# Demystifying the Digital Marketplace: Executive Summary

The digital marketplace has undergone a significant amount of change in the intervening years since *Distribution Channel Analysis: A Guide for Hotels* was published in 2012. Following a deep dive into the travel distribution landscape, three primary themes have emerged:

1. **Hotels are exploring new techniques for implementing revenue strategy. An abundance of new online models has driven an imperative for hotels to shift from traditional, analog operating methods to a focus on digital.**
   Current operating methods are costly and deployment is inefficient. This fact is evidenced by the rate of third-party commission growth rising at twice the rate of revenue growth. Hotels previously tried to be available "on every shelf" but most have realized at this point that (1) it costs too much to be prominent in every distribution channel and (2) the dominance of third party intermediaries in the consumer path can undermine the relationship between hotel and consumer. Hotels will always have the opportunity to build a relationship during the actual stay experience but risk losing out on the connection made through inspiration, information gathering and booking phases of the travel journey. Third party intermediaries are focused on developing their own customer bonds and have little incentive to facilitate the relationship between a hotel and their shared customer.

   Therefore, in spite of a mutual dependence between hotels and third parties, a sense of competition arises for "owning the customer relationship." Two critical components of revenue strategy involve **managing to a hotel's optimal channel mix,** including close tracking of acquisition costs, and **differentiating the guest experience** during the stay as well as in pre- to post- stay contact.

2. **The legacy OTA model is declining while apps and metasearch are gaining traction by providing consumers a more convenient and seamless experience across air, car, hotel and other components of travel.**
   The legacy OTA model once assisted consumers by narrowing down lists of hundreds of hotels while still offering a wide range of options. A number of new models point to a next generation consumer interface. With metasearch and social sites (like TripAdvisor and Facebook), along with some new apps (like Google Trips) now seamlessly integrating many elements of travel, the evolution toward a **curated consumer experience** is underway. In the meantime, some foundations of the traditional OTA model have been challenged. Through rigorous research on consumer clickstream data, the **"billboard effect" was dismissed as a dead concept.** The claim had been that OTAs drove multiple brand.com bookings for each one booked directly on the OTA site. However, a 2015 research study sponsored by the Consumer Innovation Forum (CIF), an American Hotel & Lodging Association committee focused on the education and research of the hospitality industry's digital and distribution space, proved there is barely any lift in brand.com bookings as a result of visits to traditional OTAs. Further, some conditions that locked up hotel inventory and rates for third parties such as rate parity and last room availability are dissolving, whether from European regulators in multiple countries or changes in large chain agreements, thereby paving the way for **greater autonomy by hotels and smaller third party distributors.** These changes will ultimately result in a more open and competitive marketplace.

3. **New entrants spell disruption for select customer segments.**
   There are a few key segments in which disruption is imminent. **Corporate travel** has long relied upon legacy travel management companies handling the larger managed travel accounts, in contrast to a high degree of fragmentation on the lightly managed and unmanaged business travel. New developments are likely to force change in the traditional RFP process for corporate accounts – such as rate scanning with auto-cancel and rebook capability up until day of arrival, reward and incentive programs for travelers to self-police their own spending, aggressive moves by third parties to aggregate the lightly managed accounts, along with consolidation by hotel chains who don't participate in annual rate bids. Corporate account activity will further be diverted by the aggregation of **home and vacation rental markets,** which will also create supply spikes during leisure high demand periods. The **groups and meetings** market is also ripe for disruption. The last five years have seen extensive offline third party intermediation, but no one has yet managed to aggregate this demand by offering a compelling online venue for casual or professional meeting planners to shop and book. Historically, the booking of groups and meetings has been inefficient and costly, but indications are that the next 3-5 years will bring new options for this segment which may finally streamline a highly inefficient process with reduced costs and an improved experience for the consumer.

