A KALIBRI LABS SPECIAL REPORT

Book Direct Campaigns 2.0:

THE COSTS AND BENEFITS OF LOYALTY 2018

kalibri LABS

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BOOK DIRECT CAMPAIGNS 2.0:
THE COSTS AND BENEFITS OF LOYALTY 2018

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About

KALIBRI LABS, LLC

Kalibri Labs evaluates and predicts revenue performance using its proprietary algorithm to generate the Optimal Business Mix for individual hotels, revealing the most promising opportunities to pursue along with specific direction on how to find and convert them. The Hummingbird PXM revenue strategy and benchmarking platform also includes the industry's most robust profiles for travel agent and OTA production. The Kalibri Labs database, updated monthly, is comprised of ADR, room revenue, room nights and acquisition costs from over 7 billion guest stays adding 100 million each month from over 33,000 hotels dating back more than 5 years to give an expansive view of the U.S. hotel industry. Real estate developers, brokers and others involved in hotel transactions also use Kalibri Labs data to improve underwriting with a more granular view of each market and benchmarks and trendlines for both individual hotels and sub-markets for all U.S. metro areas.

CINDY ESTIS GREEN, KALIBRI LABS, CEO & CO-FOUNDER

Cindy Estis Green started her career in corporate marketing and senior operations positions with Hilton International before founding Driving Revenue which was later sold to Pegasus Solutions. Since then, she has written over a dozen industry books on distribution and marketing strategy and is a frequent speaker at industry conferences. She founded Kalibri Labs to enable the hotel industry to operate more effectively in the digital marketplace. Cindy holds a BS from Cornell University's School of Hotel Administration and an MBA from The American University.

MARK MAZZOCCO, KALIBRI LABS, VP REVENUE STRATEGY

Mark Mazzocco leads the revenue strategy team, working to identify and implement new client solutions. Mark has over ten years of revenue analytics experience in the hospitality industry, having worked both on property and helping to lead Hilton's Corporate Revenue Management team. Mark holds a BS in Economics from Bates College.

Executive Summary

BACKGROUND

In 2016, many major hotel chains launched a series of campaigns aimed at consumers to join their loyalty programs and offered incentives to encourage them to "Book Direct" through the hotel company direct channels with an emphasis on their Brand.com website channel. There is a lot of interest at evaluating if the Book Direct campaigns have maintained their original pace and how the hotels fare two years later.

THE ORIGINAL STUDY PUBLISHED IN 2017

A study, *Book Direct Campaigns: The Costs & Benefits of Loyalty,* was published by Kalibri Labs in November 2017 examining the period from May-December 2016 after the initial launch of various loyalty-based offers in the market by close to 10 major hotel chains. The study evaluated the outcomes of these campaigns in comparison to a statistical analysis of what would have happened if the Book Direct campaigns were not launched. The rate of growth of OTA bookings declined while the Brand.com bookings accelerated. Those results demonstrated that the vast majority of hotels came out net positive based on a rising base of loyalty members paying rates that were at a premium to the OTA rates in the same period. The overall shift toward direct bookings resulted in a channel mix that yielded higher levels of profit contribution.

The original study, published in November 2017 reflecting transactions in the first year of the Book Direct campaigns, cited outcomes that showed that Brand.com loyalty bookings came in at 8.6% higher in ADR than OTA rates taking into account all discounts along with commissions and channel-related costs for both types of bookings.

THE HOTEL INDUSTRY'S LARGEST REVENUE PERFORMANCE DATABASE

Like the original study, the results of these campaigns were evaluated using the Kalibri Labs industrywide database which has grown to over 33,000 U.S. hotels and is updated monthly. The Kalibri Labs database of over 7 billion transactions is the only industry database with validated costs and daily rates, room nights and revenue from every individual booking, sourced directly from each contributing hotel company. Kalibri Labs aggregates and anonymizes the data for accurate reporting for distribution analysis and performance evaluation at a property, brand, chain and industry level. The Kalibri Labs database grows by 100 million transactions per month so it has a large sample to test the theories around Book Direct campaigns. Comparing performance based on revenue net of customer acquisition costs is critical for an accurate assessment since some industry observers contend that when discounts and costs are accounted for, that the Book Direct loyalty member stays may be more expensive than traditional OTA stays.

Questions persist as to whether consumer behavior can be changed to shift more bookings toward the Brand.com channel and if so, to what degree and at what cost. Some articles published since 2016 comparing Loyalty Member Rates through Brand.com with OTA bookings relied on estimates and hypothetical values and as a result, some have presented potentially misleading findings. Without actual transaction and cost of acquisition data, it is not possible to accurately determine market outcomes but since the actual data is available to do this assessment in a thorough manner, this report will summarize those findings.

ACCOUNTING FOR DISCOUNTS AND PAID SEARCH

In evaluating the benefits of the Book Direct campaigns, some argued that the early results in 2016 reflected a bump in results in favor of Brand.com largely due to the novelty of the Book Direct campaigns and the nature of their offers. Many suggested that discounting and paid-search costs diminish the net value of a direct booking making it necessary to address these variables. In order to assess the outcomes as accurately as possible, both discounts and paid search media have been factored into this analysis.

