Shifting your budget to direct
Not a fad

A white paper by OTA INSIGHT

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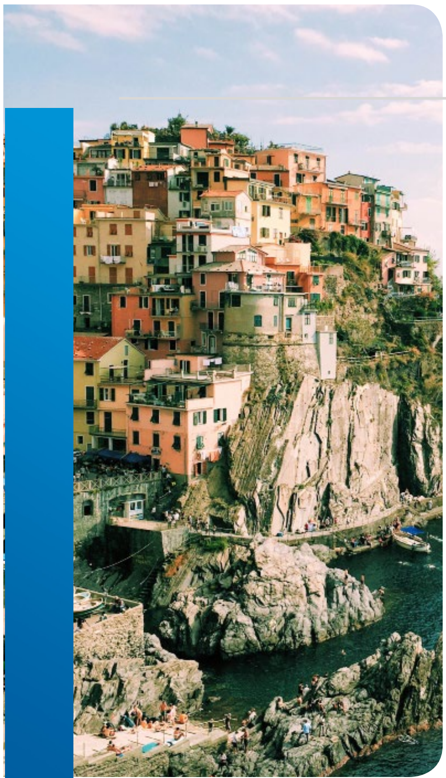


The setup: rise of the OTAs and shift away from book direct

With the explosive growth of the Internet in the late 1990s and 2000s, it is not surprising that online travel agencies (OTAs) formed and thrived. But their growth rate caught everyone by surprise, and hotels scrambled to adjust to the new reality.

The first OTA came into being with the launch of Microsoft Expedia Travel services in October 1996. By 2011, OTAs grew to about one booking for every 4.3 direct bookings[1] — roughly a 19% market share. This averages to about 1.3% increase per year.

By 2015, there was one OTA booking for every 2.7 direct bookings—roughly 27% share. OTAs were grabbing market share at the rate of 2-3% per year.

What helped the OTAs in the early days was their agility during tough times. When worldwide travel suffered in the aftermath of the 9/11 attacks and later during the 2008 financial meltdown, the OTAs' global reach gave them a competitive edge. The struggling hotels and brands were willing to strike deals with online travel agents to sell their inventory.

For instance, prior to the 9/11 attacks, between 1% and 1.4% of rooms were booked through intermediaries like OTAs. Shortly after 9/11, that percentage grew to between 4% and 6%[2].

OTAs know how to reach customers. With a huge marketing budget, they are able to find customers where hotels, even large ones, will find it hard to reach. The price for this service is the commissions paid out of booking revenue.

The more customers OTAs find, the more business for the hotels.

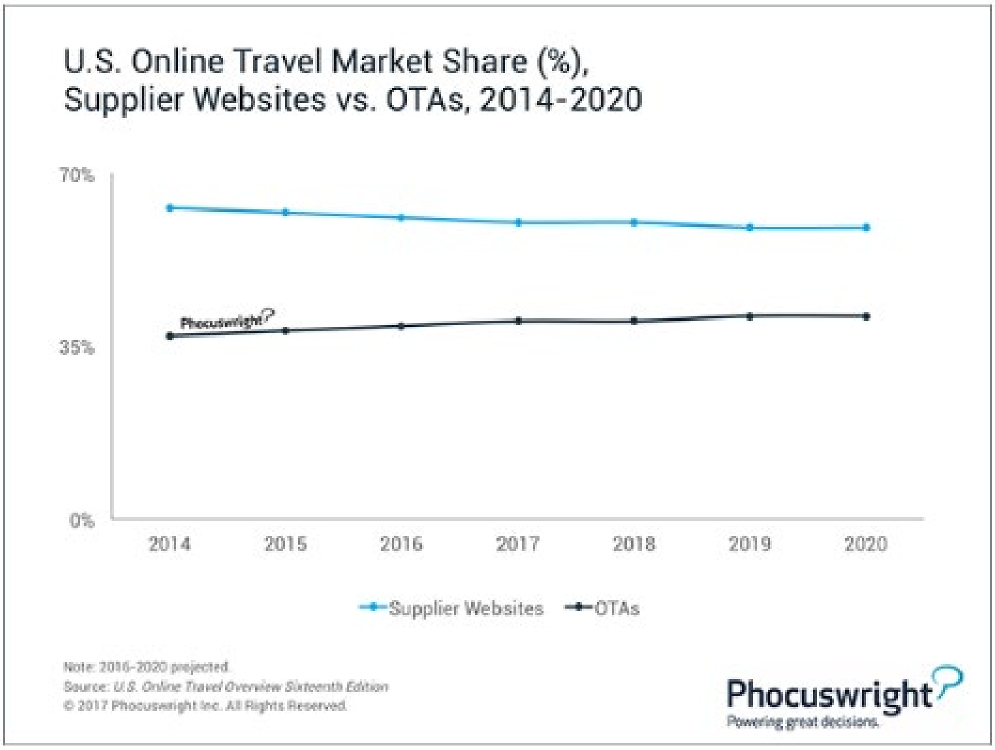
So, what's the problem?

