HOTELS AND RESORTS

CHALLENGES OF A DIGITAL REVOLUTION

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The hotel market continues to undergo a fundamental transformation. Thanks to the industry's accelerated digitalization, prices have become more transparent and visible, and hotels have become increasingly reliant on online distributors, which have already grabbed 20 percent of the value of the tourism market in less than six years. The rules of the game have been changing rapidly, tilting the playing field in favor of digital players.

But the reality is far more complex than the story of online upstarts overtaking industry incumbents. In actuality, the market has seen the gradual formation of a fragile balance of power. Although digital intermediaries have built large customer bases and a growing inventory of offers, their bargaining power has mostly become stronger with independent hotels. Indeed, the latter are paying a heavy price in the form of high commissions that can reach up to 30 percent of the nightly price in some cases. Hotel chains, on the other hand, have certainly not had their final say. Not only are they supported by ambitious development plans, but more importantly, they maintain control of the entire customer itinerary and can act at each point of contact. Nevertheless, a quiet battle is now being waged for control of the customer relationship – one of the main keys to success in an industry undergoing fundamental shifts.

THREE FUNDAMENTAL SHIFTS IN THE HOTEL MARKET

In the past five years, the hotel market has experienced three fundamental shifts that have been transforming the entire industry.

FIRST SHIFT: BUYING BEHAVIOR CHANGES AND DISTRIBUTION IS THE NEW BATTLEFIELD

Online purchases represented less than 5 percent of the market in 2000, but they have since reached the current figure of 35 percent and are expected to stabilize at about 50 percent by 2017. In total, more than one billion travelers have already reserved a hotel room online, and their buying habits have continued to evolve. On average, a traveler in the process of making a hotel reservation visits 16 sites before completing the transaction online, either through search engines, online travel agencies (OTAs), hotel operator sites, or "meta-players", such as TripAdvisor, Zoover, etc.

The proliferation of information in the industry has enabled consumers to compare products easily, resulting in an educated market that has become increasingly sensitive to price and quality. Of course, price elasticity (the variation of demand according to price) fluctuates according to local context and season, but on average it has reached levels higher than in the past, particularly in important local markets.

Hence, the challenge for executives is to adapt better to an increasingly sophisticated demand that makes hoteliers pay dearly for their mistakes. Indeed, a 30 percent drop in the consumer satisfaction rating on TripAdvisor can translate into a drop in profits of up to 10 percent.

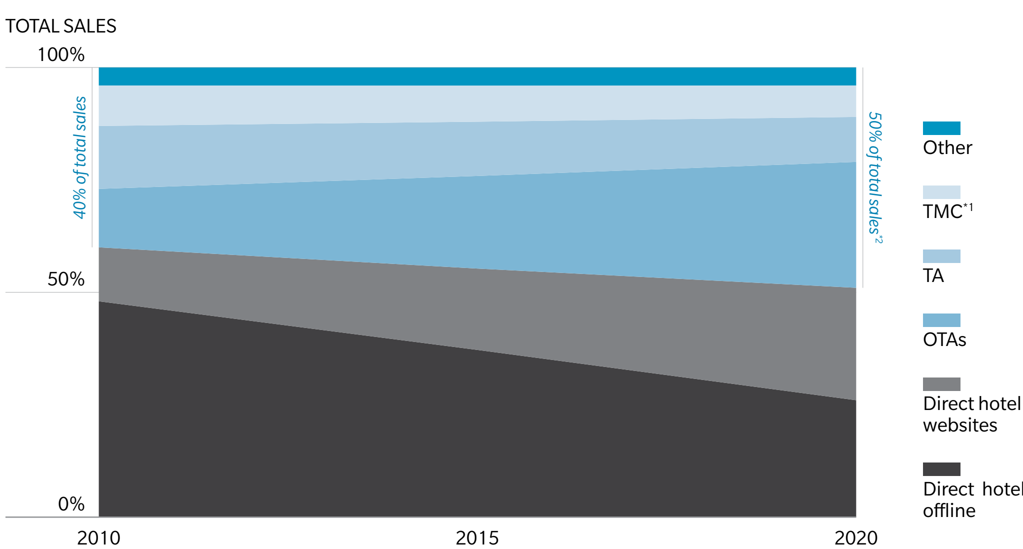
The emergence of online agencies in the second half of the 1990s greatly altered the hotel player landscape. Online agencies were able to develop a profitable model by attracting customers with promises of an exhaustive offering, enabling consumers to easily compare prices across hotels of varying quality. Those agencies have successfully imposed their game rules on the industry, particularly with respect to independent hotels (still 50 percent of the global market). And their share of the market is likely to grow, given their continued heavy spending on online advertising. In 2012, the Priceline group alone invested over $1 BN on online advertising, representing 2.6 percent of Google's total revenues in that area.

