



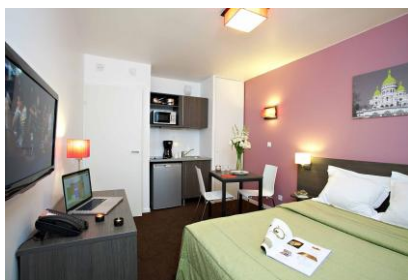
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OTAs – A HOTEL'S FRIEND OR FOE?

HOW RELIANT ARE HOTELS ON OTAs?

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Introduction

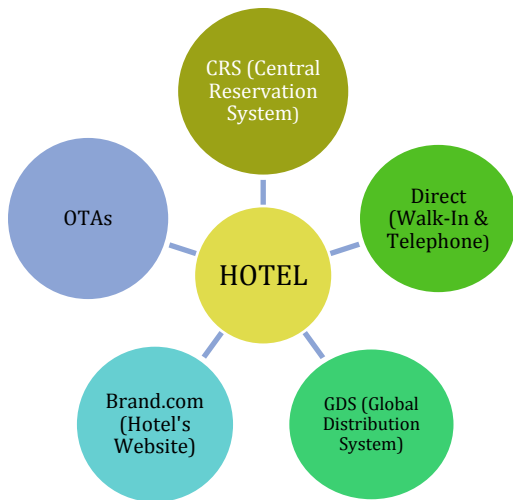
No other hotel-related topic has been as globally widely discussed over the past few months as that of online travel agents (OTAs) and their position as intermediate between hotels and guests. However, before condemning or praising their presence, how did OTAs actually emerge and how do they work?

The history of hotel bookings

Shifting habits

Whereas early on in the era of hotel bookings reservations were either made directly (telephoning the property/face to face) or via a travel agent, over the past few decades a larger offer of booking channels has emerged. Nowadays, hotel distribution channels for transient bookings can be grouped into five major categories as shown in the following chart.

CHART 1: HOTEL DISTRIBUTION CHANNELS



Source: HVS Research

With more booking channels emerging, traditional channels are slowly but steadily losing market share while new channels, notably those that allow bookings via online channels, such as brand.com, OTAs and GDS, grow in popularity. The results of individual leisure and business bookings for the first quarter of 2015 show year-on-year growth in bookings made via OTAs (15.1%), brand.com (7.1%) and GDS (1.1%), whereas direct and CRS bookings decreased by 8.4% and 6.1%, respectively (Source: Travelclick, 2015).

The OTA segment is becoming a strong competitor to the individual booking sector and distribution channels; it has already taken substantial share from traditional contracted booking channels, mainly wholesalers and tour Operators.

CHART 2: OVERVIEW – WHOLESALERS VS OTAS

Wholesalers/Tour Operators and OTAs	
The best known companies	
Wholesalers and Tour Operators <ul style="list-style-type: none"> Abercrombie & Kent American Express Carlson Wagonlit Gulliver's Travel Kuoni TUI Travel PLC Virtuoso 	OTAs <ul style="list-style-type: none"> Agoda Booking.com Ctrip Ebookers Expedia Priceline.com Travelocity

Source: HVS Research

The rise of OTAs

Around 20 years ago, no one had even heard of OTAs. The concept was slowly developing with Microsoft launching Expedia Travel Services in 1996 in the USA, followed by its European counterpart, Priceline, in 1997. Both platforms allowed customers to book their holidays online. First perceived as a dubious tool for booking, the trend quickly evolved, with booking services expanding from initially hotels only to cars, flights, cruises, restaurants and holiday packages. In 2013, travel sales generated by OTAs accounted for around 45% of total European travel sales revenue (Euromonitor, 2013), of which 76% was generated by the two major players, Priceline and Expedia (82% and 18%, respectively, emphasising the substantially stronger market presence of Priceline in Europe owing to its strong presence with Booking.com). However, this development took place at the expense of direct bookings and traditional travel agency bookings. Although OTAs still achieve the lowest market share in terms of travel sales revenue amongst all distribution channels, they have recorded the strongest growth in revenue and average rate for several consecutive quarters (TravelClick, 2015).