1. Kalibri Labs 2016 Special Report, Demystifying the Digital Marketplace
2. Hotel News Now

If OTAs just brought new customers and the hotels continued to retain those that would book directly, there would only be positives for the hotels. However, OTAs built their businesses by diverting some of the direct-booking customers to OTA customers.

Phocuswright, in its report, pegged the OTA 2016 market share at 39% (brands' share at 61%) and estimated it to rise to 41% by 2020. The dilution of direct bookings from near 100% in 1996 to 61% in 2016 with prospects of continued decline is clear evidence of the OTAs cannibalising direct booking customers away from the brands.

This meant the hotels started paying out commissions for bookings from customers who would have booked directly otherwise—a diversion of the booking traffic and a drain on profit.



Source: Phocuswright

Reduction of revenue capture from 2014 to 2015 in the chart below corroborates these increasing costs for customer acquisition.

Year	Gross revenue	Net revenue	Revenue capture
2015	145,400	120,400	82.8%
2014	135,500	112,800	83.2%
change	7.3%	6.2%	-0.4%

Source: Kalibri Labs special report Demystifying the Digital Marketplace

Also part of the same report is the observation that commissions paid to third parties were rising consistently at twice the rate of room revenue growth for the period 2009-2015.

For years, OTAs claimed that the presence of a hotel in their listings not only helped them garner commissioned bookings but also increased direct bookings through what's called the Billboard Effect.

In 2009, and again in 2011, there was a Cornell University study that reported a direct, positive correlation between a hotel's presence in Expedia listings and their rate of direct booking revenue. This is the Billboard Effect that provided fuel to OTAs' claim that they influence higher direct bookings.

However, a newer study in 2015 using clickstream analysis, which included attribution, has debunked the billboard effect. Net result: once a customer starts using the OTA interface, they rarely go back to the hotel website to conduct business.

By 2015, it was time for hotels to take countermeasures to control the cost of acquiring bookings.

The Remedy: Start of the shift to book direct

The OTAs spent considerable resources making it easy for customers to book online. Brands move notoriously slowly, and this contributed to some of the book direct customers migrating to the OTAs. Customers also liked the price-shopping nature of the OTA sites and the adoption of widespread OTA use took hold.

The brands took notice and as their market share slid, large players allocated proper resources to take back lost direct booking revenue. Series of well thought-out, properly funded, long-term campaigns started coming out.

Marriott launched its campaign, *It Pays to Book Direct*, in August 2015, and unveiled its rewards member rates in April 2016 to entice more direct booking customers. It was joined by Hilton in February 2016 with its own campaign, *Stop Clicking Around*, for growing its direct bookings.

Several hotels followed suit in the drive to take back direct bookings: Hyatt's direct-booking discount in April 2016, Wyndham Hotel Group's simple loyalty programme in May 2016, Best Western's *Better Book Direct* campaign

in March 2017, Choice Hotels' *Badda Book. Badda Boom.* campaign in February 2018, among many others.

Book direct soon became one of the biggest discussed topics in the travel industry, spawning events such as the Direct Booking Summit, and opening the door to new tech companies who sprung up to help hotels with their direct bookings.

Why would a customer book direct?

