Growing Tension Between Hoteliers and OTAs, by Max Starkov, October 19, 2009

This Just In: I have just heard through the industry grapevine that Expedia has cut off negotiations with Choice Hotels and has removed Choice properties from its sites, which include Expedia.com and Hotels.com. Choice Hotels, similar to all other major hotel brands, has been working consistently to negotiate a renewal of a brand-wide wholesale agreement with Expedia.

For some time now, we have been hearing from many industry sources that during renewal negotiations Expedia/Hotels.com has demanded new terms and conditions that are against everything the hospitality industry stands for: last room availability, guarantees that the best rates are only found on Expedia/Hotels.com sites, penalties to properties that do not use their sites 100% of the time, etc. These contract renewal "negotiations" have been described to us by some participants from various hotel companies as "here are our terms - take it or leave it"-type of meetings and "practically lack of any essence of a real negotiation," etc.

In other words, these new terms and conditions demanded by Expedia will effectively take away hoteliers' rights to manage inventory and rates at their own hotels, destroy channel management and rate parity, and will eventually lead to a long-term erosion of hotel brand and price integrity in the same manner it did after 9/11 in 2001.

Hoteliers should learn from their past mistakes and prevent history from repeating itself. The Hospitality industry should applaud the fact that finally someone is standing up and supporting its franchisees and hotel owners. Similar to Choice Hotels, hotel companies should take a bold stand in support of their long-term interests, and tell Expedia that they wouldn't sign an agreement that would give Expedia the right to become hospitality industry's sole revenue manager and ability to manage hoteliers' decisions on rates and inventory.

Is this Another Case of the Stockholm Syndrome?

Back in the spring of 2003 in the article Brand Erosion, or How Not to Market Your Hotel on the Web, I argued about the existence of a new kind of disparity in the hospitality vertical: between smart, Internet-savvy OTAs on one hand and Web-inept hoteliers on the other, and characterized some hoteliers as being the Web reincarnation of the "Stockholm Syndrome" where the kidnapped victims (hoteliers) fall in love with their kidnapper (OTAs).

Is this a repetition of a post-9/11 déjà vu? Does Expedia believe the hospitality industry has forgotten so quickly the tremendous damage done to hospitality by the online wholesale discounters (now called Online Travel Agencies - OTAs) in the months and years after 9/11/01 and the "billion dollar leakage" that went to OTAs in the form of abnormally high markups and commissions? Is this another case of the "Stockholm Syndrome," where the abuser - in this case Expedia - expects the abused (hoteliers) should feel allegiance to Expedia and accept its new anti-industry terms and conditions?

Certain OTAs have realized since then that this is a business built on relationships; agreements between hotel companies and third-party channels must be win-win. Various hotel clients have noted that some OTAs, such as Travelocity and Orbitz, are much more amenable to negotiating mutually beneficial agreements within the industry.

Why Has Expedia Become the Market Bully?

Background: Online Travel Agencies (OTAs) have traditionally charged airline ticket booking fees ($5-$7 per ticket). Back in the spring of 2009 the top 3 U.S. OTAs (Expedia-43% market share, Orbitz-26%, Travelocity-22%) followed Priceline's example and removed these booking fees permanently. When Priceline removed these fees back in 2008, they quickly gained market share: from 7% in 2007 to 9% in 2008 (PhoCusWright).

Over 54% of the OTAs' U.S. domestic reservation volume (44% of the OTA total gross booking volume) comes from selling airline tickets. The airlines, by default, do not pay any commissions to the OTAs or the traditional travel agencies for that matter.

Expedia acknowledges in its latest 10-Q SEC filings that its revenue per air ticket decreased more than 10% in 2005, 2006 and 2007, and in 2008 air revenue constituted less than 15% of the company's global revenue. In the first quarter of 2009, due to the "no booking fee" promotion, Expedia's revenue per ticket declined 14%. Now that this no booking fee promotion has been made permanent, it will further reduce Expedia's annual air revenue.

So how are Expedia and the other OTAs making money?

The OTAs rely heavily on the hotel industry for the bulk of their revenues. Hotels contribute to 37% of all U.S. domestic bookings via the OTAs, which is a little over 30% of the OTA total gross booking volume. At the same time, hospitality contributes to more than 60% of OTAs commissions/booking fees!

