The smart use of online search to aggregate travel data is no longer the sole province of the big OTAs

BOXED IN BY SUCCESS

Online travel agencies need to reinvent themselves as higher costs and a new rival undermine their business model

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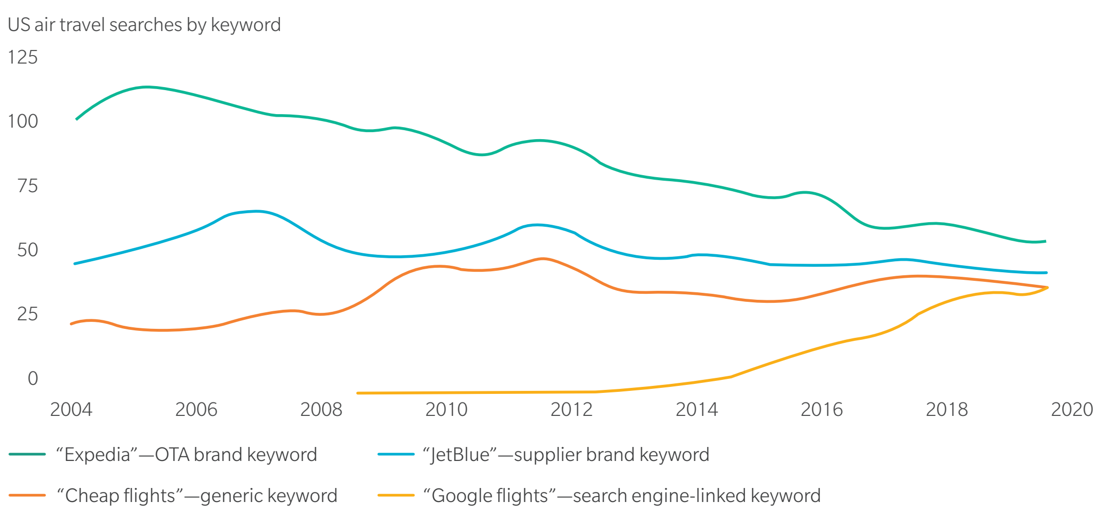
ONLINE TRAVEL AGENCIES (OTAs) are the original digital disruptors—first-generation internet businesses that identified an unmet customer need and created digital destinations that became the first stop for prospective travelers. Yet the very thing that gave rise to OTAs—the ability to aggregate digitized data to create economical, do-it-yourself travel planning—now threatens to be their undoing. As with most erstwhile digital upstarts and once-transformative business models, OTAs must disrupt again or risk being disrupted.

Where 20 years ago planning travel was a complicated, anxiety-fraught exercise, travelers today feel more in control, thanks in large part to OTAs. The digitalized travel model brought comparison shopping and price transparency to desktops and mobile devices, and travelers embraced this self-sufficient approach to planning business and pleasure trips because of its enhanced flexibility and customization.

That awakening helped produce explosive growth for both travel and OTAs but spawned myriad challengers competing for the same customer. Eventually, the explosion of rivals led to bigger and savvier OTAs as small ones were gobbled up.

TRAVELERS' SEARCH ENGINE PATTERNS ARE CHANGING



Notes: 12-month trailing averages. Indexed to Expedia search volume, January 2004 = 100
Source: Google Trends, Oliver Wyman analysis

New rivalries

The consolidation created heavyweights in the travel value chain. Booking Holdings and Expedia, the two biggest OTAs, boast a combined market cap of more than $100 billion, comparable to the four largest US airlines combined.

But competition doesn't end there. The biggest threat in travel planning could eventually come from the tech powerhouse that helped OTAs become successful in the first place. After years of quietly building a brand in travel, Google today has become a leading option for travel search, second only to Expedia.

While Google still sends most customers to its advertisers to book, the tech giant has introduced close to one-stop shopping over desktop and mobile app; it also can complete the booking for some hotels and flights. In time, it will extend the tool to Google Assistant. But what gives Google its edge in travel are the petabytes of data at its disposal from its purchases of ITA Software for flights and Zagat for restaurants, building up its hotel metasearch comparisons, and the trillions of travel searches going on daily via Google.

Costs and commissions

But Google isn't the only thorn in the OTAs' side. Besides rising competition, OTAs are also seeing their operating costs climb and the once prescient business model undermined. The culprit: The cost of search engine marketing (SEM)—the most important tool in the OTA toolkit—has been increasing. Booking.com alone spent over $4.4 billion in 2018 on performance marketing, which is essentially SEM. Booking's expense represents about three percent of Google's advertising revenue. So not only is Google pocketing Booking's money, it is also grabbing new travel data with each click.

