Online Distribution vs. Traditional Distribution Channel

By Hospitality eBusiness Strategies, Inc.

Hospitality eBusiness Strategies, Inc. is a leading Internet strategy-consulting firm for the hospitality and travel verticals. At HeBS, we advise lodging and travel companies on Internet, eDistribution and eMarketing strategies in key eBusiness areas. Whether an independent or branded hotel, major hotel chain or hotel management company, our clients stay ahead of the competition and capture new market share with an effective Internet strategy.For more information visit www.hospitalityebusiness.com/

Hospitality eBusiness Strategies, Inc.
P.O.Box 1461
USA - New York, NY 10028
Phone: 212-752-8159
Fax: 212-202-3670
Email: info@hospitalityebusiness.com
http://www.hospitalityebusiness.com/

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A. Traditional Distribution model

Distribution of hotel inventory via today's main distribution channels, *GDS/travel agent* and *call center/reservation office*, is inefficient and expensive, especially in light of the current weak economic situation. Focusing only on traditional distribution channels will result in lower occupancy rates, and higher distribution and operational costs.

Here are just a few examples of the cost savings of online vs. offline bookings *(PhoCusWright)*:
- Hilton: saves $25 online vs. travel agency booking
- Hyatt: Web $3 vs. Call Center $9
- 6 Continents: Web $3.20 vs. Call Center $8
- Marriott: Web $3.50 vs. Call Center $8

Case Study:
Hotel Management Company in California with 20 branded hotels
Cost of offline GDS vs. Direct online bookings:

	GDS	Direct
Travel Agent	10%	0%
GDS	$5	$0
CRS	$5	$3
Total Cost	$36	$3
Total %	14.4%	2.0%

B. GDS Distribution

The traditional GDS distribution is the most expensive distribution channel. Actually the GDS will contribute less than 18% of all hotels bookings in the U.S. this year, a higher percentage for major hotel brands and large business centers. Described in the table below, HeBS estimates that by 2005 Internet hotel bookings will surpass GDS hotel bookings:

Online vs. GDS bookings:

	2000	**2001**	**2002**	**2003**	**2004**	**2005**
Online:	4%	7%	10%	13%	16%	20%
GDS:	21%	20%	18%	17%	16%	15%

(HeBS, Bear Stearns, Jupiter, PhoCusWright and industry sources)

TravelClick reports that room nights booked via the GDS in the first half of 2002 have decreased by 6.4% from the same period last year. The travel agent component, which represents 94% of total GDS room nights, shows even bigger decline of 6.9%, while the GDS Consumer Internet Component shows growth of over 5%. Sabre reported a decrease of 10.3% in global bookings for Q2 2002 compared to the same period of last year, and a 15% decrease for bookings within the US.

We attribute much of the decline in the GDS volumes to the following:

- Slower than expected travel industry recovery and the weak economy
- Channel shifting from traditional Consumer-Travel Agent hotel reservations to online bookings (leisure and unmanaged business travelers) and self-booking corporate systems.
- Growing popularity of online business models (e.g. merchant) that do not utilize the GDS. For example Expedia sold 2.1 million room nights in Q2 2002 without using the GDS.
- The emergence of direct interfaces between major online agencies and major travel suppliers thus bypassing the GDS. A good example is Orbitz and American Airlines, AAA and Hertz, etc. Orbitz will get direct inventory feeds from 6 other airlines over the next 6 months. Several major hotel brands already have direct interfaces to their major corporate clients.
- Services like WorldRes, which utilize direct interfaces to the major hotel brands' CRSs also undermine GDS distribution.
- Decreased corporate travel: the latest survey by NBTA (September 2002) showed that 68% of corporate travel managers said travel was down in their companies from last year, in some cases by as much as 20%. Also, 72% of them said that current travel is below the 2000 levels—the last time travel was at normal volumes.

A typical GDS hotel booking, at average GDS ADR of $117.07 and a weighted average stay of 1.945 nights (TravelClick Q2 2002 data), would cost the hotel $24. A booking via a call center/reservation office would cost anywhere between $ 8-$12 (direct and indirect costs). A direct consumer Internet booking would cost $3-$3.50.