These three themes, along with many more, will be explored throughout Parts 1–3 of this edition of *Demystifying the Digital Marketplace: Spotlight on the Hospitality Industry.*

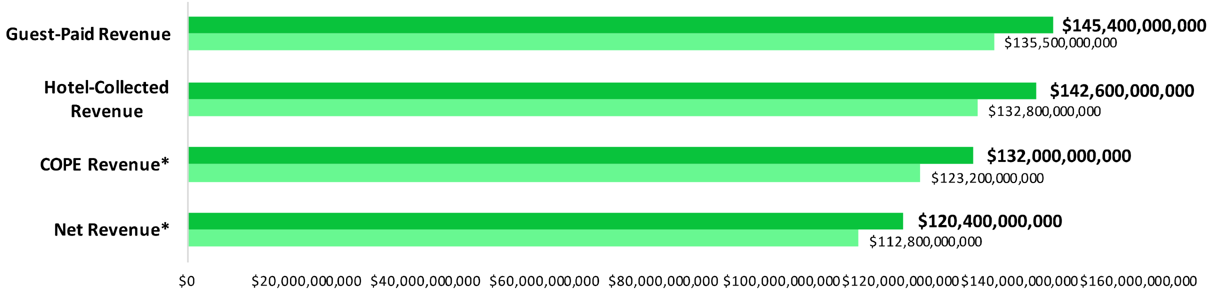
## REPORT HIGHLIGHTS: PART 1

U.S. hotels paid approximately $25 billion in overall customer acquisition costs in 2015 on guest paid revenue of $145.4 billion. This guest paid revenue grew year over year, from $135.5 billion in 2014 to $145.4 billion in 2015. Despite this, the Revenue Capture figure for the industry in the U.S., the percentage of revenue retained by the hotels after paying all customer acquisition costs, declined by .4% over that same period. The Revenue Capture decline, from 83.2% in 2014 to 82.8% in 2015, represented almost $600 million in revenue that, if it had been retained, would have contributed directly to net operating income and the hotel's return on investment. Using an 8% capitalization rate, this additional cost of $600 million reduced the asset value of the overall hotel industry by at least $7.5 billion.

### Revenue Capture for Total U.S. Market: 2015 vs. 2014

**As Hotel Revenue Capture declines, Real Estate value erodes**

**Revenue Capture Loss (-0.4) = $572.8 m**




| | Net Revenue | Revenue Capture |
|---|---|---|
| 2015 | $120,400,000,000 | 82.8% |
| 2014 | $112,800,000,000 | 83.2% |
| Change | 6.7% | -0.4% |

*COPE: Contribution to Operating Profit and Expenses (revenue less commissions and transaction fees).

*Net Revenue removes commissions, transaction fees, and sales and marketing expenses.

1. **ITS ALL ABOUT OPTIMAL CHANNEL MIX**
   Every single booking, no matter the source, comes with a price tag. A hotel will never get all of its bookings from a single channel and so hotels must work to identify and manage to an optimal channel mix. At the hotel level, managing costs is not simply about negotiating a better deal with a channel vendor such as an OTA. **It's about understanding (1) the profile of demand in a hotel's market and (2) the costs associated with getting that demand and then (3) proactively managing to a channel mix deemed optimal because it yields the highest net revenue and profit contribution.**

2. **COMMISSION GROWTH IS RISING AT A FASTER RATE THAN REVENUE**
   A 2013 Kalibri Labs study in conjunction with the Hospitality Asset Managers Association (HAMA) indicated that commissions were rising at twice the rate of revenue growth from 2009 to 2012. The Kalibri Labs database of stay data from 25,000 hotels revisited this pattern and results indicate that **commissions paid to third parties are still rising at twice the rate of room revenue growth for the period from 2011 through 2015.**

3. **TRIP PLANNING IS COMPLEX**
   The trip planning process is complex and most consumers stop at many sites on the sales path that ultimately leads to a hotel booking. Maintaining a presence in each site has a cost and tradeoffs must be made. **The days of being present "on every shelf" are over.** That approach may have worked in the early 2000s but not today. The costs have risen too high for any hotel to afford to do that. Understanding the consumer sales journey is key to making the best tradeoffs.

4. **CONTENT IS KING**
   Compelling descriptions, photos/video, and strong value propositions are the ingredients that ring the cash register. The best content leads to higher conversions for any merchandiser of hotel rooms. Making sure this content is readily available and that a hotel chooses carefully when deciding **which content should be exposed for its own direct channels and for each of its merchandising partners can be the primary engine that shifts business from one channel to another.** Managing content carefully is crucial to achieving an optimal channel mix.

