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The 'Net Effect: Survival in Cyberspace

TWO NEW studies show the unfolding impact of the Internet on travel distribution. The first study by PricewaterhouseCoopers (PwC) shows that while the Internet is stoking travel demand and more bookings, this is not necessarily translating into more revenues for hotels. The second study by Deloitte looks at the ferocious competition among travel Web sites. Both feature trends in the United States and United Kingdom that will inevitably appear in the PATA region in future.

AN ANALYSIS OF THE EFFECT OF THE INTERNET ON PRICING BY PRICEWATERHOUSECOOPERS (PWC)

The emergence of the Internet in the 1990s has had a profound effect on the lodging industry. According to the Travel Industry Association of America (TIA), the number of people using the Internet for travel research increased from three million to over 50 million from 1996-1999. By 2003, more than 60% of Americans regularly accessed the Internet, while approximately 35% used the Internet to research travel.

The Internet has served to increase both the transparency of room rates and the relative quality of hotels. The availability of real-time rates information on the Internet has allowed business and group travellers to examine all rates listed by hotels, and quickly revise their reservations if a hotel posts a lower rate. Therefore, business and group rates, instead of being true negotiated rates, are becoming negotiated maximum rates.

The Internet has also reduced search costs, particularly for leisure travellers. Third-party Web sites, such as Expedia and Travelocity, make it easy for travellers to compare prices among hotels in a given market. The act of shopping around has been reduced from time-consuming telephone calls to a few mouse clicks.

Brands vs. Independents

Independent hotels once had limited marketing options. They could list rates in global distribution systems (GDSs), pay commissions to travel agents that used GDSs, or advertise on billboards and in directories to attract walk-in business. For most independent hotels, national and international marketing campaigns were out of reach. Now independent hotels can compete more effectively against brand-affiliated hotels by conveying site, quality, service, and unique attributes on their own branded Web sites. Furthermore, they may now cost-effectively display hotel information and room inventory on third-party reservation sites.

Meanwhile, before the Internet, chain brand properties were able to use national television and/or print advertising, central reservation systems with toll-free telephone numbers and detailed directories distributed to all hotels within the brand and to other interested parties. The relatively easy access and "reach" of chain hotels enabled them to achieve premium room rates. The Internet has levelled the playing field in favour of independents.

Estimated Effects

To develop an estimate of the effects of the Internet on lodging room rates, PwC performed simulations using its econometric industry model to answer the question: What would have been the level of room rates in 2003 without the Internet?

PwC estimates the net Internet effect on the U.S. lodging industry in 2003 to be negative US$1.27 billion. This loss is composed of two components: (a) foregone revenues of US$1.987 billion due to a lower average daily rate (ADR – daily room revenue divided by total number of rooms available each day) resulting from increased transparency and price competition, and (b) additional revenues of US$715 million due to incremental bookings stimulated by lower rates.

ADR for U.S. hotels averaged US$83.28 in 2003, PwC estimates that ADR would have averaged US$85.40, or 2.5% higher, if it were not for the Internet. Travellers booking on the Internet in 2003 achieved an average room rate of US$71.27, 17% below the non-Internet ADR of US$85.40.

Internet reservations made up about 13% of all hotel reservations in 2003, according to PhoCusWright data. PwC estimates that about 7% of these Internet bookings were made by travellers who would not have booked without the existence of low Internet rates. Lower hotel rates on the Internet entice some travellers to take a spontaneous trip or choose to stay at a hotel instead of at the home of family or friends. These incremental bookings totalled about 26,000 rooms per night in 2003, resulting in an additional US$715 million in revenue for U.S. hotels, which partially off-sets losses due to low ADR.

PwC forecasts that by 2005, the net Internet effect on the U.S. lodging industry will have increased approximately 30% to negative US$1.66 billion. This will be composed of: (a) foregone revenues of US$2.90 billion due to lower ADR resulting from increased transparency and price competition, and (b) additional revenue of US$1.24 billion due to incremental bookings stimulated by the lower rate. On the bright side, ADR is forecast to increase by 4.9% from 2003-2005, but this is slower than the 9.3% increase forecast for the same period if it were not for the Internet.

ADR for U.S. hotels is forecast to average US$87.40 in 2005, PwC estimates that room rates of US$91.00 would have been achieved if it were not for the Internet. Incremental room demand is expected to increase to approximately 52,000 rooms per night in 2005, offsetting total simulated losses by US$1.24 billion.

Who's Online?

About 75% of Internet reservations in 2003 were made by "discount seekers", who actively use the Internet to secure the lowest possible price for hotel reservations. The remaining 25% of Internet reservations were made by "convenience bookers", who use the Internet to avoid speaking with a travel agent or calling a reservation centre. Compared to discount seekers, convenience bookers realise a relatively small discount on non-Internet rates.