Thanks to a very aggressive strategy resolutely focused on the end customer, online agencies now represent 20 percent of the value of the tourism market, up from a meager 1 percent in 2001. And their presence is expected to grow further in the coming years (see Exhibit 1) – by 2020, online distribution will become the main indirect sales channel (28 percent of sales) at the expense of not only brick-and-mortar travel agencies (down by 30 percent) but also direct hotel sales (down by 15 percent).

The symbiotic relationship between hotels and their online distributors depends primarily on an uneasy balance of power. Although hotels need online agencies to increase their occupancy rate in demand troughs, they are becoming more reluctant to pay high commissions (typically 15 to 20 percent) on an increasingly greater share of their business. Online agencies, for their part, are run according to an intermediation model, which by definition depends on the distributed room inventory and content data provided by hotel operators.

On top of that, purchasing behaviors continue to evolve. The sharing economy has brutally penetrated the travel market over the last years. Created in 2008, AirBnB already has a higher market capitalization and a bigger inventory than major hotel chains (current inventory estimated at 600.000 rooms). So far, the cannibalization has been low as the core demand is currently mainly composed of leisure repeaters and competes with the low end of the offer. Nevertheless, it is quickly evolving toward high end offers and will create a major turmoil considering 70 percent of the global hospitality market is leisure oriented and room potential for collaborative consumption is huge. For example in France, estimates forecast an available inventory five times as high as traditional hospitality room inventory.*

Exhibit 1: Channel mix projection to 2020



*1 TMCs = Travel Management Companies
*2 Meta-player involved in 19% of traffic
Source Oliver Wyman projections

* For additional insight on that topic, see also Oliver Wyman publications: "The Next Great Battle Over Hotel Distribution" and "the Next Digital Disruption of Leisure Travel"

