HVS

MARKET REPORT

The Internet: Friend or Foe?

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In this article, the author discusses the benefits of the internet in managing hotels.

The use of the Internet as a means of booking room reservations has grown exponentially in recent years. However, on the hotels' balance sheets, rooms sold through the Internet have tended to represent the most economical rooms sold, due in part to the nature of the consumer that Internet sites market the rooms toward and in part to the commissions charged to the hotel by the third-party Internet companies. While Internet-related rooms generate less revenue per room than rooms sold in most other demand segments, there are few hoteliers who would not defend the decisions they have made to release a significant amount of their inventory to third-party Internet sites, and with good reason. The lodging industry in many markets is coming out of some of its most dismal years in recent history. During this time, many hotels have been able to maintain very strong occupancy rates, and generate what hoteliers consider to be incremental income, by releasing their inventory on the Internet. Hoteliers are only now beginning to track Internet demand as a separate segment, but preliminary data indicate that some hotels are selling as much as 35%, and perhaps more, of their occupied rooms through these discounted Internet channels. Even though the rate can be 50% below the average daily rate among the remainder of the hotel's demand, when such a large percentage of the rooms sold are sold through the Internet, this represents a significant revenue stream. If a hotel is able to achieve a 75% occupancy while selling 35% of its occupied room nights via the Internet, the question must be asked if the hotel would have been better off releasing less inventory through the Internet and achieving a lower occupancy, particularly if the revenue to the hotel is below the departmental cost per occupied room, which is sometimes the case. Hoteliers will tell you no. Here are some of the many arguments managers present when defending their decisions to use the Internet to capture demand. The Internet as a marketing tool: "The customers that come through the Internet are, above all, price sensitive. If they had not stayed at this hotel for a discounted rate, they would have stayed somewhere else. But, if they like this hotel, they may choose to stay here in the future and pay more. The Internet is a good way to introduce people to this hotel who might not have stayed here otherwise." Incremental income: "The hotel has bills to pay. Though the rooms booked through third-party Internet websites may generate less revenue than rooms sold via traditional methods, the revenue that they generate is almost all profit. The Internet-generated rooms incur few expenses other than laundry and bathroom amenities because all of the staff involved in servicing the room and attending to the guest is already here. Besides, there is no marketing cost incurred in selling the room." Ancillary income: "Though the guestroom is selling below market value, these guests are generating income in other departments. Some buy food and beverages or in-room movies, and many park cars." Note: During a period when hotel revenues have declined in nearly all operating departments, parking revenue has increased on a per-occupied-room-basis in many hotels. A lot of the Internet demand is made up of last-minute, drive-in, weekend

travelers. Free marketing: “It does not cost anything to sell rooms via the Internet in terms of physical marketing materials or labor, and management has a lot of control about the number of rooms sold and when they are sold. During times of low demand, more rooms are released to the Internet distribution channels, and during periods of high occupancy, the inventory is closed to those sources.” Despite the effects to average rate, managers are convinced that they are making good decisions by attracting customers who would not have stayed at their hotel at a higher price. During periods of low room night demand, the use of the Internet as a booking source is considered by many to be a winning option. The arguments are compelling. However, we as an industry need to proceed with caution. As the Internet has been a major part of the lodging industry for a length of time, we are now afforded a greater perspective. Signs are emerging that the effects of the prolific use of low-rated Internet booking channels are longer term in nature than was originally anticipated. Core accounts are impacted: Although the third-party Internet channels are intended to attract customers who might not have otherwise stayed at the property, the declining overall average rates that these discounted bookings are causing are also negatively impacting a property’s core accounts. A recent example of this is the federal government's reduction of the rate it will pay for hotel rooms in select areas nationwide for the 2003-04 fiscal year. In Silicon Valley, the government rate dropped by 29%, from $150 per night to $106 per night. In San Mateo County, the government rate declined by 24%, from $134 per night to $102. In San Francisco, the government rate decline was 13%, from $159 to $139. The new rates are reported to be determined by data compiled by Smith Travel Research (STR), indicating that the average rates earned by hotels dropped by similar amounts from 2001 to 2002. While it is neither a secret nor a surprise that average rates in these markets have dropped in recent years, the price actually paid by typical customers has not dropped as much as the data suggests. Rather, the marketwide average rates were significantly diluted by an increased proportion of heavily discounted rates and, as such, the new per diem reductions do not accurately reflect the prices routinely offered to the area's core clientele. This same issue is arising in the negotiation of volume corporate accounts. When all of the data point to declining average rate, how can a responsible travel manager justify accepting a rate increase? The answer is that many are not. For at least two consecutive years hotel sales managers have reported that they have been asked to keep negotiated rates flat compared to the prior year, or even for rate to decline further, in tandem with what is reported to be happening in the market. Furthermore, the reduction in the government per diem rates or corporate negotiated rates based on the STR data is flawed. The STR data accurately reflect the rooms revenue collected at the hotel. However, the data do not reflect the fact that a hotel’s calculated average rate is below the actual average rate paid by guests. Although the cost to the hotel to sell a room via a third-party Internet site is minimal in terms of marketing material or labor, the hotel loses a significant amount of revenue in commissions to the Internet sites. Our research indicates that the mark-up between the revenue to the hotel and the revenue to the Internet site averages between 25% and 30%. For example, a hotel would release room inventory to the third-party Internet site for $70 and the consumer would buy the room for $90. However, the hotel’s average rate reflects the $70 of income to the hotel, which is then reflected in the STR data, which is then used as a basis to lower the negotiated rate. All the while, guests have been paying $90 for the room, not $70. If a hotelier becomes increasingly reliant upon discounted booking channels, he or she creates a situation in which the prognosis for year-over-year rate growth at that property is hindered. Managers may feel that they have limited options. In times of reduced demand, every promising method is being exercised to obtain as much market share and revenue as possible. The availability of the Internet presents a conundrum. The Internet is a perfect low-cost member of a hotel's sales team. In recent years, it has been a widely used, widely accepted method of attracting demand that the hotel might not have accommodated otherwise. It has brought revenue to the hotel that the hotel would not otherwise have received. However, the prolific use of third-party Internet websites as marketing partners, combined with the nature of the rooms sold through the Internet, has eroded average rates. The good news is that we as an industry are reevaluating the way we position and use what is perhaps the greatest technological asset to integrate into our workforce in the past decade. All

the major hotel companies are aggressively and effectively promoting their own websites with the promise of a low price guarantee. As demand strengthens, an occurrence that is transpiring in many markets, successful yield management efforts will result in the fewest number of rooms being sold through third-party Internet sites. The money previously collected by the third-party sites will be included in the hotel's room revenue and, as such, the hotel's average rate will accurately reflect the price of the room to the consumer. If hoteliers are able to capture all of the revenue their rooms are generating, we are poised to achieve strong average rate growth in the near term.