Here's how SEM works: Through Google AdWords or Bing Ads, companies bid on high-value keywords and phrases such as "flights to Spain" or "New York hotel" that indicate an intent to travel. The bidder—in this case, the OTA—only pays the search provider if a customer clicks on its link. OTAs make money by converting those click-throughs into purchases of flights, hotel rooms, rail tickets, or rental cars. OTA profitability depends on keeping the cost-per-click lower than the revenue on a customer transaction, multiplied by the rate at which the OTA is able to convert visitors into purchasers.

The biggest threat to OTAs comes from Google, the tech powerhouse that was key to their success

If a consumer visits multiple sites or even the same OTA multiple times from different platforms without making a purchase, the OTA loses money—a practice that is becoming common, as would-be travelers increasingly comparison-shop. *(See "The Super Informed Traveler,")* Even when consumers do complete a purchase, OTAs struggle with how to credit the sale, given the array of click-throughs and impressions associated with it. That raises the risk of overpaying for SEM.

Travel SEM is not limited to OTAs. Among the regulars competing for travel keywords: airlines, hotel chains, rental car agencies, passenger rail companies, and cruise lines. This creates a bidding war for the best keywords.

Disruptor headaches

OTAs and others in the travel industry are not the only ones facing rising SEM costs, overcrowded marketplaces, and disruption by a new wave of innovators and big corporate names. The same scenario has been playing out in sectors including real estate, autos and insurance that have also been digitally disrupted by savvy SEM. Upstarts like Zillow began upending traditional real estate over a decade ago, and the shakeup and SEM frenzy have continued with News Corp.'s purchase of Realtor.com in 2014 and the creation of online sites like Streeteasy, which specializes in big city real estate.

For OTAs, the pressure comes from more than higher costs. OTAs' primary source of revenue—commissions paid by travel providers—is threatened by industry consolidation and providers' push to promote direct booking. Airlines, which have been consolidating for more than a decade, are using apps and loyalty programs to encourage customers to book directly with them. Because airlines rely less on OTAs, they pay significantly lower commissions. The new OTA economics can mean that net of the SEM costs, an OTA may lose money on the sale of a flight.

While hospitality and cruises have offered OTAs an opportunity to earn higher margins than on air travel, consolidation and competition here too are starting to cause problems for OTAs. Large hotel chains are determined to get their distribution costs down by negotiating lower OTA commissions and pushing their own direct channels. To accomplish this, most reserve their best deals and properties for their own channels and OTAs willing to play ball on commissions. OTA hotel offerings are also suffering because of competition from alternative lodging platforms like Airbnb that don't make their offerings available through OTAs.

Fork in the road

OTAs do have options to grow and better compete. One would be to fine-tune their use of paid search. Developing the capabilities to integrate search activity, site activity, and customer relationship management data could help OTAs identify keywords associated with the most attractive customer segments—those that generate higher margin per transaction—and keep ahead of rising SEM costs.

Another option would be to become one-stop shops, like the travel agents of yesteryear but adapted to an online, data-driven environment. OTAs have the reach and capabilities to provide full-service vacation planning, including tours, attractions, classes, and theater tickets, which would offer more margin opportunity and appeal to a new generation of upscale travelers. Surprisingly, travel agents are enjoying a mini-resurgence with millennials, who want curated, personalized travel planning, according to the 2019 Portrait of American Travelers survey, conducted by travel agency MMGY Global. The survey suggests that not doing everything online and providing person-to-person expertise might lead to more customer loyalty. Creating call centers and a local presence, once eschewed by OTAs, could be differentiators.

A third route is to rethink the marketing mix and reduce reliance on SEM. Some OTAs are looking at traditional media, such as television, radio, and outdoor advertising, as a more cost-effective way to reach buyers. The goal would be to get customers to bypass search engines and go directly to an OTA-branded website or app.

Finally, OTAs could change how they interact with customers. Instead of simply taking orders and delivering the goods, they could become travel advisers, telling travelers about what they haven't considered, but may very well enjoy. Such inspirational power is well within the capabilities of today's artificial intelligence and visual rendering technologies. And it just may be the new identity that could help OTAs disrupt the status quo again with a 21st century business model built to satisfy a much savvier traveler.

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