SECOND SHIFT: MOBILE OPENS UP NEW POSSIBILITIES TO ENRICH GUEST EXPERIENCE … AND INCREASE SALES

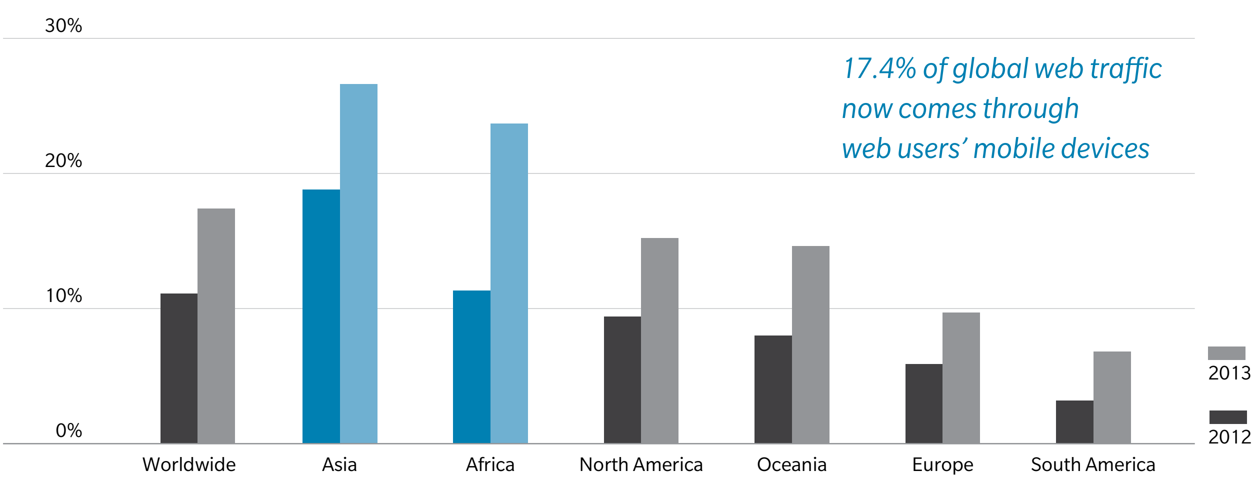
By the end of the third quarter of 2013, 63 percent of US consumers owned a smartphone and penetration rates were even higher in many Asian countries, allowing to compensate for the somewhat lack of investment in broadband infrastructure. Moreover, mobile coupon usage has grown dramatically: from 7.4 MM in 2010 to 29.5 MM in 2012 and expected surge to 47.1 MM in 2014.

Already Marriott, Starwood, and Hyatt have launched mobile check-in and are using it to transform and streamline the guest arrival process, but this is just the tip of the iceberg in terms of potential. One hotel company has observed that 62 percent of mobile bookers reserved a stay within 48 hour prior to their arrival, 33 percent of tablet bookers and 28 percent of desktop bookers did the same. So mobile potentially opens up the window to more dynamic and versatile on-the-fly adjustments to bookings closer to arrival.

Mobile coupons in combination with location-based data gathering techniques allow retailers to see not only how many coupons were redeemed, but often more granular data such as GPS-tagged location, as well as device-specific data that can then be aggregated with past digital shopping history. In hospitality, coupling mobile couponing to on-property amenity marketing and Bluetooth "beacons" could drive substantial upticks in F&B revenues, spa revenues, and other ancillary services.

Starbuck's passbook app illustrates the way that mobile could transform loyalty program connections. It's not just about the earn/burn value proposition now, it's about the convenience and ease of paying for things on the property, it's about transforming the guest experience, it's about improving the liquidity of the loyalty currency and the guest's ability to do mixed cash-plus-points payments for all manner of services around the property.