All travel suppliers and hoteliers are looking for alternative and less expensive distribution for their perishable inventory. The Internet is a viable alternative. Traditional channels like the GDS are not only prohibitively expensive, but structurally unable to handle group bookings and block allotments, support special accounts, hotel packages, last room availability, rich media, etc. Room distribution through the GDS came decades after the advent of the GDS.

The traditional distribution model in hospitality: *Hotel Brand CRS - Switching company - GDS - Travel Agent -Consumer* is being aggressively augmented and in some cases replaced by new eDistribution models:

- Hotel Brand CRS-B2C Web application- Consumer (e.g. www.hilton.com)
- Hotel Brand CRS- Online Intermediary-Consumer (WorldRes-Starwood)
- Hotel Brand CRS- B2B Web application - Corporate buyer (e-Travel, GetThere)
- Hotel Brand CRS- B2B Web application- Meetings Organizer (Passkey), etc.

One other point: in the world of commoditized travel products and prices, hoteliers have to stand out from the competition. *Unique products and unique pricing* is the new game in town, the only winning strategy today. This game requires hoteliers to re-evaluate their distribution channels and pay more attention to cheaper and more flexible non-GDS distribution channels, such as Direct Web Distribution.

C. Travel Agents

Travel Agents have been slow to embrace the Internet as a productive distribution medium.
Their over-reliance on airline bookings, hence the GDS, is one of the main reasons. Another is the so-called "Merrill Lynch Syndrome" --the fear of cannibalizing your own retail operations and the general notion that the Internet will make all intermediaries obsolete. Travel agency management and organizations wasted precious management time and resources to fight against commission cuts, unfair online competition, boycotting GDSs with B2C Internet initiatives, etc.

The fact of the matter is that none of today's major online agency/intermediary players have originated from the brick-and-mortar travel agency community and almost none of the major brick-and-mortar travel agency groups, travel agency consortia and organizations have any meaningful B2C Internet presence today. The online presence of American Express, Rosenbluth International, Navigant International, etc cannot be compared even with second-tier online agencies, such as OneTravel.com, TravelNow and Trip.com.

ASTA reported that 41% of travel agents did not have websites in 2001, and from those with websites, 66.7% did not offer online reservations.

<u>US Travel Agencies with a Website:</u>

	2000	**2001**
• Have own website:	52%	59%
• Do not have a website:	48%	41%

(ASTA, 2001)

It should be no surprise that only 11% of online US business travelers name a traditional travel agency when responding to the question “Where have you booked business travel online?” (Forrester)

As of June 2002, there were 26,120 US travel agencies, a 12% drop from June 2001, according to ASTA. This year IATAN and ARC report 300 travel agency (independents, branches, etc) closings per month on average. Meanwhile, online intermediaries continued to profit from the more than 21 million consumers who are now buying their travel exclusively over the Internet. This trend is expected to continue well into 2003, especially after the end of this fiscal year, which has proved to be another difficult year for the travel agency community. Another trend is the ongoing consolidation in the retail travel sector.

The continuous drop in GDS bookings and growth in Internet adoption and online bookings will continue indefinitely. We expect the shift from traditional travel agency/GDS distribution toward online hotel reservations to intensify in the foreseeable future. Based on what we see in the industry, we do not believe that over the next 18-24 months the major hotel brands will attempt to cut travel agency commissions across the board. A more likely scenario will be to introduce differentiated commission structures based on productivity.

Hoteliers should focus on ways to best leverage the potential of the existing travel agency community to its own advantage:

- Partner with the best and most productive travel agents and through incentives, higher commissions, etc., entice travel agents to book rack rates, promotions even Web-only specials through the brand website. Any room sold though a merchant model operator is at best at 25% below lowest rack rate—there is sufficient space for overrides to a proactive travel agency that books on the Radisson.com website.
- Partner with travel agencies that are destination-specialists to develop simple hotel packages, FITs, weekend packages, theater or museum packages, etc, which will allow hoteliers to sell distressed inventory in opaque fashion, bundled with other services, without jeopardizing its brand and pricing policies, as it happens with the merchant model services.
- Embrace the 80:20 rule to the fullest: introduce differentiated commission structure based on productivity. Reward those 20% of the travel agents that produce 80% of your travel agency hotel bookings.

