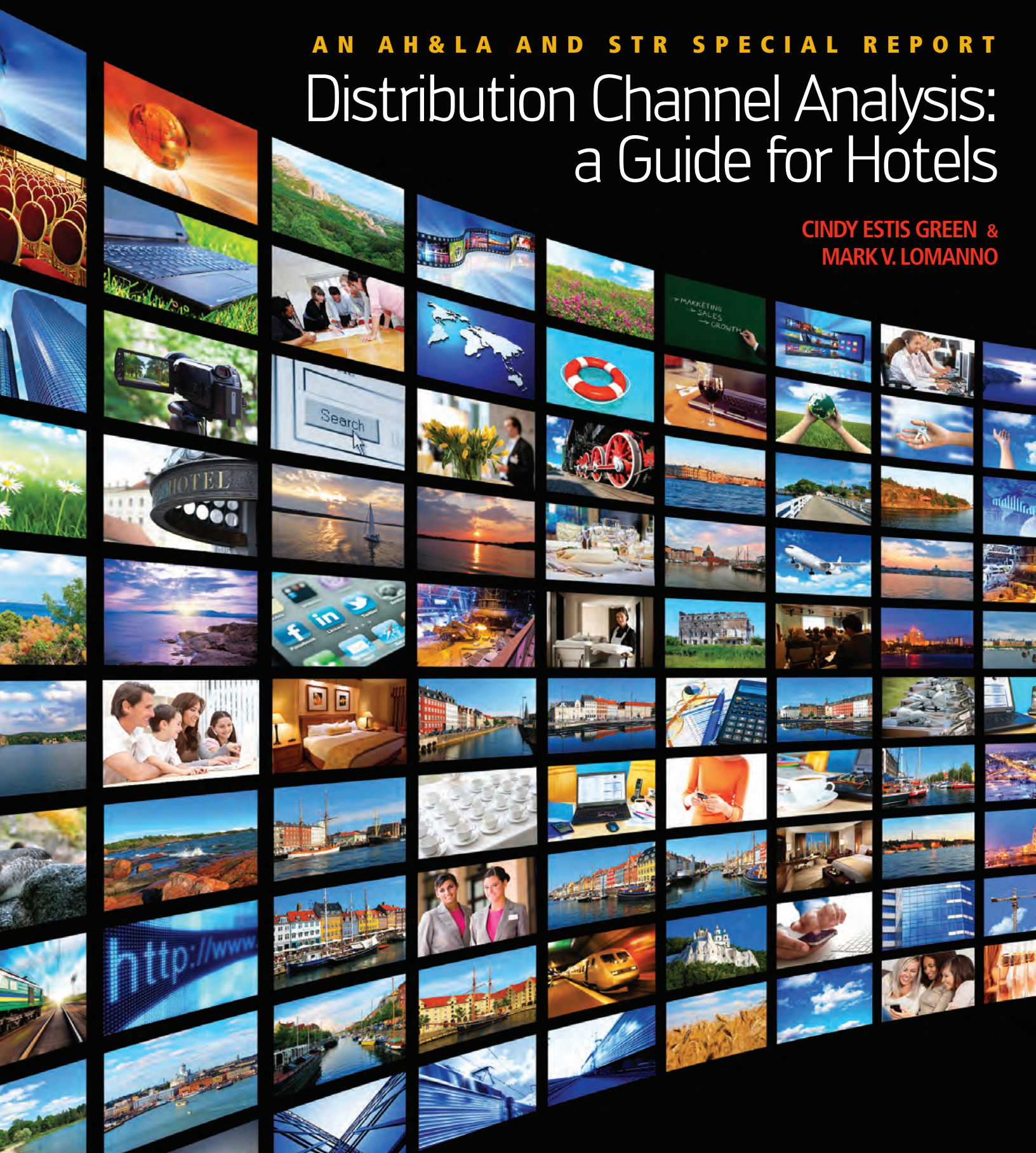


AN AH&LA AND STR SPECIAL REPORT

Distribution Channel Analysis: a Guide for Hotels

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Executive Summary — Distribution Channel Analysis

The Ten Things You Should Know, Detailed Findings and Implications

This study is the culmination of research on distribution practices, the distribution landscape and hotel performance based on channel mix. Distribution costs have been rising steadily. As current and emerging intermediaries take advantage of an active digital travel market, they will wield substantial influence as gatekeepers, imposing fees and charges for directing the consumer traffic to the hotel. Growth in digital travel shopping will expand the transparency of hotel pricing structures putting additional competitive pressure on rates. The combination of the higher booking volumes passing through intermediaries, the costs imposed for intermediation and the pressure on rates will challenge the hotel owner and manager to maintain profit levels. This report and analysis is meant to be a starting point for any member of the hotel community to better understand distribution dynamics and its impact on hotel profitability.



The focus of the study is primarily on the U.S. hotel industry, and although many of those interviewed manage distribution worldwide, and the strategic issues are global in scope, they may play out differently in different parts of the world. It also focuses on the transient business so although the increased usage in third party intermediaries in the group / meetings segments is recognized as a distribution issue, it is not addressed in this study.