Booking direct seems attractive for the hotels. But it will only work if it is good for the customer.

Before launching programmes promoting book direct campaigns, revenue managers needed to understand what their customer would like.

- Best price — an immediate motivator. A direct price advantage is hard to resist.
- Best value — additional services that enhance the stay experience and diminish the importance of the raw price point. For example, free wifi for customers who book direct.
- Personalised service — using knowledge of specific customer preferences, tailor the stay experience to match each customer.
- Brand booking system — make the booking experience painless. Quick and easy process that should match the experience with OTAs.
- Loyalty programme — accumulate credits for repeat use of the brand book direct to enjoy a future benefit. Using points to track loyalty and offering exchanges of points for free stays is common.

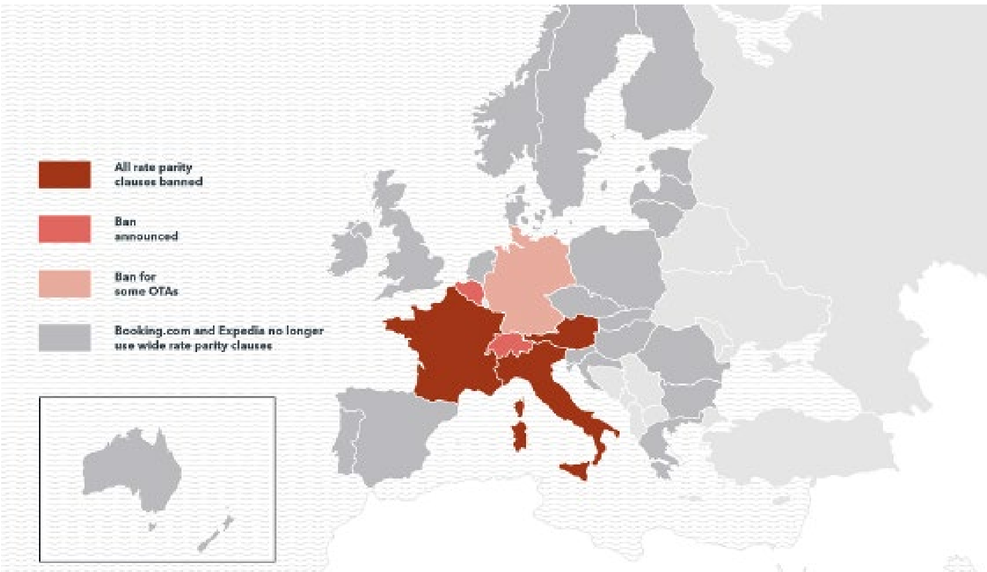
Best price is still key. Offering cheaper rates to entice direct bookings makes sense because there is no commission to pay and the hotel is simply passing on some of the savings in distribution costs to the customer. If a customer is not yet a member, cheaper rates incentivise them to join the programme.

It is important that an OTA or other intermediary doesn't offer cheaper rates — that would defeat the direct booking advantage.

This is why brands, even before loyalty clubs came into vogue, introduced rate parity into their contracts with OTAs whereby an OTA couldn't discount room rates to gain advantage.

The OTAs, in turn, required the hotels to adhere to rate parity as well. In a perfect world, everyone would offer the same price and there will be no differentiation based on price. However, each player in the hospitality business wants to have a way of gaining the price advantage and hence rate parity contract clauses have come under scrutiny and have faced legal challenges and intense lobbying.