The following paragraphs compare the two existing models for OTAs.

The two models

The merchant model

The merchant model has its roots in the individual wholesale and tour operator segments and is also known as the 'net contracted rates' model. Net contracted rates are agreed between hotels and wholesalers/tour operators for the sale of a fixed number of hotel rooms and have to be marked up by an agreed-upon percentage if not sold as a part of a bundle with other services (such as air, transportation, sightseeing tours and so forth). These rates are generally calculated using the expected best available rate for a specific period, minus a 25-30% mark-up, and sold to the wholesalers and tour operators (also referred to as B2B wholesale net rates).

In return for the comparably low net rates, wholesalers ensure hotels enhanced visibility and more incremental bookings and revenue resulting from the guaranteed allotments as well as the opaque¹ and bundled packages. However, wholesale rates negatively impact average daily rates as only the net rates are reflected in average rate calculations (total rooms revenue generated divided by the total number of rooms sold) as opposed to the rates effectively sold on the market.

While this model is still applicable today for wholesalers and tour operators, most OTAs have moved on to the agent model over the past few years (for example, Booking.com).

The agent model

Initially, the merchant model was also applied by OTAs albeit on an online platform, but most of the biggest players have switched to the agent model, which entitles OTAs to a so-called 'success fee' for each booking generated. This model guarantees a fixed commission per booking (on a per room and per night basis) to the OTA and leaves the client with the option of paying either upfront at the time of booking or at time of check-out at the hotel. Commissions payable by

a hotel depend on the market share and exposure guaranteed by the OTA as well as the buying power of the hotel (independent hotels generally have limited buying power compared to large hotel chains, which leaves them with little negotiation power and thus generally higher commission rates than those achieved by larger hotel chains). Whereas independent hotels and small hotel brands might be facing OTA commissions as high as 30% of rooms revenue, larger chains might be able to squeeze them to as low as 15%. However, large OTA players, given their global exposure and market strength, tend to have the upper hand and manage in most cases to charge commissions ranging around 20-25%.

The agent model allows hotels to be more flexible in terms of rooms to be allocated to OTAs and they can thus manage their inventory more flexibly and react to sudden market changes. The latest large player to introduce this model was Expedia with its Expedia Traveler Preference Program (ETP), in 2012/13.

The comparison

Depending on what role a stakeholder is playing in the interaction between hotel and OTA, one might prefer one or the other model. While operators might prefer the agent model as paying directly at the hotel will allow for the accountability of higher average rates (as full rate is accounted for within rooms revenue whereas for the merchant model only the net rate is used), hotel owners might not be so fond of this model, as higher rooms revenue might subsequently lead to higher management fees to be paid to operators. Furthermore, allowing guests to pay at the hotel will result in higher credit card fees, which is a further liability on profit margins that ultimately has to be born by the hotel owners.

However, at the same time, hotels can be more reactive in regards to market changes and can adjust room rates instantly via the agent model, whereas the merchant model is seasonally static. Additionally, reports prove that giving the customer the freedom to pay for their stay upfront or at the time of check-out will lead to increased number of bookings. This means, for example, that while cancellation policies do not change depending on whether a stay is paid fully upfront or at the time of check-out, a cancellation under the second scenario might seem less stressful for the client, as he will not have to claim money back

¹ Opaque pricing consists of wholesalers only disclosing the name of the hotel after a stay has been booked, while bundled pricing consists of selling hotel inventory in a bundle with other services such as flights and car rentals. Both techniques prevent the end client from identifying the price of the hotel room, as only the final package price is visible, allowing hotels to sell unsold inventory at discounted rates in when needed without displacing full-paying guests.

from any third party. Thus, deciding which channels to prioritise will ultimately depend on the overall sales strategy of the hotel, as established by the operator, and in alignment with the investment objectives of the owner.

