A substantial market

By any measure the UK leisure travel industry is a large, **highly fragmented** and **competitive** market. In total, UK consumers take almost 115 million **holiday trips** each year. Of these, some 40 million trips are overseas (“Overseas Holidays”) – a market worth £17.5 billion.

The position of the Overseas Holiday market in the context of the overall **leisure travel market** can be summarised as shown in the diagram below:

**Destination**

The most popular overseas destinations for UK holidaymakers are Spain, France, Greece and the USA (see chart below). By definition, many of these destinations require air travel as part of the holiday experience, with self-drive only being a practical option for certain Western and Northern European destinations. However, a wide range of holiday experience is possible in any of the above countries.

**Segmenting the market**

Understanding how a market is **segmented** is an important part of assessing the nature of competition in an industry.

The Overseas Holiday market can be segmented in several ways:

**Transportation**

The key distinction here is between holidays involving an element of air travel (“Air-Inclusive Tours” or “AIT”) and holidays involving other means of transport (Non-AIT). The most significant type of Non-AIT transportation is “Self-Drive”, particularly to France, Italy and Ireland.
the tour operator controls and manages most of the holiday experience. Coach holidays are a good example of this, as are “soft adventure” holidays where small groups are guided round a selection of pursuits such as trekking and white-water rafting.

**Activity**

A number of holidays are designed around offering a particular type of activity such as sailing, scuba diving, walking or skiing. Such holidays can also offer expert tuition as part of the package or alternatively be designed for well-experienced participants. Activity holidays have enjoyed particularly strong growth in recent years. Although many activities can be considered to be niche products, some - like skiing - have become more mainstream over the years.

**Duration**

Most holidays tend to be taken for either 7 or 14 nights. However, according to the International Passenger Survey, the fastest growing segment by holiday duration is for holidays taken for between one and three nights (i.e. weekend and short break holidays). The rapid growth of the low-cost airlines has made it easier and cheaper for customers to organise holidays with shorter or more flexible durations. This is reflected in the substantial growth in overseas short breaks as shown in the graph below:

![Growth of Overseas Short Breaks](chart)

**Price and Quality**

As in any consumer market, operators position holiday products in a range of prices from unbranded, discounted holidays priced at less than £99 per person to luxury, all-inclusive and highly bespoke itinerary holidays in excess of £10,000 per passenger.

The majority of Overseas Holidays taken by UK consumers involve taking either a scheduled or charter flight to their chosen destination and so fall into the AIT category. Within the broad AIT classification, there will be a plethora of different destinations, accommodation types as well as varying degrees of customer management. All of this translates into a continuum of holidays covering a broad range of price points.

**Mass market versus specialist holidays**

An important distinction can be made between “mass market” and specialist holidays.

Mass market holidays describe the traditional summer sun-type package holidays. This segment is described in more detail later.

The specialist holiday market comprises two segments – “Specialist AIT” (12 million passengers) and Specialist Non-AIT (9 million passengers) (as illustrated on the chart on the previous page).

**Sizing the prize - market size and growth**

The air-inclusive market is the biggest and most valuable part of the Overseas Holiday industry. According to the Civil Aviation Authority (“CAA”), in the year to September 2003, some 27.8 million AITs were taken by UK consumers. The total value of these holidays was £13.1 billion. This compares with 1993 when the number of AITs taken was just 15.4 million with an aggregate value of £5.3 billion. The growth in the AIT market is illustrated in the chart below:

![Growth in Air-Inclusive Holidays](chart)

Since 1993, the total value of AITs has, on average, grown at over four times real GDP growth. In other words, the AIT market has grown much faster than the UK economy overall. By any measure, overseas
holidays involving air travel has been a high growth industry.

**Digging deeper into the structure of the market**

As summarised in the industry structure chart, there are four **key segments** in the UK holiday market:

- **Mass market AIT** – 17.5 million trips
- **Specialist AIT** – 10.0 million trips
- **Specialist non-AIT** – 8.5 million trips
- **Domestic holidays** – 74 million trips

Note - by definition, domestic holidays are “Non-AIT”!

A major difference between the AIT and non-AIT segments is that all operators of AITs are **regulated** by the CAA. In 2003, a total of 1,619 firms held the requisite **Air Travel Organisers’ Licence (“ATOL licence”)** permitting them to sell AITs to the public. The CAA seeks to protect consumers and requires that holders of ATOLs must satisfy a number of criteria, including a financial fitness test. The importance of this regulation is considered in the case study on bonding and the collapse in summer 2004 of two large travel firms - Golden Sun and Travelscene.

**The Mass Market Business Model**

As mentioned previously, “mass market” refers to the largest segment of demand which, for the last 25 years has centred around taking **large volumes of passengers** principally to Mediterranean destinations, in particular Spain.

As in many industries, there is a high degree of **market concentration** amongst the main operators in the mass market AIT segment.

The mass market is dominated by a few large, **vertically integrated** tour operators, each of whom own and operate:

- Their own aircraft fleets
- A portfolio of tour operating businesses and brands
- Distribution networks in the form of **retail travel agents** as well as a number of **direct-selling** channels.

The five largest groups together represent around 51 per cent of the total ATOL-licensed market, or some 16 million passengers. These are:

- World of TUI (formerly Thomson Travel Group)
- MyTravel Group (formerly Airtours)
- Thomas Cook Group
- First Choice Holidays Group, and
- Cosmos

The balance of around 12.4 million licensed AIT capacity is spread among the remaining 1,600+ ATOL holders.