Rate Parity and Law



Graphic courtesy Trivago

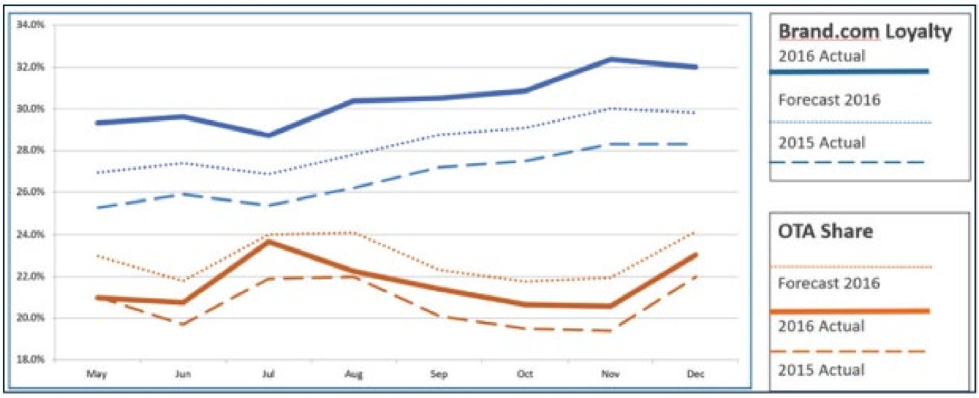
While the rate parity clauses have withstood the legal challenges in the US so far, it is a different matter in Europe. Rate parity's legal landscape has taken several turns and the changes are ongoing. To assuage the players, there is now a differentiation between a wide rate parity (parity everywhere) and a narrow rate parity (parity in public information — gated listings exempted). Trivago has reported on the current state of rate parity around the world.

The trend in rate parity legislation offers price advantage as a tool for book direct campaigns.

Has book direct worked?

Even as direct bookings and loyalty club programmes were taking off following the launch of Marriott's programme, Kalibri Labs conducted a study of the effectiveness of direct bookings over a period of May through December 2016. There were four primary takeaways from this study, all boding well for the future of book direct initiatives:

1. Consumer behaviour shifted in favour of Brand.com.
2. Net ADR of Brand.com loyalty rates surpassed Net ADR of OTA rates.
3. Results showed net positive revenue outcomes.
4. Loyalty is a powerful driver of demand and growth is strong.



Source: Kalibri Labs Special Report

When compared to 2015 performance and an estimation of 2016 performance, Retail Transient Room Nights Demand Share Mix came consistently higher than projections for Brand.com and consistently lower than projections for OTAs.

Besides *transactional analysis* that examined one-time transactions, the study also conducted *lifetime value analysis* that examined repeat usage of guests. Considering that the study sample of 12,000 hotels and 52 million transactions confirmed a channel shift in favour of Brand.com during the study period, and lifetime value considerations would only accentuate this benefit, the 2016 Kalibri Labs study reaffirmed the advantages of book direct campaigns.

A counterpoint to this view has been presented based on a 2017 Piper Jaffray report comparing the price of booking a room through OTA/ Metasearch Site and Hotel Direct. Piper Jaffray analysts reviewed cost of booking through Brand.com and intermediaries for top four hotel chains—InterContinental Hotels Group, Marriott, Hilton, and Wyndham Hotel Group—in the largest 25 cities worldwide.

Out of the 86 hotels sampled, just 13% of them had book direct pricing below OTAs and 21% of them experienced the OTAs/metasearch sites undercutting them in pricing. The rest exhibited rate parity.

This seems to suggest that some of these hotels were losing out in the price competition while most of them relied on criteria other than price to compete. However, a deeper dive presents a clearer picture.

The results of this study may be skewed because the pricing used in comparisons did not include discounted loyalty member rates. Both Marriott and Hilton asserted availability of the best price to its loyalty club members.

This suggests that these hotels are willing to incur a higher cost of initial customer acquisition because they are confident of their customer retention and expect to gain handsomely through their lifetime value.

Book direct is a serious advantage to hotels.

Should every hotel invest in book direct campaigns?

If booking direct is so attractive and several hotels are joining the movement, is it universally attractive? Would every single hotel benefit from a book direct campaign?

The answer lies in the specifics. Discounting direct booking has an immediate hit on the revenue. True, hotels save on commissions, but marketing is now required. It's not enough to have the discount; the hotel must make sure customers know about it.

Against the massive marketing done by the OTAs, the brand is often at a disadvantage. The price discount and these marketing costs combined must be less than the OTA commission. Marketing costs for acquisition and retention can be very different and this will influence what the brand can do.

When the hotel offers the best price, the Piper Jaffray study found that the average book direct price was 3.80% less than the OTAs. When OTAs offer the best price, they were 4.2% lower than the book direct price. The rest had rate parity.

Let's look at some numbers for perspective. We'll consider all three flavours of book direct pricing against the OTA pricing of $150.