THE TEN THINGS YOU SHOULD KNOW

- 1 Hotel demand in the U.S. market is “price inelastic” on an industrywide basis for all hotel types. That means lowering prices will not stimulate enough incremental demand to make up for the rate reductions; there isn’t enough demand in most markets to compensate—therefore, the net result of lower rates is lower revenue levels. This is mainly due to limited demand for lodging services overall in a mature U.S. hotel market.
- 2 On a property level, a hotel may be able to lower prices in certain circumstances to generate enough demand within a comp set to result in a net positive revenue outcome. However, because the rates are so transparent and prominent in current and emerging digital venues, by the time the competitors match the lowered rate, the first hotel that lowered its rates loses any benefit in terms of a demand bump and the entire competitive set may have a harder time increasing rates commensurate with the increased cost of doing business.
- 3 The U.S. hotel market at the comp set level operates as a near zero-sum game. The fact that there has been limited hotel demand growth in the U.S. market (averaging 1.6% year-over-year for the last 20 years) means that any claim that a channel vendor will create substantial new industry level demand is unrealistic. Channel vendors may be very effective in helping a hotel shift share, from one hotel to another or one time period to another. Despite the fact that they might generate some new demand coming from inbound international markets, they are unlikely to bring meaningful incremental demand into any U.S. marketplace in the near term.
- 4 Hotels rooms are for sale in a dynamic and volatile distribution landscape that is launching many market savvy and financially well-endowed “gatekeepers” who will become a new breed of third party intermediary (e.g., Google, Facebook, Apple); their power will grow as they gradually become the preferred points of entry for consumers to do travel shopping and buying. They will charge fees for referrals to hotels and, while there is no firm evidence pointing to an exact number, it is plausible that upwards of half of the hotel business could ultimately pass through third parties before being delivered to a hotel or brand;
- 5 also possible is that costs may run as much as 10% to 20% of revenue for this emerging new network. Although they also pose great opportunities, how the hotel brands manage them in the near future will be critical to the longer-term outcomes and hoteliers will have to remain vigilant to ensure that each new channel has a reasonable return on investment. The categories to watch are meta-search (e.g., Google, Hotel Finder, Room Key), social (e.g., Facebook, Trip Advisor) and mobile (e.g., all OTAs, all hotel brands and new mobile-only players). New technologies like voice- and map-activated applications that are suited to the native mobile environment will become attractive substitutes for the traditional search engine browser for consumers to initiate their shopping and buying. Even when these new third parties send a hotel its business directly, they will charge referral or media fees and these bookings will still require a technology infrastructure to support the inquiries and transaction delivery, all adding to the cost.
- 5 For those concerned about intermediary costs such as the estimated \$2.7 billion cost of OTA commissions in 2010 (as calculated and estimated by this study) or the additional estimated \$1.3 billion paid to retail travel agencies through the GDSs (as calculated and estimated by this study), the prospect of paying double these costs to a widening array of third party intermediaries within 3 to 5 years may be shocking, but it is not unrealistic. Using a hypothetical example, a hotel with \$3 million in room revenue may have paid \$120,000 to \$150,000 in distribution costs in 2010 and may well be paying close to \$200,000 to \$250,000 by 2015. When the U.S. hotel industry ADR in 2010 appears to be \$10 below the inflation-adjusted rate charged in 2000, these added costs aggravate an already challenging profit picture for a hotel owner.
- 6 The primary source of new incremental demand in the U.S. market will come internationally. Despite security restrictions on inbound travel to the U.S., the growing number of Chinese and Indian travelers will provide meaningful growth in major markets. Many large hotel companies are building brand awareness in China and India through aggressive hotel development efforts, but the third parties with marketing savvy and substantial budgets also have their eye on capturing this lucrative inbound demand potential and are laser-focused on securing adoption and loyalty as a reservation channel of choice within these new markets, making them crucial players in the consumer hotel selection process.

- 7 Some third party distribution channels may start to offer similar services as those provided by current franchise and branded hotel organizations. They may develop into a kind of “soft brand” to support client hotels by (1) maintaining a brand presence, (2) providing substantial reservation contribution, (3) maintaining quality metrics for customer evaluation and (4) offering the benefits of a frequency/loyalty program.
- 8 For the hotelier who does not take proper precautions and execute careful planning and control, “last minute” pricing strategies can (1) make forecasting more difficult; (2) lower rates overall; (3) reduce the volume of high rated business booked further out from arrival (why book early when you can wait and get a better deal?); (4) cause consumers to believe that there is little difference between hotel brands (there is a growing commoditization of hotels as a product); and (5) put into question the issue of who “owns” the guest by making the reservation portal the “place to go” for hotel buyers and, in so doing, potentially degrading the value of the hotel brand.
- 9 The prominence and transparency of rates on the Internet and emerging mobile applications, and the concern for “rate parity” to keep the same rates in all channels, may result in a “one-rate-fits-all” pricing structure for many hotels. This undermines the power of marketing which is a discipline built on a foundation that calls for offering relevant products and services with corresponding rates by segment in order to best meet the needs of each customer group. Rates are often diluted by (1) the pressure to keep prominent online rates as low as possible, (2) the reality that many customers have been trained to believe that he or she will find a lower rate closer to arrival, and (3) a propensity for hotels to think that the demand generated by lower rates will always compensate for the rate reduction.
- 10 With a highly fragmented distribution network and limited marketing resources, it is imperative for hotel marketers to understand which promotional efforts to credit with their bookings. The Cornell's Center for Hospitality Research (CHR) published two studies concluding that Expedia creates a “billboard effect” that causes a major lift in a hotel's website bookings. The studies documented specific hotels in conditions that may not mirror a realistic situation for many hotels and do not address variables that may influence the findings in a meaningful way. It would be misleading for a hotel marketer to assume that the study findings can be projected to his or her own hotel. However, the study has become part of the industry dialogue that has lead many hotel companies to develop “attribution models” that systematically help the brands figure out how much to credit each consumer touch point with its contribution to bookings. There is no simple answer to this question and it will become even more complex as new channels come online making a clear case for brands and marketing partners of independents to focus on this question in order to most efficiently deploy marketing resources.