Exhibit 2: Percentage of page views coming from mobile devices



Source StatCounter

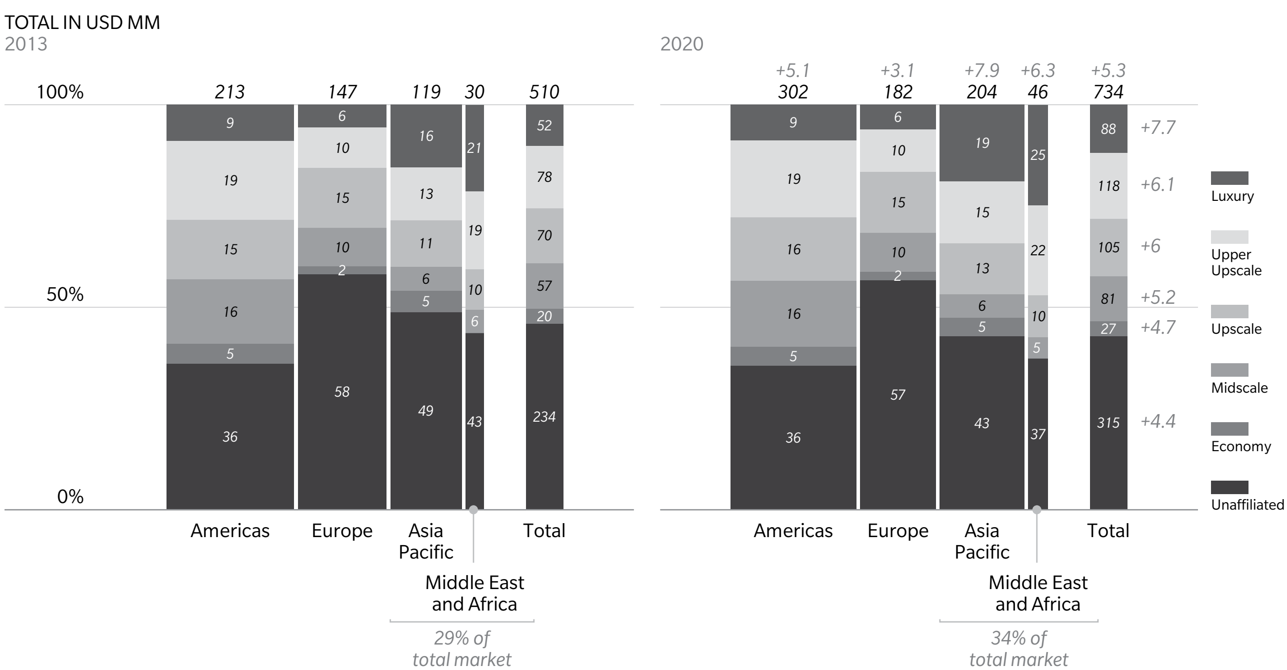
THIRD SHIFT: THE GLOBAL HOTEL LANDSCAPE IS NOW BEING STRUCTURED

With 30 percent growth by 2020, the huge €600 BN hotel market is expanding and moving rapidly toward emerging countries. Indeed, the share of Asia, the Middle East, and Africa will double within the next seven years to reach nearly 40 percent of the total market, including both chains and independents.

The highest growth is expected in Asia, where hotel chains are being developed at an annual pace of 8 percent. That continent accounts for 45 percent of room volume under construction, particularly in the highest-end segment. After Asia, the Middle East and Africa will be the two most dynamic regions, with expected growth of 6 percent per year by 2020 (see Exhibit 3).

Inevitably, these three shifts will largely tend to favor hotel chains at the expense of independent hotels. In the United States, independent hotels have already seen their margins decline by 2.5 percent over the past three years, and their share of the global market is losing over 10 percent every four years. In 2020, chains will control 62 percent of the market, compared with 52 percent today. This trend will principally occur in Europe and emerging regions, as the North American market is already largely consolidated. In fact, currently in the United States the ten leading chains already represent over half of the hotel offering.

