legacy customers were (slowly) shifting some of their work onto email; and their national network of couriers could be used to serve other customer needs. For example, Citysprint is very successful in the healthcare same-day delivery market - transporting blood samples and delivering pharmaceuticals to patients. This required a new proposition, with enhanced tracking, chilled storage and a health accredited workforce. Citysprint found a way to cost-effectively equip generalist couriers to serve this proposition, allowing both the generalist and healthcare customers to benefit from the scale of the combined business. They have made similar investments to enable them to serve the bespoke needs of automotive parts and retail same-day customers.

In common with pallet networks, the other strategy which Citysprint deploys very effectively is franchising: their self-employed couriers are much more productive than employed couriers and they also have a great IT system to enable a high-quality service.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Industry: car rentals

WHEN WILL CAR RENTAL COMPANIES STOP TRYING TO TURN BACK THE TIDE?

Car rental companies are having a tough time. At major locations such as airports, all the brands are present; the loyalty schemes are nearly identical; and, most importantly, the cars are almost exactly the same. **The result? Profits have moved upstream** (e.g. to the airports, which rent out parking lots) and downstream to online distributors, such as Rentalcars.com and CarTrawler.

Price comparison sites have compelling advantages for consumers (e.g. full market access, price optimisation and a better interface), and they are also outperforming rental players on conversion rates and upselling, which allows them to outbid on pay-per-click as well as for white label microsites (e.g. those linked to airlines).

So what are successful rental companies doing to respond? Well, our first observation is that many are simply trying to push back the tide by attempting to win back direct traffic, but with such undifferentiated propositions and less marketing budget than aggregators, this is proving expensive.

The more successful rental companies are deploying three strategies straight out of our TTL playbook:

- Focusing on customer segments which don't buy via price comparison sites, in particular, B2B or non-airport rentals, which each make up over 50% of the market in Europe.
- Franchising local rental offices, which can be over twice as successful at developing local customers vs. owned offices.
- Dealing smartly with the new intermediaries, by collaborating with them as a sales-and-marketing outsourcer, and placing much less budget through direct channels (a strategy that has worked especially well in the motor insurance market, where some brokers have re-designed their *entire business* simply to be the winner on price comparison websites).

FOCUSING ON CUSTOMER SEGMENTS WHICH DON'T BUY VIA PRICE COMPARISON WEBSITES

THE PRIZE IS SUBSTANTIAL: RECLAIMING FAIR SHARE WOULD BE WORTH €70 BILLION IN EXTRA PROFITS

A CALL TO ACTION

Average ROCE across the Transport, Travel and Logistics sector is 13%. But, some of the major players in TTL are not achieving anything like this – they are losing out to more focused or lower cost competitors, to sales intermediaries or to over-powerful suppliers.

The management teams of these businesses are often told there is no alternative. But in our experience it needn't be this way. And the prize is substantial: reclaiming their fair share would be worth c. € 70 billion in extra profits globally.

The executives of every large TTL company should be asking themselves five questions:

1. Can we **target specific customer groups** better, without sacrificing economies of scale?
2. How can I **harness local entrepreneurialism** without the downsides of losing control?
3. What can I do to work with, not against **online distribution channels?**
4. Have we really looked hard enough at achieving a **step change** in our cost base?
5. Are **my profits** going to dominant suppliers, and what can I do about it?

In a nutshell, the path to better returns is within the grasp of all TTL companies. The challenge lies in picking the right path for your industry and your specific business, and galvanising your team and your shareholders for what are often difficult and sometimes radical decisions. If you would like to discuss how businesses in TTL and other industries have made this work, we would be delighted to talk.

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