DETAILED FINDINGS

Prices, Price Elasticity and Demand

- ▶ In the mature U.S. lodging market, with demand growth for hotel rooms over the last 20 years averaging 1.6% per year, and indications that this pattern is likely to continue for the foreseeable future, the primary expectation of hotels from their distribution channel partners will be in shifting demand share, rather than generating new incremental demand.
- ▶ Aggregate hotel room demand was found to be relatively inelastic. This is true both at the total U.S. level as well as for each Smith Travel Research (STR) chain scale category. That means that a reduction in room rate will yield growth in demand, but not enough to offset the lower price charged for the room resulting in a net negative result in room revenue. This generally applies at the property level as well, but can play out differently under certain competitive conditions.
- ▶ If increases in hotel room rates are not at or above the inflation rate, then the price increases year-over-year are not sufficient to cover the increased cost of doing business. When ADR growth was examined over time, the U.S. industrywide ADR in 2010 was approximately \$10 below the inflation-adjusted rate charged in 2000.

Channel Production Profile and Relationship Between Channels

- ▶ More than eight in ten room nights (81%) in 2010 were booked through direct channels — voice, brand.com, property direct — as opposed to almost 20% through third party channels (online travel agency or OTA, global distribution system or GDS).
- ▶ Greater than one-third (35%) of the hotel room bookings in 2010 came to the hotel digitally (i.e., brand.com, OTA and GDS), up from 33% in 2009. This component is expected to continue its upward trend through 2011.
- ▶ West coast markets tend to have a much higher percentage of their room nights booked through digital channels than other parts of the country.
- ▶ There appears to be an inverse relationship between customer usage of brand.com and the OTA channels. The data showed that when the percentage of bookings through one of these two channels rose there was a decline in the percentage booked through the other and vice versa. A more detailed analysis of this pattern should be undertaken to better understand the magnitude and nature of the relationship.

- ▶ The flow-through of revenue to gross operating profit (GOP) or net operating income (NOI) by channel varies dramatically when the full cost of hotel operations are applied to a hotel's base revenue. An examination of some chain scale average rates and expenses by channel reveal that some hotels do not attain a high enough average rate in every channel to cover the hotel operating expenses. An analysis of average distribution costs versus average ADR for 2010 indicated that the average contribution to NOI for the respective booking channels in the mid-scale limited service hotels had a range of \$29 per room night from the highest to lowest channel with an average hotel average daily rate (ADR) of \$76.13. The spread for upscale full service hotels was \$75 from highest to lowest contribution by channel to NOI per room night with a hotel ADR of \$132.46. (Note: the analysis of marginal costs applied to incremental room revenue is a different model and both models are included in the chapter on Distribution Costs and Benefits.)
- ▶ Length of stay and ancillary spend vary widely by booking channel and can impact revenue and profit and therefore, have a meaningful effect on channel mix evaluation.

Individual Channel Profiles

- ▶ Brand.com continues to capture a larger share of both the absolute number of rooms booked and the percentage of total rooms booked in year-over-year comparisons representing (in 2010) 16.4% of the demand and 18.5% of the revenue.
- ▶ Central Reservation System (CRS)/Voice share of total rooms booked continued to decline in 2010 as more consumers shifted to digital channels. However, this channel still accounts for more than 13% of all rooms booked and 17% of revenue.
- ▶ Property Direct/Other remains by far the largest booking channel for each chain scale category although it is a mixture of group/meetings, walk-in, contract and other local business so cannot be easily compared between hotel segments. However, the erosion caused by digital channels in both demand and room revenue share is dramatic and consistent. Nonetheless, in 2010, it contributed 51.4% of demand and 45.9% of revenue.
- ▶ GDS bookings, which are dominated by transient business travelers, grew substantially in 2010 as the lodging demand in this segment rose rapidly. It represented 8.3% of demand and 10.8% of the revenue in 2010.

