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; 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.
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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.

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.

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.

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.