TRANSACTIONAL VS. LIFETIME VALUE ANALYSIS

As in 2016, many third-party vendors and operators continue to compare single stay transactions between the Brand.com and the OTA channels as though there was no future benefit from those customers who may recur and come back at a lower cost and/or a higher rate. While the analysis could be done in this way, it would be flawed if recurring stays are not considered. **The concept called "Lifetime Value Analysis" is the basis for Loyalty programs and is grounded in the higher value of repeat business when compared to one-time stays.** The assumption is that once a consumer participates in the loyalty program and recurs, that future stays in the same or a sister hotel will benefit the overall system by increasing volume and reducing costs. While consumers may stay multiple times independent of channel, as the loyalty membership grows, the repeat stays are more likely to be those of loyalty members. With the incentive built into the loyalty programs to book direct in order to get credit for bookings and to tap the conveniences afforded to members, most go directly to a brand website or app to consummate a booking with a lesser dependence on search engines or other third parties to build that loyalty base; some use the call center as well, another direct channel with a high percentage of loyalty contribution. Further, many one-time stayers in one hotel who are loyalty members may in fact be repeat stayers at a brand level, using multiple hotels within the brand.

These Book Direct programs were purpose-built with the goal of growing the loyalty base of the brands to improve the number of recurring guests, whether they recur in the same hotel or in a sister hotel. When receiving business from an OTA channel, the hotel is less likely to observe repeat behavior and has to cycle through multiple guests without an expectation that the guest may come back to them or to sister hotels. In keeping with the OTA business model, guests using the OTA channel are strongly encouraged to return to the OTA channel by the vendor, however, they are given no incentive by the OTA to repeat at the same hotel or brand and if or when they are, it is likely the hotel or brand is paying an upcharge for that cooperative sales effort.

KEY TAKEAWAYS

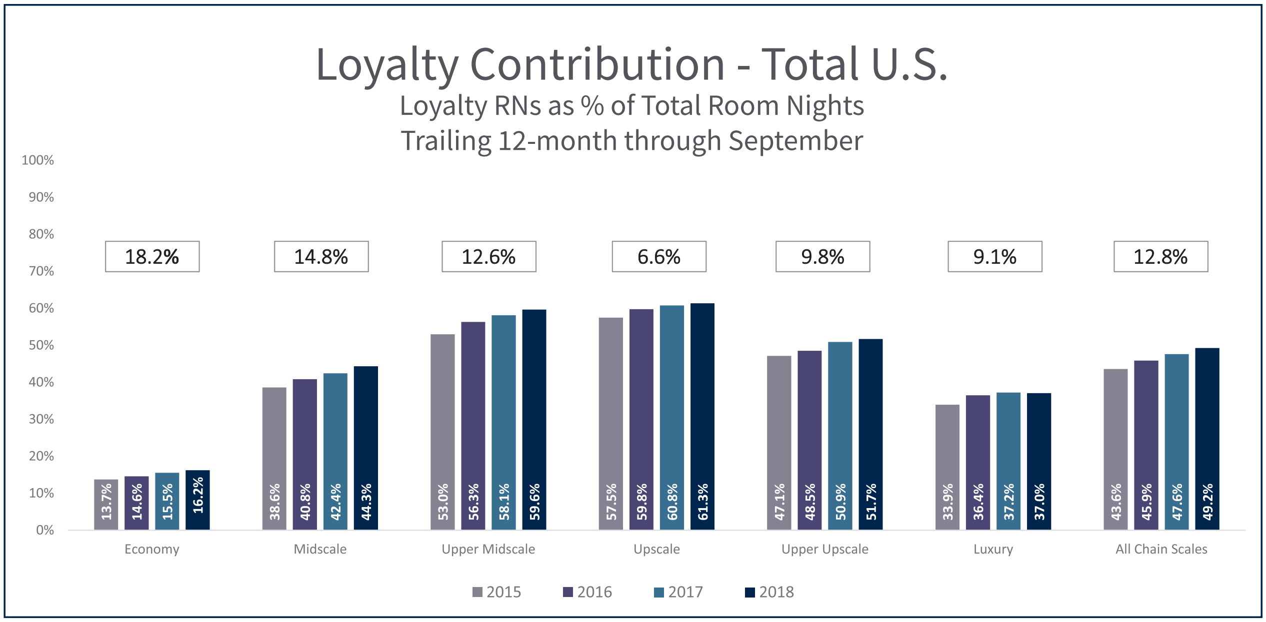
1. **Loyalty members represent the largest customer base for branded hotels in the U.S.**
   The loyalty base for the hotel industry chains experienced rapid growth of 30-40% year-over-year from 2015 to 2016 when the Book Direct programs were first introduced; the pace has stabilized but continued at a healthy rate into 2018 that is still 2-5X the rate of growth from the pre-Book Direct period (before 2016). Almost half of the business in the U.S. branded hotels is derived from loyalty members.