While PwC estimates that the number of Internet bookings as a share of all hotel reservations is expected to increase from 13% in 2003 to approximately 24% in 2005, this growth is expected to be equally shared among discount seekers and convenience bookers. Thus, while Internet bookings as a share of all hotel reservations will increase, the average percentage discount achieved by Internet bookers is likely to decrease.

Multi-channels and Flexi-prices

The price transparency created by the Internet will continue to affect the ability of hotels to increase room rates, forcing them to more closely watch the market and become more flexible in their pricing strategies. While hotels may be unable to raise rates during periods of low demand, during periods of strong demand, the transparency of the Internet may enable hotels to increase rates more rapidly than was possible before the Internet.

Increasingly effective channel management by hotel companies, and improving industry performance, will result in smaller discounts available on third-party Web sites. Many chain management companies and franchisors have launched effective programmes to maintain rate integrity and manage inventory across all distribution channels. As multi-channel management improves, more rooms will be distributed through the Internet, yet fewer hotels will have to resort to deep discounting on third-party Web sites.

Increased competition will lead to higher marketing costs as hotel companies endeavour to strengthen brand loyalty. At the same time, hotels will have to define what it is they are selling over the Internet as compared to traditional distribution channels. For example, loyalty points might not accrue to customers who make discounted Internet reservations and/or they may have to pay extra for late check-out.

ONLINE TRAVEL AGENTS CAST THEIR WEB WIDE BY DELOITTE

Travel currently fills the largest e-commerce space on the Internet, representing around one-third of total online transactions. Airline tickets make up three-quarters of these, but consumers are increasingly keen to book other travel products online.

Atlantic Crossing

With the success of online agencies such as Travelocity and Expedia, structural changes in the distribution of travel products and services have been most acutely felt in the U.S. These companies are now targeting a high potential growth market in Europe and are starting to compete head-to-head with existing European players, ebookers and lastminute.com.

According to research by PhoCusWright, Europeans spent US$6 billion on online leisure travel in 2001, compared with an estimated US$13.3 billion in the U.S. in the same year. Forrester Research predicts that Europe will soon overtake the U.S. in online leisure travel booking.

Chairman and CEO of ebookers, Mr. Dinesh Dhamija, agrees, citing a pan-European population of some 100 million more than in the U.S and the fact that Europeans enjoy an average of 33 days annual holiday compared to just 13 days in the U.S. He also points to decreasing Internet access costs and increasing consumer confidence in e-commerce.

Forrester Research and Mr. Dhamija's arguments are supported by a recent MORI survey in the U.K. Half of the survey's respondents indicated they were likely to book a holiday via the Internet within two years

Finding the Best Deal

In order to eliminate travel agent commissions and reduce

Recent consolidation of travel Web sites

Year	Acquirer	Target	Deal value
2000	Sabre	GetThere.com	US$757m
	Amadeus	OneTravel.com	Undisclosed
	Amadeus	Vacation.com	US$95m
	Galileo	Trip.com	Undisclosed
	Expedia	Travelscape	US$90m
	lastminute	Degriftour	GBP59m
	ebookers	Flightbookers	Undisclosed
	ebookers	Viajes Dimensiones	Undisclosed
	ebookers	Geotours	GBP1m
2001	Cendant	Galileo	US$2.9bn
	Cendant	Cheaptickets	US$425m
	ebookers	Mr Jet	Undisclosed
2002	Travelocity (Sabre)	Site59.com	US$43m
	lastminute	Travelselect.com	GBP9m
	lastminute	Travelselect.com	GBP32m
	lastminute	Exhilaration	GBP1m
	lastminute	Travel4less	GBP12m
2002/ 2003	USA Interactive	Expedia	US$3.3bn for remaining 46% in 2003
2002/ 2003	USA Interactive	Hotels.com	US$1.1 billion for remaining 32% in 2003
2003	lastminute	Holiday Autos	GBP43m
	ebookers	Travelbag	GBP55m

Source: Mergermarket, Corpfin, Reuters, Company Web sites.

distribution costs, travel suppliers are now encouraging people to book directly through their Web sites. However, the lack of brand and product variety on these single sites has limited their success.

Far more popular are online agencies that search for the best travel deals and offer choice, 24-hour access, real-time content updates and powerful aggregation capabilities, allowing users to package multiple brands and products. These sites also hold out the promise of the lowest price, though this may be perceived rather than real.

Packages don't always offer the best value. A recent survey of UK tour operators by Goldman Sachs surprised many because it revealed that in 80% of cases it was 26% cheaper on average to separate the components of a brochure package and book directly through the individual suppliers' Web sites (70% of the time) or via an online travel agency (10% of the time), rather than buy the same (or similar) package offered by a tour operator. With the Internet giving customers a more transparent view of prices and the ability to book parts of the holiday separately, the traditional model of the tour operator is at risk.