Online Travel Agency (OTA) Profile

- ▶ OTA share of room night bookings grew substantially in 2010 over 2009, representing almost 11% of all room night demand and 7.7% of the revenue.
- ▶ Historically the highest percentage of OTA penetration had been in the higher end chain scale segments. Beginning in 2010, the economy and mid-scale chain segments experienced a notable jump in that they captured the highest percentage of rooms booked through OTAs of all the chain scale categories.
- ▶ All three of the OTA business models (i.e., merchant, retail and opaque) experienced growth in both their demand and room revenue share in 2010 over the prior year. Of the three, the retail segment was the fastest growing in 2011 largely driven by Booking.com's entrance and success in the U.S. market.
- ▶ There has been a recent shift in the percentage of total room revenue booked through the OTAs. Between 2001 and 2009, the OTA share of total room revenue booked experienced big jumps primarily when the economy dipped, and leveled off when lodging demand growth was strong. However, this pattern seems to have changed in 2011, in a year when the economy was recovering and lodging demand rebounded strongly; the OTA channel had a notable rise in revenue likely due to strong growth in the retail model, higher rates overall, and the rise in use by the economy and midscale hotel segments.
- ▶ Spending on hotel rooms by the guest was estimated by this study to be approximately \$2.7 billion higher in 2010 than what was reported on hotel profit and loss (P&L) statements due to the portion of the revenue collected directly by the OTA (using the merchant and opaque models) that did not pass through the hotels.
- ▶ When the actual customer spend collected by the OTAs (using the merchant and opaque models) is factored into industry room revenues, total overall U.S. average room rates nationally increased about \$2.35 in both 2009 and 2010, to more than \$100.
- ▶ The OTA model, supported by healthy profit margins, is popular in the investment community. For example, in Q3 2011 Priceline's market capitalization was more than \$27 billion, which was almost three times that of any hotel company. Ironically, this value transfer from hotel companies to their intermediaries is largely fueled by the hotel fees and commissions making up the majority of the OTA profits.

Marketing and Distribution Strategy

- ▶ The two largest consumer media budgets applied in the promotion of hotels in the United States are spent by OTAs and hotel brands. In 2010, the OTAs outspent the hotels more than 2-to-1 in TV advertising and almost 4-to-1 in online paid search advertising.

- ▶ Most hotel performance is evaluated on the basis of total room revenue. Little is known about how each hotel performs compared to its competitive set in terms of channel mix and how that mix affects overall relative performance. Lack of data on this subject limits the hotel's ability to monitor and manage by channel.
- ▶ The online consumer sales path is complex. Although it would be helpful for marketing planning purposes, there has not been an industrywide analysis of online attribution to determine which promotional vehicles should be credited with triggering hotel website (brand.com) bookings. The only studies published on this topic came from Cornell's Center for Hospitality Research in October 2009 and April 2011, both of which referred to a "billboard effect." The two CHR "billboard effect" studies document outcomes, but do not prove causation between a presence on Expedia and production of brand.com bookings. While helpful to focus industry discussion on an important topic, neither the April 2011 study nor the earlier "pseudo-experiment" in October 2009 sufficiently tested all the variables involved in the complex issue of identifying and appropriately crediting each of the many touch points that lead to brand.com bookings.

The first "billboard effect" study in October 2009, called a "pseudo-experiment," looked at brand.com production to see if it increased or not while the four test hotels were cycled on and off Expedia. It concluded that a presence on Expedia increased brand.com bookings significantly, however, it did not consider the fact that other promotional activity was undertaken by those four properties (or their parent brands), and this activity could also have a material effect on brand.com bookings. It also did not test whether ranking the test hotel in a position other than the top of page 1 would make a difference to the number of brand.com bookings. The more comprehensive April 2011 study of 1,720 hotel bookings does not give any credit to the other seven to eight travel websites visited by consumers in the run-up to each booking, nor does it evaluate email, offline advertising, banner ads or any other commonly used promotional vehicles, each of which may create the effect of an added "billboard" on a travel shopper's path. It also does not consider rank placement on the OTA. Both studies examine Expedia in isolation, in an environment where many points of contact play into the outcomes, and neither study factors these other touch points in or out of the consumer decision process. The industry would benefit from a more comprehensive examination of this topic.

- ▶ The three greatest emerging forces in online distribution are: search, social media and mobile. Driven by consumer behavior and some large influential online companies such as Google, Facebook and Apple, these three categories are dynamic and volatile and are likely to dramatically change the travel shopping/booking paradigm and, with it, the overall hotel distribution landscape over the next 2-3 years.

IMPLICATIONS OF THE FINDINGS

The online environment imposes constant and significant changes on lodging distribution. Paradoxically, the more diffused consumer Internet usage with its many new emerging website types, the more centralized the players will be that control it. The power will be in the hands of gatekeepers who control consumer access, and many are vying for that position, especially in the travel sector. This doesn't bode well for a fragmented industry such as lodging that largely divides its ownership, management, and branding. There are already powerful online media interests (e.g., Google, Facebook, and the OTAs) that are well positioned to control the traffic leading to the demand for hotel rooms. These companies have deep pockets, centralized product and marketing strategies and are rewarded by the investment community for attaining near-monopoly positions. This dynamic can push up the costs of acquiring and retaining demand, and challenge a hotel's ability to achieve acceptable profit levels; conversely, it can create competition between intermediaries that can be leveraged to the hotelier's advantage. To compete effectively and retain control of pricing, inventory, and brand value, the hospitality industry has to make a substantial commitment to manage a burgeoning array of transactional and marketing channels and harness its customer relationships, the asset it can control best, more effectively than any third party intermediary. Given the limited demand growth in the mature U.S. lodging market, distribution channel marketing will be a primary tool used to shift existing share among hotels. Proactively managing to an optimal channel mix objective will drive resource decisions for a hotel, and although no one can make a consumer choose a particular channel, a bias can be created for direct channels, primarily through improved content on a hotel's own website and the application of consumer intelligence in the shopping and buying processes to favor the use of direct channels. Closely managing channel costs and choosing the best mix of channel partners can refine a distribution strategy to deliver optimal results at a brand and hotel level.