Exhibit 3: Hotel market size by geography and segment – projections to 2020



Source STR, Oliver Wyman analyses

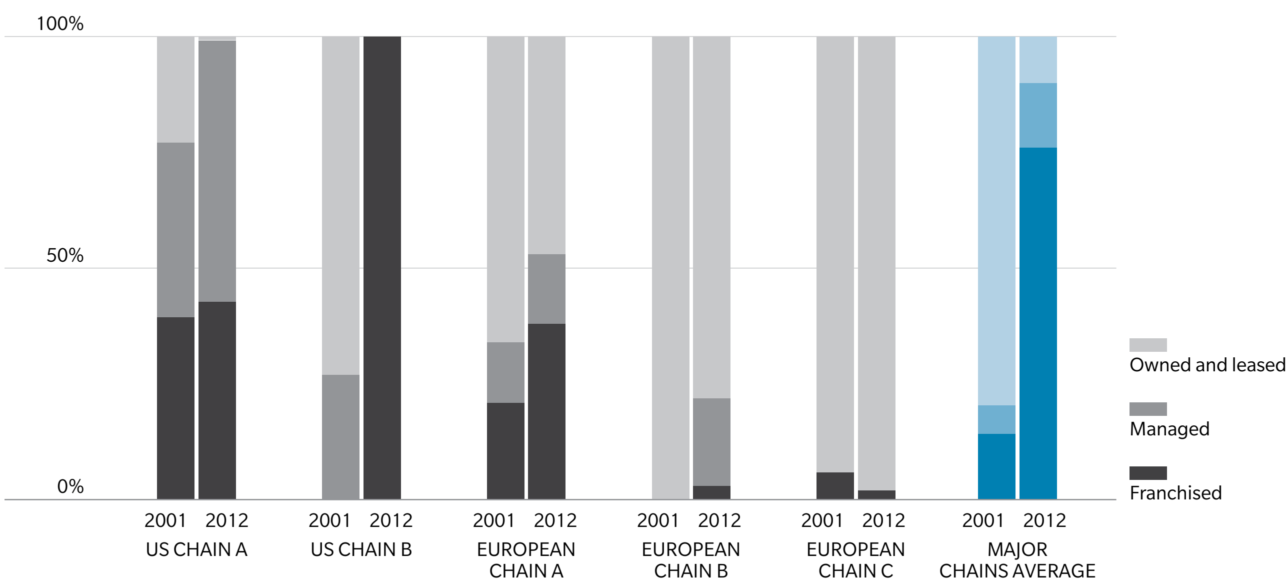
THREE CHALLENGES FOR HOTEL OPERATORS

To meet a constantly rising demand (60 percent more international tourists by 2020), hotel chains have been announcing ambitious development plans that have required them to adapt their asset ownership models. Moreover, to support that growth and to cope with the downward pressure on prices, hotel operators must continue to develop their know-how in order to reinforce the operational excellence and industrialization of their platforms. And finally, in the context of channel proliferation, all players – chains, independents, and distributors – are preparing to lock horns in a decisive battle to gain control of the all-important relationship with the end customer.

FIRST CHALLENGE: DEVELOP ACCELERATED GROWTH MODELS

In the space of a few short years, hotel chains have profoundly modified their asset ownership strategy and are gradually moving those portfolios toward an asset-light model. The substantial development of franchised or management ownership models that are less capital-intensive (see Exhibit 4) enables accelerated growth while reducing risks and allowing to amortize the growing fixed cost base that is connected with the required development of sales and marketing platforms.

Exhibit 4: Ownership models by hotel chain



Source Oliver Wyman analyses

In this new model, the hotel profession is evolving toward a B-to-B service in which the value proposition of the franchisor or the management company is focused on generating a higher RevPAR from its brand, operational know-how, and efficient sales platform.

Although this strategy is now increasingly commonplace due to its more attractive risk profile, other ownership models may nonetheless turn out to be lucrative and better adapted in some situations. For example, owning and operating assets in the luxury segment provides a player with control over investment and renovation programs. Finally, certain hotel operators such as Banyan Tree have used REIT (Real Estate Investment Trust) vehicles as an effective mechanism to raise funds (where local tax laws are attractive) and then use that capital to increase their portfolio of directly owned assets.

These new strategies also have direct impacts on operations: new above-hotel organizational models emerge for certain critical skills sets (e.g., Finance, HR, Sales, Revenue Management). Beyond the fact they generate higher profitability (+5% to +10%), they are also considered as critical enablers for growth and scale, especially in some emerging markets, where the relevant skill sets are typically scarce and traditional at-property models just can't scale.

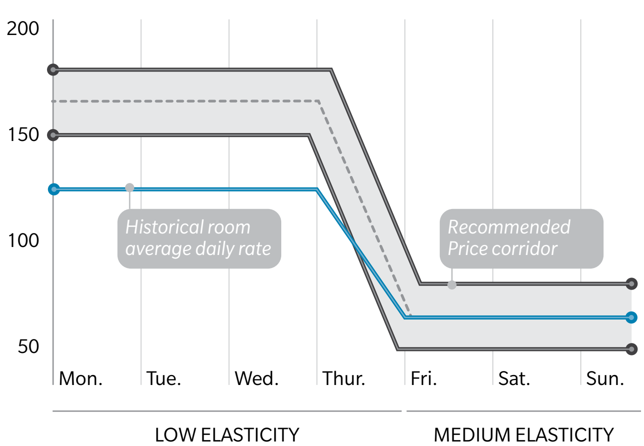
SECOND CHALLENGE: INDUSTRIALIZE PLATFORMS

To support accelerated growth and to cope with the downward pressure on prices, hotel operators must rapidly reinforce the industrialization of their sales distribution platforms with sophisticated dynamic pricing and revenue management methods, CRM performance, and better channel management.