An example of the vertically-integrated nature of the largest group - World of TUI - is shown below:
These operators have also invested heavily to secure accommodation in popular destinations through a combination of equity ownership and long-term contracts.

In order to maximise the returns from such a business model, these operators have been forced to focus on those destinations which attract the largest customer volumes – allowing them to maximise the operational leverage from vertical integration across all parts of their business.

It is the availability of accommodation, the aircraft capacity and flight frequency which determines the scale of any vertically integrated operator’s programme to a particular destination.

Price and discount driven market

The level of demand is effectively solved by flexing the price charged. In the mass market AIT industry, demand can always be created by operators: the key question is - can it be created profitably?

The high degree of competition between each of the market leaders combined with the mass-market consumer’s desire for low prices and a reasonable degree of similarity between each competitors’ products means that the majority of these scale benefits are passed back to the consumer in the form of discounts and cheap fares.

As a result, operators in the mass market have tended to make relatively low margins, but on very large customer volumes.

The Specialist Holiday Business Model

There are two main segments of the holiday industry in which specialist holidays are sold:

- Specialist AIT (12 million trips)
- Specialist Non-AIT (9 million trips)

Another case study analyses the business model of the specialist holiday market and considers the example of a group (Holidaybreak) which has benefitted from the strong growth of consumer demand for specialist travel services.

Specialist AIT

The specialist segment of the AIT market is a large segment with approximately 12 million passengers in 2003. Success in this market is less dependent on scale and much more dependent upon delivering a clearly differentiated holiday offering. There are three characteristics which distinguish specialist operators from those in the mass market.

- First, the ownership structure is very different with a large number of businesses in the specialist segment being run by owner-managers.
- Second, they are not vertically integrated.
- Third, the focus on a particular segment which has a discrete size has meant that there is little opportunity to become similar in size to one of the mass market companies.

It is each of these factors which have contributed to the fact that most specialist operators are relatively small. However, smaller does not automatically mean less profitable. There is much evidence to show that specialist operators are successful at driving high margins and profits per passenger, particularly where the operator has a clearly positioned brand and is able to achieve high levels of customer loyalty.

Adding value

Customers of specialist operators are prepared to pay a premium for getting exactly what they want and, compared to mass market consumers, they are relatively price-inelastic. By specialising, there is less opportunity for the consumer to find ready-made substitutes (although certain specialist areas do offer greater scope than others – skiing being a key example).

This greater degree of differentiation between competitors is another key difference between the two segments. In the mass market, it is market capacity,
rather than an individual business’ operation which tends to drive its level of profitability.

**Specialist Non-AIT**
The specialist Non-AIT market represents approximately 8.5 million trips, the vast majority of which are Self-Drive.

Self-Drive refers to holidays where the consumer drives themselves to the destination.

The principal Self-Drive destination is France with some 5 million visits, followed by Ireland, Spain, Italy and the Benelux countries.

France as a destination offers an extensive range of holiday products. The most popular products include camping and mobile-home holidays, apartments, self-catering cottage, Gite and villa rentals and city breaks. Activity-related and cultural holidays are becoming increasingly popular.

There are over 250 tour operators to France alone, many of which specialise in particular holiday products or regions.

**Competitive Importance of Cash Flow**
Finally, in this introductory case study, we consider a key and distinctive feature of competition in the holiday industry - cash flow.

Almost without exception all profitable tour operators, regardless of their size, have strong cash flow characteristics. In many cases, this strong cash flow makes up for the low profit margins achieved on each holiday sold.

Taking **customer deposits** well in advance of departure and also receiving full payment for the holiday often well in advance of payment to both airlines and providers of accommodation means that they tend to operate with large levels of **negative working capital** and accumulate large cash balances throughout the main selling season.

Therefore a tour operator proving a summer-based programme would probably maximise cash balances in July/August while a winter-based ski operator might do so in December/January.

In comparing the mass market operators with those in the specialist market, the key difference is that the specialist operators have very little in the way of accommodation commitments or assets (they do not have fleets of aircraft or a large retail network to pay for).

Therefore, because they have greater profit per pax and lower cash expenses, specialist operators tend to generate even greater amounts of cash.

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**Jargon Buster**

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**Segmentation**
The process of dividing the total of consumers in a market into distinct groups, with the aim of treating those groups differently. This is particularly important in the holiday industry where customer needs and wants are so varied.

**Air-inclusive tours (“AITs”)**
Holidays that package a flight with accommodation and other services.

**Market concentration**
The degree to which a market is controlled by the largest operators. A high degree of market concentration suggests that a market is dominated by just a few operators who are likely to enjoy the highest profits.

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**Questions of Strategy**

- Assess the reasons why France and Spain are the most popular overseas holiday destinations for UK tourists.
- What are the advantages that operators such as MyTravel and World of TUI enjoy from being “vertically-integrated”?
- What are the barriers to entry for a new tour operator wishing to sell holidays to Greece?

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**Web Watcher**

- World of TUI (Thomson Holidays)
- Laskarina (example of a leading specialist tour operator)
  [http://www.laskarina.co.uk/](http://www.laskarina.co.uk/)