We believe that in the long term the survivors in the travel agent segment will be:

- Mega agency groups (e.g. American Express, Rosenbluth, Carlson Wagonlit, Navigant) that can introduce efficiencies and economies of scale on one hand, and muster enough purchasing power to make deals with the major travel suppliers on the other. They also have the deepest pockets and resources for adopting technology innovations and Internet applications.
- Destination specialists: travel agencies that focus on destinations they really know and market well.
- Special-interest travel focused travel agents (gay, singles, religious, spas, cultural, student, etc).
- Internet Experts -- travel agents that embrace the Internet and specialize in finding the best deals and offers for their clients.

D. Call Center

Over the past 24 months there has been a visible shift of consumer behavior away from the phone, as vendors, including major hotel brand websites, are replacing voice channels.

Plog Research reports that there is a definite shift away from the phone to online among business travelers seek to obtain travel information:

<u>Sources used by U.S. business travelers</u> to obtain travel related information (% of respondents):

	2000	**2001**
• Called a toll-free number:	50%	41%
• Went online:	57%	67%

(Multiple responses allowed. 2001 Plog Research)

Jupiter Media Metrix estimates that nearly 60% of the 2001 online population in the US (141.5 million users), used the Internet to research travel. Only 50% of those searching for information online actually made their purchases online. The other 50% looked online, but booked offline, due to privacy issues, security concerns, purchasing habits, or needed to speak with a live agent to finalize the travel booking, etc.

US Internet Users Trip Planning Activities, 2001:

• Do not use the Internet for travel shopping:	42%
• Research and purchase travel online:	29%
• Research travel online, but purchase offline:	29%

(Jupiter Media Metrix)

PhoCusWright also reports that 50% of US Online Travelers looked online, but booked offline:

Internet Usage Habits of US Online Travelers:

	2000	**2001**
Visited travel-related websites:	84%	91%
Looked online, bought offline:	52%	50%

(PhoCusWright)

Choice Hotels reports that 17% of its website revenues come from customers who looked on the website, then booked by phone.

As Internet users become more experienced with the Internet and convert to online shoppers, and especially when website owners succeed in building trust and alleviating security concerns, we can expect the number of people that looked online and booked online to increase. All major research services, including PhoCusWright report such a trend in their findings.

In addition to the organic growth of online bookers, hoteliers can help online lookers convert into online bookers by offering Web-only specials and promotions, and loyalty program perks and incentives.

Popular cost-cutting measures used by other major travel players are:
- Consolidating call center operations
- Introducing multi-brand call centers
- Outsourcing call center operations
- Creating virtual call centers using latest Web-based technology

"Push-to-talk" Customer Support Applications

How valuable is the "Push-to-talk" functionality used by certain industry leaders. The “P2T” technology allows someone to reach a person by clicking on a button on the brand web site for immediate face-to-face or voice-to-voice contact. Video-based face-to-face online applications will become part of customer support sometime in the future when broadband becomes a commodity. The Voice-over-Internet Protocols (VOIP) applications (push-to-talk) and real-time interaction with a live agent in a chat room, which became popular with some online retailers and software vendors, has not yet become widely used on travel and hospitality websites. The Venetian Hotel in Las Vegas (http://www.venetian.com/home.cfm), whose rich media and Flash-intensive website introduced this feature less than a year ago, is one of those early adopters.

A review of the top five major hotel brands (Marriott, Hyatt, etc) shows that only Hilton uses "live agent" or "push-to-talk" functionality. Expedia and Travelocity do not use this functionality as of yet. Feedback from hoteliers that have installed "push-to-talk" functionality for over 24 months now, shows that consumers rarely use this feature and prefer to call the hotel 1-800 number when they need more information or don't feel comfortable transacting online.

For further information contact:

Hospitality eBusiness Strategies, Inc.
http://www.hospitalityebusiness.com/
P.O.Box 1461
USA - New York, NY 10028
Phone: 212-752-8159
Fax: 212-202-3670
Email: info@hospitalityebusiness.com