According to the Association of British Travel Agents (ABTA), the number of UK high-street travel agents dropped from 9,097 outlets in 1999 to 8,863 by the end of 2002. Over the last six years, as tour operators encouraged bookings through their own Web sites, the number of people booking their package holidays directly through a travel agent has dropped by nearly 20%. Meanwhile, the number of people booking a holiday over the Internet increased from 6% in 2000 to 19% in 2002.

Many suppliers have either capped commission fees or scrapped them completely. In turn, based on the results of a 2002 ABTA/PwC Travel Agents' Benchmarking Survey, around 70% of travel agents have been forced to charge service fees to secure their survival.

Tailored to Suit

Advanced technologies are enabling existing players to attract more customers and exploit cross-selling opportunities through two distinct strategies – dynamic packaging and merchant pricing.

Dynamic holiday packaging enables larger sites to create their own packages from a selection of air, hotel and car hire products already available at negotiated rates. This bundling provides an opportunity for online agencies to increase average revenue per customer through cross selling. Established names such as ebookers, Travelocity, lastminute.com and Expedia have developed the technology to allow customers to create their own dynamically-packaged holiday. To date, these 'flight and hotel' packages have been mostly limited to key cities on major flight routes and some charters.

Dynamic packaging currently represents a bigger threat to mass-market business models than it does to niche providers. However, the strategic intent for expansion in this area is confirmed by Expedia's recent application for an ATOL licence, as an online tour operator that doesn't own a single seat, bed or store.

More Flexible

Merchant pricing, the second emerging strategy, also enables consumers to find a better deal, but lets agencies derive higher profit margins. More online agencies are adopting this flexible revenue model, whereby they negotiate the bulk purchase of available inventory from travel suppliers at discounted rates. They then resell inventory at a margin to consumers.

Unlike the traditional agency model, where an online intermediary distributes a supplier's product in return for a fixed commission, a 'gross spread' above the negotiated rate can be achieved. Depending on the relative negotiating strengths of the online intermediary and supplier, this spread can often be in the region of 20-40%. Another benefit for the online agency is that they usually only buy the right to acquire the inventory by a pre-agreed date, therefore, if the product fails to sell then the agency is not out of pocket.

The merchant model was one of a series of competitive responses to reduced commissions from travel suppliers, and represents a 'win-win-win' outcome for all. Suppliers can offload excess capacity at a minimum acceptable rate in a way that does not damage the integrity of published fares. Online intermediaries achieve higher margins than under the traditional agency model. Consumers pay lower prices.

Companies that have successfully adopted merchant pricing include Hotels.com and Expedia (both owned by InterActiveCorp), both of which are fighting back against consortium sites. Four major consortium sites have emerged so far – Orbitz and Opodo (airline consortia) and TravelWeb and Hotwire (hotel consortia). These offer a broad range of brands and products, while also achieving the necessary scale to compete effectively with large online intermediaries. Consortium sites also reduce agency commission levels and cut distribution costs.

Online agencies are responding to the threat posed by consortium sites by broadening their product portfolios. They are also offering ancillary travel services, such as personal travel profiles, destination guides, travel news, weather reports, maps and currency converters. Increasingly, they are also providing customer support via the telephone and improving customer relationship marketing techniques. When online customers can switch suppliers in seconds, there's little room for complacency or poor service levels.

A Question of Survival

As the online market grows, the battle for market share intensifies. This has led to consolidation as players pursue increased scale, access to better technology and increased inventory across more product categories. The pace of consolidation will continue as the big brands seek to entrench their position, and scarce finances forces smaller companies to merge with larger companies to survive.

Meanwhile, ebookers and lastminute.com have been busily acquiring 'bricks and mortar' companies across Europe to encourage more sales through their low-cost online channels. The decline in revenues from traditional travel agents has also forced global distribution systems (GDSs), such as Amadeus, Sabre and Galileo (now part of Cendant Corporation), to acquire online reservation specialists.

Suppliers are reacting to the shift in the balance of power within the travel industry in two ways. First, by enticing customers with incentives, to book on their own branded Web sites; and second, by throwing their weight behind consortium sites.

Clearly, as consumers become more comfortable booking their holidays online and begin to appreciate the independence and variety this offers, suppliers who have until now viewed online intermediaries as competitors rather than as strategic partners may have to think again. The balance of power in tourism distribution has shifted. Those who fail to react will undoubtedly lose their ability to compete.

The editor and PATA's Strategic Intelligence Centre welcome your comments and feedback. Please contact Mr. John Koldowski via e-mail at johnk@PATA.org or Mr. Imtiaz Muqbil at imtiaz@loxinfo.co.th.

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