1. Price Elasticity at the Competitive Set Level

The fact that year-over-year growth in hotel room demand is small (1.6% average since 1990) is a factor at the industry and local market level. Saying that this demand is "price inelastic" means that room rate reductions on an industrywide level will not generate enough incremental demand to compensate for the lower room rates and, therefore, will result in eroded industrywide room revenue. However, on a property basis, this price elasticity plays out differently. For example, Hotel A can lower its rates and as long as no other hotel matches the lower rate, it is feasible that it can generate enough incremental demand to come out net positive from a room revenue standpoint. Unfortunately, Hotels B, C, D, and E, in the competitive set, are unlikely to stand by without also lowering their rates to ensure that they get their fair share of the finite demand coming into the comp set. Therefore, the result can be that Hotel A gets some benefit, reduced by the degree to which the others match the room rate, resulting in all hotels ending up with lower rates and profits. As this dynamic continues over time, all hotels in the comp set may well continue to lower rates to try to be the one hotel in the comp set that gets the short-term bump in demand, but since they are all chasing the same limited demand, it can become a "race to the bottom." When these rates get so low that a hotel can no longer sustain employment levels and capital reinvestment, it is not good for the hotel, the community in which it operates, or its customers.

2. Its All About Share Shift

As demand growth in the mature U.S. lodging industry typically only varies in a narrow range from year to year, incremental demand brought by any channel partner will be marginal. However, each channel can be viewed for its potential to "share shift" from another hotel in its market, which is the primary method a hotel can use to gain an advantage. OTAs are particularly adept at helping a hotel shift share either from one time period to another or from one hotel to another. This facility appears to be the primary reason why hotels have been drawn to work so closely with them. Some mistake the contribution from share shifting to be creation of incremental new demand, however, the overall demand patterns recorded for the last 20 years, and consistent for the last 10 since the advent of the OTA model, do not support this. Due to finite and limited demand, especially at the comp set level, the dynamic usually plays out as a zero sum game. One hotel wins at the expense of the others in their immediate comp set or in the nearby market. But, even so, there is still often "not enough to go around" to those contending for the limited demand.

Sometimes, in a high demand market, several hotels will gain share, but as demand through the OTA channel grows in the comp set, since demand for hotel rooms is always finite, at some point, it will divert business from other channels. The data in the study from 2009 through June 2011 point to brand.com as the primary channel that loses as the OTA channel grows; it also appears that when the brand.com channel grows, the OTA channel share shrinks. This may occur because both are “fishing in the same pond” and tapping many of the same channel-agnostic online shoppers. Hotels should develop the tools to share shift the business from all channels, not limit share shifting just to the OTA channel. Taking business from a competitor through voice, GDS or brand.com could incur lower transaction fees and may have less of an impact on the ADR. Share shifting largely occurs (1) from one hotel to another in the same or a different chain scale, (2) from one time period to another and (3) from one channel to another. In a model where a marketer allocates resources to acquisition, persuasion, and retention, hotels would benefit by working harder at converting existing traffic from all channels at higher rates (persuasion), and on retention, rather than solely focusing on acquisition which can be most expensive, especially without a strong conversion and retention plan.

3. Costs and Benefits of Distribution

Each channel carries distribution costs; the range is wide and can run from 10% to 50% of revenue. Hotel owners and managers have not always measured the full cost of distribution consistently and have not factored these costs into channel decisions. Too often, when hotels price rooms below marginal and fixed costs with an eye toward cash flow, they will withstand long-term negative effects on rate structure and profit. However, costs in 2010 may look reasonable when compared to where they might be in 2015. The following is a hypothetical scenario using 2010 business volumes and estimated costs and projecting a potential outcome in 2015 with many new intermediaries in the hotel sales path.

a. **Industry Level:** For anyone concerned about the almost \$4 billion paid to third parties in 2010 (as estimated in this study), the prospect of paying double that amount within 3-5 years may be shocking, but not unrealistic. When the U.S. hotel industry ADR in 2010 appears to be \$10 below the inflation-adjusted rate charged in 2000, these added costs aggravate an already challenging profit picture for a hotel owner.

On \$10 billion in OTA revenue in 2010 (consumer spending on hotels), the OTA commissions and transaction fees are estimated in this study to cost the

Intermediary Distribution Costs— Estimated 2010 and 2015 Scenarios

2010 Intermediaries	Revenue (Base: \$100 billion)	Estimated Costs
OTA	\$10 billion*	\$2.5 billion
GDS	\$11 billion	\$1.3 billion
TOTAL	\$21 billion	\$3.8 billion

*estimated consumer spending through OTAs: hotels collected \$7.7

2015 Intermediaries	Revenue (Base: \$100 billion)	Estimated Costs (based on 15% of revenue)
50% of total revenue: meta-search, mobile, social, OTA, travel agency	\$50 billion	\$7.5 billion

industry approximately 25% or \$2.5 billion. (Refer to the Intermediary Distribution Costs chart.) Add to that the 12% in commission and fees on \$11 billion sold through the GDSs (also estimated in this study), and the major third party agencies incurred distribution costs of approximately \$3.8 billion (3.8% of the overall industry total of \$100 billion in room revenue¹). Projecting the current trend of increased online access and a spike in mobile usage for hotel buying, the potential exists for the industry to pay commissions or transaction fees on as much as half of the business when more is booked online and large media enterprises control access to that demand. To play out this scenario, assuming an estimated 15% cost margin on average charged against 50% of total revenue (using the 2010 baseline of \$100 billion), this could cost the industry close to \$7.5 billion or 7.5% of the total room revenue².

b. **Property level:** Managing costs and channel mix will become a priority. To illustrate this hypothetical situation for an individual property, a relatively small hotel with \$3 million in annual room revenue may be facing distribution costs of \$225,000 or more per year (refer to Hotel Distribution Costs chart), up from \$150,000 in 2010. Due to the prevalence of net rates, not all costs may be documented on the P&L.