A changing landscape

The most significant players amongst OTAs are Expedia and Priceline (better known for its European branch, Booking.com). With Expedia's acquisition of Travelocity in January 2015 and Orbitz Worldwide shortly thereafter, Expedia² gained first position in terms of worldwide gross bookings, whereas Priceline

controls around 62% of the European market, whereas Expedia accounts for around 70% of the total

CHART 4: RELATIVE MARKET SHARE (IN TERMS OF REVENUES) OF MAIN OTAs IN EUROPE (2013)

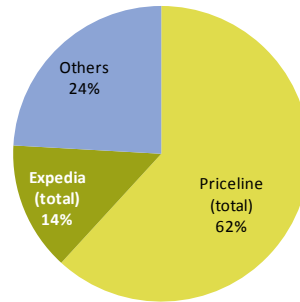
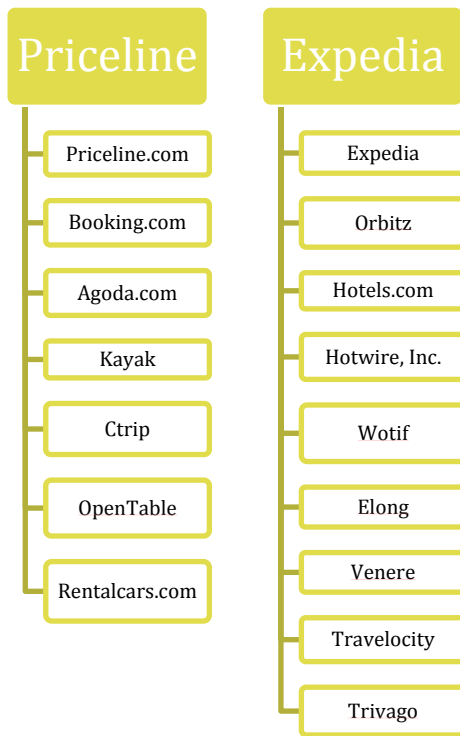


CHART 3: THE TWO BIG OTA PLAYERS AND THEIR 'BRANDS'



Source: HVS Research

remains the largest OTA by revenue (collecting on average US\$0.17 per dollar booked compared to US\$0.12 for Expedia).

Challenges

Through their strategic acquisition of smaller regional OTAs, both Priceline and Expedia have secured their position as the two most powerful global OTAs. With Priceline acquiring Booking BV in 2005, it now

² We note that Expedia sold its eLong stakes in late May 2015.

Source: European Hotel Distribution Study: The Rise of Online Intermediaries (2014)

US market, owing to its acquisition of both Tavelocity and Orbitz.

The risk in this duopoly of Expedia versus Priceline lies in the growing market power and control of these two giants in regards to both hotels as well as smaller-scaled OTAs.

It begs the question (or concern?) as to whether increasingly dependent hotels might be forced to work with these two major players with limited negotiation room in terms of commissions payable, whilst at the same time having a reducing number of alternative OTAs to turn to?

So...friend or foe?

The rate parity debate remains a much discussed industry concern.

The rate parity agreements that OTAs make their hotel partners sign upon entering into a relationship used to be commonplace. These agreements were to ensure that the rates offered on brand.com were the same as those offered to all OTA partners, irrespective of commissions charged in return or the market exposure provided. However, recent claims have arisen, pointing out the potential market regulation that these agreements might entice. The first official action taken against rate parity clauses was in January 2013, when the Higher Regional Court of Düsseldorf ruled against Germany's largest OTA, Hotel Reservations Services (HRS), and its practice of 'best rate guarantee'. Ever since, an increasing number of antitrust legislators

within the European Union have been following up on the same and impose OTAs to amend their rate parity agreements to refrain from regulating the market, and thus ensuring higher economic market transparency. Following HRS, Booking.com eased its rate parity clauses as well, after having been under severe pressure from regulators in Sweden, France³ and Italy. The former 'best rate guarantee' is now the 'narrow price parity', which still enforces the same rate to be offered on brand.com and on booking.com, but no longer implies that the same rate is offered on competitor OTAs.

While some industry experts argue that the loosening of the rate parity clauses might lead to a downward spiral in pricing, resulting in price wars between brand.com and OTAs, others argue that the pricing market will become more appealing as hotel revenue managers become more aware of what rates to offer on what channels and to which clients.