In its latest 10-Q SEC filing, Expedia acknowledges that in 2008, over 60% of its revenue came from transactions involving the booking of hotel reservations, with less than 15% of its worldwide revenue derived from the sale of airline tickets. In other words, hotel reservations are financing the OTAs' operations and allowing the OTAs to remove airline ticket booking fees.

Case Study: Expedia's Revenue from a New York City Boutique Hotel under net rate contract:
- ADR: $275/night
- Average Length of Stay: 2 nights
- Total Booking Volume: $550
- Net room revenue to hotel: $385
- Expedia mark-up/commission: 30% = $165.00

This distribution cost is 4000%-$6000% higher compared to the $2-$4 cost per booking on the hotel's own website.

Online Packaging (Dynamic Packaging):
The OTAs love packaging as it helps them generate fees from airline tickets—as mentioned, if sold alone, an airline ticket provides zero commissions/fees for the OTAs.

No wonder all OTAs are heavily promoting their packaging services! Yet, this segment contributed to less than 16% of the OTAs total gross booking volume in 2008. This year, its share is expected to increase to 18% and remain flat at that level in 2010.

Car Rental:
Traditionally, the OTAs have charged similar booking fees for car rental reservations since many car rental companies do not pay any commissions to the OTAs. So this segment still generates revenues for the OTAs, but unfortunately car rentals account for only 7% of U.S. domestic OTAs booking volume.

Cruise Segment:
The OTAs are generating hefty commissions from the cruise lines. Unfortunately, this segment accounts for only 2% of the OTAs gross U.S. domestic bookings.

The Bottom Line:
Now that they have removed the airline booking fees, Expedia and the OTAs can survive but only at the expense of the hospitality industry.

Having realized that in this economic environment the only option for survival is to find a way to increase revenues from the hospitality sector, Expedia has adopted increasingly aggressive market behavior toward the hospitality sector, fueled by the following factors:

• Desperation within Expedia and the OTA ranks:
Due to the "No Booking Fee" for airline tickets policy adopted recently by all OTAs, hospitality remained the only serious source of revenue for Expedia and the OTAs. Hotels contribute 37% of all U.S. domestic OTA bookings, yet hospitality contributes to more than 60% of OTAs commissions/booking fees! In 2008, 44% of Expedia's global revenue came from the sale of airline tickets, which brought less than 15% of the company's global revenue. Now that the ticket booking fees are gone, airline ticket revenue has further eroded and will have a single digit contribution to Expedia's bottom line.

Simply put, the Expedia and the OTAs have no other choice but to go after the hospitality sector for their mere survival.

• Desperation within the hospitality sector:
The industry as a whole has been hit hard by the economic recession. Smith Travel Research projections paint a very grim picture in the hospitality industry: in 2009 ADRs will drop by 9.7%, RevPAR will be down 17.1% year-over-year, and occupancy will drop 8.4% to 55.4%.

Many hotel companies (including some major brands who should know better) have exhibited a typical "knee-jerk" reaction to the deteriorating economic environment by embracing the indirect online channel (OTAs) to compensate for decreasing business. These hotel companies have been willing to accommodate the OTAs with bigger discounts, unique promotions, etc., thus jeopardizing their direct online channel and destroying years-worth of achievements such as rate parity, best rate guarantees and more.

In other words, some hotel companies have literally betrayed the industry by succumbing to the temptations of the indirect channel and demands of Expedia, some of them doing this in a particularly unintelligent way.

Hoteliers and Expedia: The Prisoners' Dilemma

Expedia has been quick to exploit this new situation in which hotel companies are increasingly becoming desperate for more business. This OTA has successfully deployed an economic approach to the industry, originally tested with great success by Hotels.com back in the post 9/11 period.

By playing one hotel company against the other, Expedia has been able to extract further discounts and concessions from the weakened hospitality sector, unthinkable until just recently.
In game theory and economics, this approach of dealing separately with each industry player, twisting their arms and getting concessions by playing hotel companies against each other is called "The Prisoners' Dilemma."