¹ This estimate does not include travel agency business booked through other sources besides GDS, or traditional wholesaler business that may substantially raise the third party-sourced revenue and associated costs in many hotels.

² These numbers are estimates to illustrate a scenario that reflects an anticipated large increase in third party participation in hotel shopping.

The wide range of profit contribution by each channel, and the fact that some channels in some markets may deliver rates that drop below the break-even point, creates urgency for a deeper dive into a hotel's channel mix. Knowing the costs associated with each channel will be essential for managing a hotel in the highly fragmented distribution landscape, even when these costs do not appear as line items on the P&L statement. It is equally crucial to evaluate the full benefit from a channel including length of stay, ancillary spend and repeat and referral potential.

Some of the costs are easier to identify such as the portion that is transaction-based, while others may be less visible such as the degree to which rates have to be lowered to accomplish the goal of shifting share and the impact a channel may have on a hotel's ability to engage its customers. Each channel will vary and, therefore, needs to be carefully assessed. Shifting share is a good objective to expect from each channel partner, but it has to be done with a mix of channels that yields optimal profit. Shifting share to gain occupancy without regard for the price incurred is rarely beneficial to a hotel in the short term and never in the long term.

Careful tracking of costs and benefits by channel can lead a hotel to pursue a channel mix that results in higher profits. Shifting focus from generating revenue to generating profit will be a change for many revenue managers, but a useful perspective to apply to inventory and rate decisions.

4. Threats and Opportunities on the Horizon

There are new threats that are emerging in the distribution ecosystem; with these threats comes opportunity. Hotels will have to be cautious and monitor the environment. Some new channels may incur high costs and provide hotels minimal leverage for negotiating acceptable terms and some may prove to be highly effective venues to reach a large customer base at a reasonable price; the outcome will depend on the manner in which hotel companies engage them early in their development.

a. With a clear domination in general search, if Google becomes equally successful in travel search it may: (1) bias the search results to point travelers to the advertisers most active in using the Google travel tools; (2) create competition for those wanting a prominent position in search results thereby pushing up the cost of acquisition for any hotel that wants to

Hotel Distribution Costs

Estimated 2010 and 2015 Scenarios

Timeframe	Hotel Room Revenue	% through third party intermediaries	Average cost as % revenue	Dominant third party intermediaries	Estimated Distribution Costs
2010	\$3,000,000	25%	20%	OTA, GDS, Travel agency direct	\$150,000
2015	\$3,000,000	50%	15%	Meta-search, Mobile, Social/travel inspiration, OTA, GDS, Travel agent direct	\$225,000

utilize the travel-specific search tools, which then may make it more difficult for travel marketers with limited budgets to use this resource cost effectively; (3) limit the leverage a hotel or brand has in negotiation over cost since there is no inventory involved and fees may be incurred whether there is a booking consummated or not; and (4) expand its role in travel planning, with added tools like the travel inspiration tool Schemer to further cement its already strong position as the point of entry for a majority of travel buyers.

b. New players, such as Facebook, already in a relationship with Microsoft (active in travel search with Bing), and Apple, possibly in partnership with Kayak (or other meta-search sites, like Room Key, with access to a robust travel inventory), are dabbling in travel and can gain traction quickly due to deep pockets and a high level of consumer adoption. Likewise, large consumer sites like Amazon, eBay or other consumer-savvy retailers as well as media companies who need to expand their traditional reader base like *USA Today* or *The New York Times* may well get in the game. It is not clear which business models they will offer and what kind of control a hotel may have to gain visibility and participate cost effectively. The traditional travel shopping path of the browser-to-search-engine model will likely be diversified with new methods including direct access to travel shopping through mobile devices, social sites and through some new search media such as voice-activated (e.g., Apple's Siri, Google's Majel, Microsoft's Tellme) or map-based models, which lend themselves well to travel planning.

c. The primary source of potential new incremental demand for hotel rooms in North America in the upcoming five-year time horizon (and likely beyond) is through inbound international travelers from the rapidly growing economies, especially China and India.

Third party vendors may dominate these markets and train the consumers to use them before hotel brands have a chance to gain recognition through their hotel development efforts in those markets. Whoever gets the Chinese and Indian consumers in the habit of using them to book travel to Europe and the United States may hold onto that position for a long time because early adopted habits may be hard to break. For the secondary or tertiary U.S. markets that are unlikely to benefit from the inbound global demand, there will be some general improvement in demand in all hotel segments as the economy improves.

d. Some third party distribution channels with strong marketing positions may choose to offer services similar to those that current franchise and brand organizations may provide. This may create a new type of model that will compete with the legacy franchise and brand operators as a kind of “soft brand” based on the strength of the third party’s ability to (1) maintain a brand presence (2) provide a meaningful reservation contribution (3) maintain quality metrics for consumer evaluation and (4) offer the benefits of frequency/loyalty programs.