Assuming a 20% OTA commission rate, the following table illustrates the break-even marketing budget for the hotel in each of these cases:

Channel	Discount (%)	Price ($)	Commission	Break-even marketing budget	Net revenue
OTA		150.00	30.00	0.00	120.00
Hotel direct 1	3.8	144.30	0.00	24.30	120.00
Hotel direct 2	-4.2	156.58	0.00	36.58	120.00
Hotel direct 3	0	150.00	0.00	30.00	120.00

The larger the hotel, the easier to control the per room marketing spend as the total marketing costs can be amortised over many rooms. Marketing for initial customer acquisition may be challenging for smaller hotels.

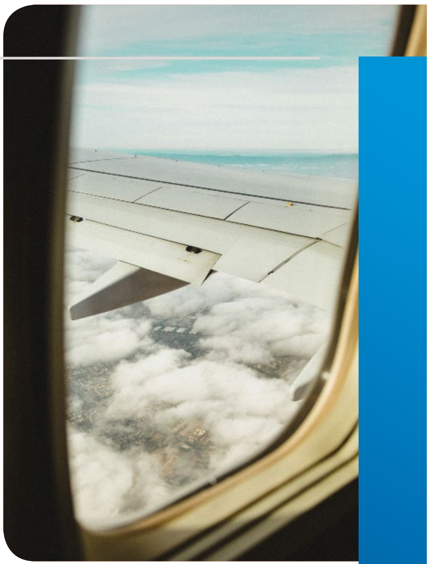
While the commission for an OTA is a significant cost of acquisition, they are good at what they do. It may make sense for a brand to concentrate on the retention side of the customer relationship. Brands of all sizes can invest in building a seamless customer journey from the Brand.com website displaying rooms and services clearly, offering an easy and secure booking process, all the way through providing a great stay experience so that the customer is more likely to return or post a positive review online.

Direct booking is an essential part of this relationship building. But managing it in the midst of other distribution channels is complex.

For example, metasearch sites like TripAdvisor and Trivago operate with a lower commission schedule. While this comes out of revenue and hence doesn't require a marketing budget, they may involve bidding for placement. Even OTAs like booking.com, Expedia, HRS, Ctrip, and others come in different sizes and contractual terms. Google and Facebook advertisements do require the brand to have a marketing budget in mind. They would require decisions on where to target the ads. Future options in the marketing model will require constant tuning of the hotel's distribution mix for channel optimisation.

To harness this complexity and establish a revenue strategy, Revenue managers can turn to a specialised platform like OTA Insight.

Where's direct booking headed?



In the span of just over two years since Marriott launched their campaign, several hotels have joined the fray in the move towards direct bookings and loyalty clubs.

A quick scan online turns up the following programmes: Best Western, Choice Privileges, Club 5c, Club Carlson, Fairmont President's Club, Hilton Honors, IHG Rewards Club, iPrefer Hotel Rewards, Kimpton Karma Rewards, Leaders Club, Le Club AccorHotels, Marriott Rewards, Omni Select Guest, Ritz-Carlton Rewards, Starwood Preferred Guest, Stash Hotel Rewards, World of Hyatt, Wanup and Wyndham Rewards, plus many more.

With the ever changing hotel brand and group landscape, big mergers are bringing big changes to loyalty programmes. Marriott announced in 2018 the Marriott Rewards programme is merging with its counterparts at Ritz-Carlton and Starwood, unifying guest benefits across its 6,500+ combined properties. The highly anticipated merge is being watched anxiously by consumers, as the Starwood Preferred Guest Programme (SPG) has long been considered one of the more popular loyalty programmes in the industry.

The message here is that this trend is here to stay. Loyalty programmes are still booming. Direct booking is an essential part of the distribution strategy for hotel marketing, and can only help, over time, in nibbling bit by bit at the OTA cake.

However, as we saw, there is a place for OTAs as well in the overall scheme, and it takes careful analysis by revenue managers to strike the proper balance between these options. As the landscape gets complex with new entrants in the mix, a platform like OTA Insight, designed to analyse your options, becomes essential.

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