The friend

When it comes to market exposure, there is limited comparison to the market exposure a large OTA can provide a hotel with, which is especially appealing for unbranded properties, which might otherwise have limited visibility⁴. Allowing for global market exposure and with marketing budgets of substantially bigger scales than those possibly provided by hotel chains or even independent hotels, OTAs have much more power to invest in marketing campaigns and thus reach a much wider audience. Marketing being one of their core business pillars, OTAs have much more substantial resources to ensure large market exposure. These include for example sites in multi-language settings, a large variety of country-specific domains (for example OTA.com, OTA.es, OTA.co.uk, OTA.fr and so forth) and the ability to launch market- and country-specific campaigns. This level of exposure is difficult to reach by a hotel company, let alone an independent hotel.

³ We note that as per HOTREC (European Trade Association of Hotels, Restaurants and Cafés) the French National Assembly signed a law prohibiting rate parity clauses between OTAs and hotels in June 2015, which, according to the association, 'allows hoteliers to regain their entrepreneurial freedom'.

⁴ For more elaborate information on OTA exposure and its costs, please refer to 'Understanding Online Distribution Channels', an HVS article published by Juan Duran in June 2015.

Another advantage of selling inventory via OTAs is the possibility of selling opaque rates and bundled rates. Opaque rates are referred to as being heavily discounted rates for unsold inventory offered on a non-transparent basis. This means that the brand of the product remains hidden until completion of the purchase. Bundled rates also consist of heavily discounted rates; however, the booking is offered as a package, wherein the purchaser only sees the final price and not the breakdown per item included in the package (for example, hotel + flight, as offered by Expedia). Both these strategies allow hotels to push occupancy in periods of need without affecting their price positioning or at the expense of full-paying demand.

The foe

While OTAs offer a range of advantages, their high commission rates constitute a major concern to most hoteliers. With commissions ranging from 15% to as high as 30% depending on the OTA and the size of the hotel/chain, OTAs are a heavy burden to hotel profit margins.

Furthermore, with a growing trend of OTAs entering the loyalty programme sector, hotel companies are at risk of losing one of their main unique selling points when comparing brand.com versus OTAs. Whereas a few years ago, loyalty programmes were only offered by hotels themselves and rewarded guests for booking directly with the hotel, some OTAs have now introduced their own loyalty programmes, rewarding their clients with points for any booking completed via their channels, irrespectively of the brand or type of property booked.

Another limitation imposed by OTAs is their insistence on best price guarantee and rate parity amongst all channels⁵ (although this practice might soon become a thing of the past). As previously outlined, OTAs' agreements signed with their partner hotels ensure that rates offered on OTA sites need to be in line with those offered on other channels as well as on brand.com. This leaves limited manoeuvre space for hotels in order to make brand.com more attractive and more likely to be chosen for bookings.

⁵ We note that on 25 June 2015, Booking.com confirmed that it will remove its rate parity clause from all its European contracts. In future, they will only claim rate parity between brand.com and their own webpage.

Best practices – recommendations

While cutting off OTAs as a booking channel for your respective hotel might not be the best solution, the focus should remain on how to achieve a healthy balance between OTA bookings and hotel webpage bookings. We discuss a few options below.

Hotel webpage (brand.com)

In order to drive traffic to brand.com and ultimately enhance the brand.com conversion rate, it is essential for the hotel-owned webpage to be up-to-date, including all relevant information and the newest and most accurate pictures of the property⁶. A growing trend shows that guests are eager to compare offers and presentations of a hotel prior to taking a final decision. With the extensiveness of booking channels available at easy disposition, and given the hotel's duty to comply with rate parity throughout all channels, it might come down to small details that make guests decide upon what channel to book through. These factors might include criteria such as:

- Accuracy of the property description;
- Extensiveness of property related topics;
- Time required to complete booking;
- User-friendliness of booking channel;
- Feeling of payment security;
- Simplicity of altering or cancelling a booking;
- Availability of brand.com-specific promotions.