5. New Priorities in the Distribution Landscape

Due to the anticipated rapid growth in consumers’ use of search, mobile and social tools for travel shopping, planning and booking, a hotel has to become conversant in the multitude of ways these tools may be utilized. Each hotel and hotel company should have a plan for how to leverage the opportunities presented. Given how quickly consumers have adopted mobile and social media tools, the need is immediate to develop strategies for each. Taking advantage of the native mobile environment and building functionality that is purpose-built for it will be essential to succeed in this space. Although the current mobile apps focus on “last minute deals,” as mobile access grows, more robust capabilities will be demanded by consumers such as voice-activated or map-based capabilities. Hotels will benefit from moving away from offering “cheap deals” and into higher value offers tapping mobile’s unique functionality that lends itself so well to travel planning. Mobile users are not likely to use dozens of travel apps so there will be a shakeout at some point, and hotels have to be sure they make the cut. Monitoring and testing the new travel-specific search models will also be important since they are likely to become another major set of portals through which consumers will explore their travel options. Social sites are quickly evolving into sales channels. Consumer review sites, Facebook business and fan pages and travel inspiration/trip planning sites with heavy social components will all offer opportunities to travelers to gather information and then refer them to suppliers. Search, mobile and social media tools

will need to be mastered for their role in merchandising, as information sources, and as commercial transactional platforms. Costs and benefits have to be monitored every step along the way.

SHIFTING FOCUS FROM GENERATING REVENUE TO GENERATING PROFIT WILL BE A CHANGE FOR MANY REVENUE MANAGERS, BUT A USEFUL PERSPECTIVE TO APPLY TO INVENTORY AND RATE DECISIONS.

6. Consumer Media and Commoditization of Hotel Rooms

Knowing that a dominant theme being conveyed to the consumer in the current marketplace is that last minute bookings typically result in discounted hotel rooms, hotels have to be mindful of the implications that message sends and reinforces with the consumer. It renders hotel rooms to be a commodity purchase with the primary distinguishing feature being price, with secondary consideration for quality level. When hotels provide “last minute” inventory, they are fueling the spread of this message. In the short term, it can reduce rates and profits, but in the long term, it reinforces the message that it is better to wait until the last minute to book a room to get the best rate, and that there is little difference between any hotel at a given quality level — any hotel will serve the same purpose for the traveler. For the hotelier, this (1) makes forecasting more difficult; (2) lowers rates overall; (3) reduces the volume of high rated business booked further out from arrival; (4) causes consumers to believe that there is little difference between hotel brands; and (5) puts into question the issue of who “owns” the guest. Besides causing some hotels to operate with a disproportionate amount of marginally profitable business, on an industrywide level, the brand erosion may be one of the most damaging outcomes of the situation. With brand erosion comes the associated marginalization of frequent guest programs that are currently vital to the chains for sustaining a recurring profit stream from a base of repeat customers. With third parties pursuing the same customers as hotels, and even deploying similar tactics (best rate guarantees and loyalty programs), the question of who controls the guest relationship may strongly affect the value proposition of a brand.



7. The Transparency of the Internet

Although the OTA channel may only represent 10% or less of most major hotel chain demand, due to the prominence and transparency of rates on the Internet, along with rate parity guidelines, the rates posted on these sites affect those sold through the channels that bring the other 90% of a hotel's business. The same is likely to hold true for new media sites and mobile applications. Meeting planners, corporate travel managers, citywide attendees, and others will often check the rates offered online through third parties, and those rates will influence the negotiation of rates sold through all other channels. This is a major departure from the "old days" when the rack rate was the anchor and all other rates keyed off that rate. Now, hotels set the highly prominent OTA rate and the other rates are likely to cascade from that. The public nature of the OTA rate, or for that matter any other rates offered online, along with rate parity terms, also limit a hotel from offering a range of customized rates and/or value packages to sub-segments of its customer base so it seems that there is often a "one-rate-fits-all" pricing structure. This undermines the power of marketing which is a discipline built on a foundation that calls for offering relevant products and services with corresponding rates by segment in order to best meet the needs of each customer group. Rates are often diluted by (1) the pressure to keep prominent online rates as low as possible, (2) the reality that many customers have been trained to believe that he or she will find a lower rate closer to arrival, and (3) a propensity for hotels to think that the demand generated by lower rates will always compensate for the rate reduction.

8. Billboard Effect and Online Attribution Models

The number of factors influencing how a hotel booking is consummated is large and untested; there has not been a conclusive study in the lodging industry to determine how to independently credit the source(s) of direct bookings to a hotel or hotel brand. Because each hotel or hotel brand has its own set of customers, each needs to examine the websites, media, and other promotional vehicles that are part of the travel shopper's sales path (there are many billboards) and work on testing which one(s) can be credited with affecting the booking decision. This will likely differ by many variables including customer group, hotel brand, hotel type, season, day-of-week and trip purpose. Before deploying significant marketing resources to generate online traffic, deepen engagement and trigger bookings, the hotel marketer should decide how much credit to apply to each element of an online marketing plan so the resources are most effectively applied to meet the marketer's objectives.