In its classical form, "The Prisoner's Dilemma" is presented as follows (Concise Encyclopedia of Economics, Wikipedia, Britannica Concise Encyclopedia): Two suspects are arrested by the police. The police have insufficient evidence for a conviction, and, having separated both prisoners, visit each of them to offer the same deal. If one confesses and the other does not, the one who confesses will be released immediately and the other will spend 20 years in prison. If neither confesses, each will be held only a few months. If both confess, they will each be jailed 15 years. Each one is assured that the other would not know about the betrayal before the end of the investigation. Prisoners cannot communicate with one another. Given that neither prisoner knows whether the other has confessed, it is in the self-interest of each to confess himself. Paradoxically, when each prisoner pursues his self-interest, both end up worse off than they would have been had they acted otherwise. How should the prisoners act?

In today's world, Expedia acts as the police who have imprisoned hoteliers, and has been playing them against each other by extracting concessions which would be unthinkable in any other situation.

We have seen this happening this year all over the industry:

- Independent hotel level, where one hotel is being played against another. Typically competing hotels in the same destination are invited to participate in a "24 hour sale" or "48-hour sale" on Expedia sites and "suggested" what the discount should be. Hotels that ignore these "sales opportunities" are risking losing their "preferred status" with Expedia.
- Expedia's approach is similar to smaller and midsize hotel chains and boutique and luxury hotel brands.
- Especially interesting is the approach towards whole destinations, where the "threat of exclusion" motivates hotels to participate in destination-wide or city-wide promotions that demand 25%-30% discounts on top of the existing margin discounts of 25%-30%.
- Hotels are being sent communications for margin increases (e.g. from 25% to 30%) and it is implied that their competitors have already accepted a similar increase.
- With most corporate agreements up for renewal with the major hotel brands for 2010, we are witnessing Expedia exhibit similar behavior towards all major hotel brands.

There is no doubt that Expedia has gained new market clout in this economic downturn. The 24-hour and 48-hour sales, as well as city-wide sales offered by hotels in breach of established rate parity principles and best rate guarantees on hotel's own site, have convinced the traveling public that Expedia offers the best hotel deals today. Major hotel brands and the industry as a whole have been slow to develop a counter-strategy of their own and as a result have "lost momentum":

- In Q2 2009, 70.1% of CRS online bookings for the top 30 hotel brands came from the direct online channel (i.e. the major hotel brands own websites), while 29.9% came from the indirect online channel (the Online Travel Agencies-OTAs) (eTRAK).
- In Q1 2009, 74% of online bookings come from the direct online channel (i.e. the major hotel brands own websites), while 26% came from the indirect online channel (the Online Travel Agencies-OTAs) (eTRAK).
- There is a significant increase of OTA contribution to the brands CRS bookings, compared to Q2 2008, when only 25.4% of online bookings came from the indirect online channel (OTAs), and the bulk 74.6% came from the direct online channel.

What Should Hoteliers Do?

As mentioned earlier, the industry should follow Choice Hotels' example and take a bold stand in support of their long-term interests, and tell Expedia that they wouldn't sign an agreement that would allow Expedia to become the de facto "Rate Police" of the whole industry and dictate its inventory distribution and revenue management decisions.

Furthermore, hoteliers should develop a robust strategy to decrease over-dependence on Expedia and offset loss of business from this OTA:

1. Direct Online Channel: Invigorate the push in the Direct Online Channel on unprecedented levels. Even in dire economic times like these, characterized by sharp declines in travel demand, a comprehensive ROI-centric Internet marketing strategy can help hoteliers continue to generate much-needed incremental revenues and out-smart their competition.
2. GDS Channel: Re-examine and invigorate the comprehensive GDS channel strategy to gain market share and take advantage of incremental revenue opportunities.
3. Local Direct Online Channel Strategy: Hotel brands and multi-property hotel companies should develop and implement a robust strategy to take advantage of abundant local revenue opportunities at the property level.
4. Indirect Online Channel: Expand relationships with hospitality industry-friendly OTAs like Travelocity, Orbitz, Priceline/Bookings.com and their global networks.
5. Partner for Success: Partner with an experienced direct online channel strategy and full-service hotel Internet marketing firm to help you adopt industry's best practices, implement latest trends, and utilize the Direct Online Channel to its fullest potential.

Max Starkov is Chief eBusiness Strategist at Hospitality eBusiness Strategies (HeBS), a leading Internet marketing strategy consulting firm for the hospitality vertical, based in New York City (http://www.hospitalityebusiness.com).

Article location:
http://www.hotelmarketing.com/index.php/content/article/growing_tension_between_hoteliers_and_otas/