Search engine optimization, meta search and pay-per-click advertisement

A successful way of enabling hotels to increase their hotel webpage conversion rates and thus achieve more profitable return on investments from this sales channel is by investing in 'Search Engine Optimization' (SEO), which is a process of improving the visibility of a website on search results, one of the most popular being Google Ads. Through target-specific 'Search Engine Marketing' (SEM), hoteliers have the possibility to strategically place small ads in selected areas on search engines that entice customers towards their

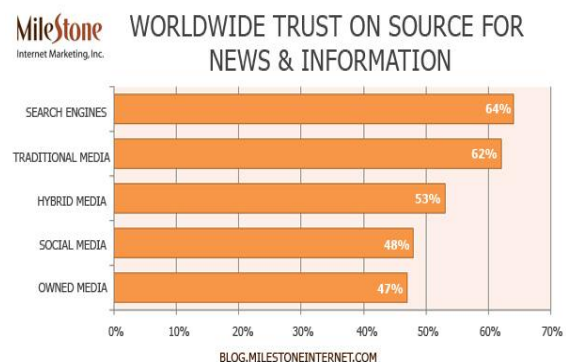
⁶ For further information on the importance and cost of a hotel webpage, please refer to 'Understanding Online Distribution Channels', an HVS article published by Juan Duran in June 2015.

brand.com webpages. While those campaigns are not cost free, they ultimately aim to increase brand.com conversion rates, with comparatively lower costs than rooms sold via OTAs. While the placement of ads through SEM is free of charge, the hotels pay for each customer click to access the hotel-owned webpage (referred to as PPC or pay-per-click).

Hilton Worldwide claims to have increased its conversion rate by 45% since working with Google Ads (Source: thinkwithgoogle.com, 2015). While SEO campaigns are comparably cost-efficient when compared to OTAs, they might also result in stronger customer brand loyalty and guest brand retention.

Furthermore, according to the 2015 Edelman Trust Barometer study, search engines have grown into the most trusted source of information (64%), surpassing traditional media by two percentage points. Millennials are proven to have even stronger trust into digital media (72%).

CHART 5: WORLDWIDE TRUST ON SOURCE FOR NEWS AND INFORMATION



Source: Milestone Internet Marketing Inc., 2014

Nevertheless, hotels' PPC strategy is threatened by OTAs' intrusion into the SEO concept, meaning that several OTAs, while already benefitting from large exposure, further increase their market appearance by implementing PPC strategies that result in OTA ads to be placed above those of brand.com. This is also referred to as mirror-marketing. This indirectly reduces hotel's investment and efforts in building brand loyalty, customer retention and increased conversion rates driven via their own webpages.

Conclusion

While OTAs are the subject of much controversy and significant animosity, their advantages and

disadvantages need to be evaluated with care. In general, OTAs are a successful additional distribution channel, that, even though charging high commission rates, allows for valuable market exposure. However, the commission rates charged do weigh heavily on profit margins. Nevertheless, it is important for each revenue manager or hotelier to fully understand the costs related to each distribution channel prior to taking any decisions.

Furthermore, it is important that hotels ensure that their own webpage (brand.com) is complete, up-to-date and offers advantages such as special rewards to clients when booking through brand.com. This will stimulate brand.com conversion rates and ultimately not only result in lower distribution costs, but at the same time in enhanced customer loyalty and thus retention.

It is also increasingly helpful for hotels' websites to contain some of the stronger marketing techniques and design attributes of the OTAs and comparison websites ('beat them at their own game.').

While some hotels' strategy is to limit OTAs' share as much as possible, the question that remains is whether these properties are able to substitute the missing OTA bookings with reservations received either directly or via other lower-cost channels?

Thus, the core question is how much of your total business shall be derived from OTAs? By limiting OTAs as much as possible, hotels might be able to decrease distribution costs; however, will it be at the expense of overall occupancy and does this then limit the hotel's revenue earning capacity in, say, restaurants and bars? At the end of the day, there is no right or wrong approach in regards to how many OTA bookings should be accepted, it will ultimately depend on the hotel-specific requirements.



About HVS

HVS, the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries, celebrates its 35th anniversary this year. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 35 offices and more than 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. www.HVS.com

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