9. Optimal Channel Mix

Each hotel has an optimal channel mix; this is the case whether the hotel is in the U.S. market or anywhere else globally. It is affected by supply and demand; the number of rooms booked through the channel, and at what room rate; the strategy of each competitor; and the position of each hotel in its marketplace. Most of the hotel business in North America remains a "street corner" business. Other than destination hotels and resorts, which have their own competitive dynamic, most hotels in highly populated areas compete with their immediate neighbors. Understanding the hotel's potential in its marketplace will drive its tactical actions and refine the decisions of its management in terms of pricing, marketing and yield management. Being mindful of the use of discounting to drive demand and the affect it has on overall ADR is at the heart of achieving an optimal channel mix. Improving techniques to systematically evaluate merchandising through every channel will go a long way to improving conversion rates on existing traffic even when incremental traffic is not available. If a hotel can accurately set objectives for its optimal channel mix, it is more likely to achieve them through better use of marketing resources and more targeted and decisive actions.

10. The Devil We Know, The Devil We Don't

While it is easy for a hotel to agonize over high-cost channels or limited demand in a market, knowing the available demand generators, the costs and benefits of each, and which ones are a good fit at any given time is the best defense in times of economic adversity. As long as a hotel has control of its inventory and pricing,

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one of its most crucial marketing decisions will be about its channel mix, which reflects the way in which that inventory is sold. Riskier even than lowering rates, ceding control of inventory (or access to inventory) — such as offering last room availability, especially for low value business — can do great damage to near- and long-term profits if it is not tightly controlled.

There will be many emerging new distribution opportunities; some will be booking channels, others will be marketing and referral channels. Learning how to assess each opportunity is essential given the rapidly changing nature of the distribution environment. With eyes wide open, a hotel management team has to confront its market position, establish its optimal channel mix and use every tool available to achieve its objective. The mature nature of hotel demand in the U.S. market has to be taken into account and hotels have to realize that with a slow-growing market pie, they will spend most of their time shifting share from their competitors, who at the same time will be trying to do the exact same thing to them. Historically, hotels have not focused clearly on their channel mix, have not had the metrics or inclination to manage this way, and have not systematically worked on merchandising techniques to improve conversion, retention and ancillary spend in each channel.

Leveraging new distribution opportunities, knowing they will primarily facilitate share shift, should put a laser focus on managing demand in lockstep with associated costs. In the absence of buoyant demand, the share a hotel gets of that limited demand has to deliver optimal profit. Placing an emphasis on generating ancillary revenue will be part of the centerpiece of a successful hotel's revenue strategy. Many channel partners will promise to grow a hotel's "slice" of the comp set "pie," but each also takes a bite in exchange for helping. This "bite" may also include less visible costs such as the need to impose deeper discounts on the rate in order to accomplish the desired shift in market share. The hotel's actions determine the size of its slice and how many bites are left after all channel partners are compensated. In the interest of a sustainable profit stream to support a hotel's employees, its community, and its customers, how much can a hotel keep for itself?

LEVERAGING NEW DISTRIBUTION OPPORTUNITIES, KNOWING THEY WILL PRIMARILY FACILITATE SHARE SHIFT, SHOULD PUT A LASER FOCUS ON MANAGING DEMAND IN LOCKSTEP WITH ASSOCIATED COSTS.



FIVE ACTIONS A CHAIN/ BRAND CAN TAKE NOW

Invest in and develop internal and external low-cost channels with as much control over rates, inventory and branding as possible. If you can only focus on one new thing internally, get your mobile strategy right.

Build up programs to expand high margin ancillary revenue streams through centrally controlled channels and facilitate the same for hotels to supplement efforts at the local level.

Hold the line as tightly as possible on costs for existing and emerging channels keeping in mind that a growing percentage of the business going forward will pass through intermediaries prior to arriving at brand-controlled channels.

Audit every channel to ensure it is capturing the most incremental business possible from all traffic that passes through it; view all channels through the same multi-channel lens the customers use so the management and development of them is integrated. Investigate and develop attribution modeling, examining all channels to understand which touch points are contributing to the bookings.

Tap the intelligence you have about your customers and apply it extensively at every touch point possible to optimize acquisition, persuasion and retention through customer service and merchandising. This may be the primary advantage a hotel chain can leverage when competing with the many new third parties that have strong adoption in consumer markets but limited knowledge of hotel customer's personal preferences and stay patterns.

FIVE ACTIONS A HOTEL MANAGER OR OWNER CAN TAKE NOW

Determine a hotel's optimal channel mix and manage to that objective. Determine the potential for the hotel based on the nature of market demand, competitive behavior and consumer perception.

Monitor the hotel's ability to manage its channels relative to its competitors in the marketplace as well as new channel opportunities that arise in the market. Compare channels in their ability to shift share and the cost they each incur including transaction fees, commissions, impact on rate and impact on customer engagement.

Seek out, develop and invest in channels that help acquire, engage, and retain customers and also create sustainable profit streams.

Guard your most valuable assets: a hotel's pricing structure, inventory and brand — this applies equally to national branded hotels and independents. Evaluate channel opportunities carefully before putting these assets at risk. Price smart.

Conduct a systematic audit of every channel to ensure it is functioning at its peak, that the channel and the processes supporting it are designed for the customers it is best suited to serve, and that its position in the distribution ecosystem makes it accessible and compelling in comparison to its competitors.