5. **THE BILLBOARD EFFECT IS DEAD**
   A study conducted by AH&LA's Consumer Innovation Forum (CIF) examined consumer clickstream data from 2012 and 2014 and concluded that consumers used OTAs considerably more from 2012 to 2014, and when they visited OTAs they rarely returned to book at the hotel brand*. In fact, the likelihood of an OTA shopper returning to book at brand.com was only 7%. The concept promoted by the OTAs that was called the "billboard effect" claimed the visibility given to hotels by listing with OTAs resulted in many more bookings on brand.com as a result of a presence on the OTA. The 2015 study was conducted by systematically testing this theory using three different statistical models. The study indicates, unequivocally, this "billboard effect" does not exist and it appears that the multi-billion dollar marketing spend by the OTAs has benefited the OTAs at the direct expense of brand.com. This has not been particularly beneficial to consumers as rate parity has kept rates essentially the same on both, and third party bookings have been tainted by the many deceptive practices employed by some OTA affiliates.
   **the study examined routine bookings, not those made when specific joint promotions between OTAs and hotel brands were in effect.*

6. **LAST ROOM AVAILABILITY (LRA) AND RATE PARITY**
   The constraints in the market around last room availability (LRA) and rate parity have been in play over the last few years and have become much more flexible over the last two years. For a hotel, having flexibility in deciding the rates and inventory offered in each channel are key to achieving an optimal channel mix. These conditions can be important levers for a hotel to favor one channel over another in their quest to find the optimal blend and achieve the optimal profit contribution. **Changes made by major brands and by legislation in many European countries is driving the industry toward a more open model where hotels have more control over rates and inventory than they have had in many years.**

7. **ONLINE TRAVEL AGENCY (OTA) CONSOLIDATION**
   The merger and acquisition activity in the last few years has lead to two primary players in the OTA space: Expedia and Priceline/Booking.com. Expedia has grown by acquiring many smaller OTAs and meta search sites and is exploring offering enterprise level technology to the large hotel chains. In addition to its own acquisition of other merchandising websites, Priceline is competing with traditional hotel brands by offering technology services to independent hotels such as property management, revenue management, and website development. Both have acquired vacation rental companies thereby supplementing their hotel room sales. **Both large OTA companies face significant threats by Google, TripAdvisor, and others with strong consumer adoption that offer better cross-travel search functionality.**

8. **SEARCH, META SEARCH AND APPS: WHERE IS IT GOING?**

By 2015, traditional search was fast evolving into meta search combined with instant booking. This will divert business from the traditional OTA models. Good examples are Google, TripAdvisor, and Kayak (now owned by Priceline). The future is in travel apps, not in traditional search, and Google's Destination app is an indication of what that may look like when a consumer can explore options for air, car, hotel, and other ground services. **This reality of metasearch growth is driving the OTAs to diversify and find other revenue sources knowing their legacy models will be eclipsed and that Google's dominant position in mobile devices may put them at a serious disadvantage.**

9. **BOOK DIRECT CAMPAIGNS**

Kalibri Labs' examination of stay data and costs from 25,000 hotels indicate that in 2011 there were 4.3 room nights booked directly for every one that came indirectly but by 2015 there were only 2.7 room nights booked directly for every one booked indirectly. A 40% drop in direct bookings from 2011 to 2015 along with the higher profitability of these direct bookings, 9% in room revenue when compared to OTA, are some of the primary reasons for a stepped up effort in the market for Book Direct campaigns. Major hotel chains are offering loyalty members compelling reasons to book on brand.com while smaller chains and independents are adding pricing widgets to their booking engines to give consumers price comparisons without having to leave their site to rate shop on a third party site.

10. **CORPORATE TRAVEL: THE DAYS OF THE RFP ARE NUMBERED**

There are two new business models emerging in the market that will be a "one-two" punch to the traditional RFP process for business travel. (1) Sites such as TripBam can scan prices constantly and cancel and rebook travelers when lower rates are posted. (2) Services are being offered to corporate accounts by companies like Rocketrip and TravelPerk that pay incentives to travelers for choosing lower cost travel options by sharing a portion of the cost savings with the traveler. **No need to lock in annual rates through a bidding process when a traveler can get the lowest rate available up to the day before arrival and when travelers "self-police" their travel by receiving incentives; these changes put into question the future role of Travel Management Companies (TMCs).**

11. **AIRBNB AND THE SHARING ECONOMY**

The Sharing Economy is adding accommodation supply to markets without any new hotel construction. There are regulatory and tax issues that need to be resolved so the home rental inventory is operating under the same rules as hotels. Beyond this hurdle, **hotels in some markets will be feeling the pressure of this added inventory which may reduce occupancy and challenge pricing power for some hotel products during high demand periods.**