Exhibit 5: Impact of price repositioning on margins

PRICE REPOSITIONING

SITE 1 – ROOM TYPE B
ADR (€)



KEY RECOMMENDATION

HIGHER PRICE POSITIONING ON WEEKDAYS

- Week: low elasticity (0.8 in absolute value) and constrained days (occupancy rate > 95%)
- Week-end: Medium elasticity (1.3 in absolute value) and unconstrainted days (occupancy rate < 70%)

IMPACT

- Occupancy rate: +0%
- ADR: +4%
- RevPar: +4%
- Margin: +3%

Source Oliver Wyman analyses

As an example, sophisticated dynamic pricing and revenue management techniques can now be used to make the optimum tradeoffs between volume and margin based on historical and competitive data at a very fine level of granularity (season, type of product, customer origin, etc.). Theses methods evolve toward more segmented approaches: smaller hotels need help with above-property support on simple and automated dynamic pricing systems while larger, more sophisticated properties need help setting their overall pricing structure and invest in better understanding how they should respond to corporate and MICE rate solicitations and group pricing. Hotel operators with the most successful dynamic and segmented systems, imbedded with an above property model, have generated gains of 3 to 10 percent of additional revenues and far more in profits (with labor cost savings on Revenue Management team going up to 50 percent, through a reduction of team size and a focus on higher skilled employees).

But price-positioning optimization is a tricky process, requiring the careful consideration of the impact on margin. Unfortunately, many turnkey solutions on the market fail to take into account the margin levels by site. This profound transformation requires to invest on the one hand in analytical skills and on the other hand in agile and ergonomic support decision tools to handle a new level of complexity.

THIRD CHALLENGE: CONTROL THE CUSTOMER RELATIONSHIP

The battle waged between hotel operators and their intermediaries will center at a crucial location: control of the customer relationship. Each side currently has information the other does not: hotel operators have information relative to buying behavior throughout the customer itinerary (particularly during the hotel stay), while OTAs are able to track reservations by a single customer at different hotel chains. Given that some OTAs have launched proprietary loyalty programs, such as Expedia's Expedia Rewards, hotel chains must now reinforce their control of the customer relationship. This means implementing richer and more differentiating loyalty programs and CRM that are better adapted to the changing needs of customers. Excellence in capturing and exploiting customer information will be crucial in defending market share. Specifically, hotel operators must adapt the customer experience to customer behavior in increasingly sophisticated ways through a strong and recognizable brand positioning.

CRM performance involves the selection of databases that capture relevant information on customers, and the analysis of this data to identify specific segments and trends (guest analytics). The goal is to ultimately deploy marketing initiatives aimed at winning, developing, and retaining customers according to profile, buying history, and predicted future behavior. All these customized and private offers can be pushed all along the customer experience (prestay, during the stay, …).

Channel management has also become critical at a time when the balance of power has never been so favorable for online distributors. This process involves defining the route to market for each customer target and then adapting the tools available to hotel operators to reach those customers. Optimized channel management helps for example to avoid needless online agency commissions, which can reach up to 30 percent in some cases.

Linked with CRM, optimized channel management can favor differentiated reservations capabilities that only give the customer the full ability to personalize their stay experience if they book through preferred channels. This combines CRM with new reservations capabilities (for ancillaries or for specific room attributes, for instance) to drive guests' channel selection behavior.

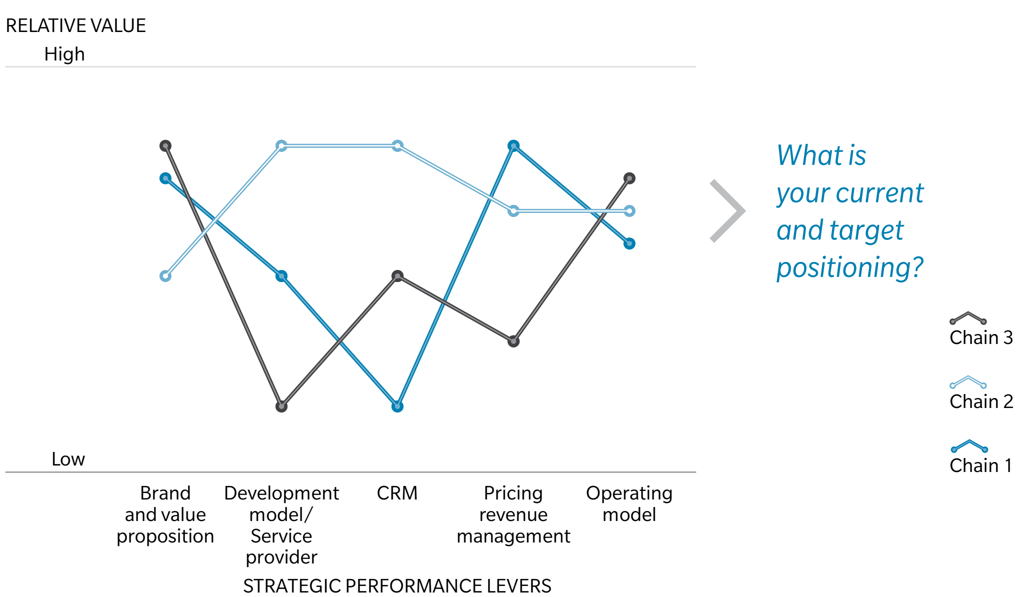
Controlling the customer relationship requires to transform these « online stores », often purely transactional and cold, and move towards a relational paradigm, offering unique and differentiated services along the customer journey and fully leveraging new mobile capabilities (E-check, after sales services, loyalty program management, hotel amenities and products, available activities in the surrounding environment, …).

CONCLUSION: THE HOTEL OPERATOR PLAYBOOK

To achieve their strategic vision, hotel operators need to selectively focus on the targeted performance drivers that will maximize the added value of their investments. In doing so, we have found that the industry leaders tend to deploy a strategic framework that can be summarized by the following "playbook":

- The rules have changed. Development drivers that will be effective in the future will not be the same as those that have worked in the past. Is the strategic vision of hotel chains sufficiently ambitious and novel to handle the fundamental shifts in the market? And are senior teams in place in all geographical regions to deploy such a plan?
- Rapid execution will be a decisive driver. Hotel chains must focus on allocating resources efficiently to the most promising initiatives and geographies.
- Success will require judicious decisions regarding which initiatives to develop and their sequencing over time. Suitable initiatives must be implemented to reinforce short- and medium-term process deployment. Among the various potential initiatives, what are the investment priorities to optimize the pace of growth and profit without spreading resources too thin?
- Success means different things to different stakeholders. Aligning the leadership team and stakeholders around the strategic vision is essential. What does success mean to each party? And does the plan clearly and unambiguously state the "why" and "how" of the transformation?

Exhibit 6: Strategic performance drivers



Source Oliver Wyman analyses

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

Oliver Wyman's Services, Travel & Leisure practice supports its clients in addressing their strategic and operational challenges. The practice combines deep industry expertise with specialized skills, offering a broad suite of consulting services encompassing strategy & business development, commercial effectiveness, operational transformation, value sourcing and value transformation. Based on that experience and knowledge, we publish industry specific studies and benchmarking data-bases that are available to our clients.

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