2. **Brand.com has grown at the same rate or faster than the OTA channel**
   When compared to the contribution to occupancy from the OTA channel, the Brand.com channel maintained its growth running approximately 50% greater than the OTA bookings. The initial campaigns showed a rapid acceleration in 2016 and for the last two years, that pace has stabilized and maintained a steady gap to OTA growth. The increase for Brand.com is 50% more rooms sold per month on average compared to OTA rooms sold per month during the same period.

3. **Net ADR for Brand.com loyalty bookings remain higher than Net ADR for OTA bookings**
   The ADR for Member Rate/Loyalty bookings still reflects a solid premium compared to OTA bookings after acquisition costs are removed and has grown to 9% in 2018, up from 8.6% in 2016. Even when tested for weekend/weekday and lead time differences, Net ADR for Brand.com loyalty bookings are higher in total, and for each chain scale.

4. **Loyalty members yield better results for hotels and a better guest experience**
   The loyalty base of business in a hotel serves as a foundation of business to which a hotel can supplement with groups, locally sourced and other ad hoc demand drivers to reach its targeted occupancy. When calculating the benefit of a recurring guest coming three times after an initial visit and comparing that to cycling through 4 different OTA customers, the average net benefit to a hotel using industry averages is approximately $65 per loyalty member. This economic advantage, in combination with enabling more personalized service, gives the hotels with a large recurring loyalty base an advantage over a third-party base and can contribute to a more tailored guest experience.

FIGURE 1:



THE STUDY

This research initiative examines hotel stays over a period from January 2016 through August 2018. Since the campaigns have been in the market for over two years, this study looks at (1) the pattern of loyalty member growth and (2) the differences in average rates (ADR) net of booking costs. Any discounts given are accounted for by showing actual rates paid and the booking costs that are calculated include commissions, channel costs, transaction fees and loyalty fees charged by the hotel brands. Wholesale commissions are added back to Merchant model (net)* OTA bookings so the merchant, retail and Brand.com rates will all be comparable.

The study examines 19,000 hotels, all of which had loyalty programs in play in the market during this period. The hotels ranged from Economy through Luxury chain scales and each scale was examined individually as well as in combination across the U.S. in total.

There are just under 80 million transactions included in the sample over the period examined.

Like in the original study published in November 2017, an analysis was conducted to illustrate the Lifetime Value Analysis by using industry average rates and costs for a loyalty member that recurs three times in comparison to an equal number of stays by multiple OTA guests. This data is updated to reflect the average values in 2018 for the same types of stays.

*merchant model (or net) OTA bookings are those when the guest pays the OTA in advance of the stay and the OTA pays an agreed rate to the hotel and keeps the difference as their compensation.

Conclusion

Almost three years after the launch of the first industry Book Direct loyalty member programs, a study sample of 19,000 hotels and 80 million transactions provides conclusive evidence with some variation between hotels but a common pattern. The loyalty member campaigns have either strengthened or stabilized the growth rate of bookings through Brand.com while the OTA channel has either held steady or has somewhat decelerated. Both online channels are growing, but Brand.com is growing at a stable rate or faster maintaining the current position across the U.S. industry where Brand.com generates 50% more bookings on average to U.S. hotels than the OTA channel.

The Loyalty member rates through Brand.com deliver a 9% premium to OTA bookings across U.S. hotels in terms of ADR net of booking costs (compared to 8.6% in 2016). Therefore, in most cases, Loyalty member bookings through Brand.com represent a more desirable opportunity than an OTA booking when a hotel is determining its Optimal Business Mix. The member discounts offered as incentives over the last three years have declined from 5-10% when initiated in 2016 to closer to 2-5% in 2018. Even more fundamental to the sustainable profitability of the hotel industry, the purpose of the campaigns to grow a hotel's loyalty base appears to have been achieved as the current average base of loyalty contribution is between 40-60% and is growing 2-5x faster than before these campaigns were introduced.

Beyond the transactional benefits of the programs in an initial stay, building this powerful base of recurring guests leads to lower acquisition costs in subsequent stays. Since 2016, the benefits to loyalty club members have also expanded notably from rate discounts to conveniences through the brand mobile apps enabling services such as mobile check in, choose-your-own-room, keyless entry and other guest services. This results in higher profit margins to hotels with less reliance on discounting and a higher proportion of direct bookings through the hotel apps with fewer bookings through metasearch. These digital services which continue to expand with a focus on improved guest experience offer the potential for recurrence to the same or sister hotels within a brand further reducing the appeal of third-party booking vendors who cannot enhance the guest experience while on site. It appears likely that these digitally delivered convenience-based services will play a significant role in the ongoing competition for the traveler's attention during the shopping, buying and stay experience.

Introduction

This Special Report provides an update on the consumer campaigns launched originally in 2016 and continued through 2018 by the large hotel chains to offer Affinity/Loyalty program members special rates as an incentive to book directly with the hotel company.

Book Direct initiatives were applied for different reasons by hotel companies, but there were some common themes.

1. **Change consumer behavior to encourage Brand.com,** or other direct channel bookings by shoppers who might otherwise have chosen an OTA. (Although call centers honor Book Direct offers and some hotel companies allowed large travel agents to have access, the Brand.com channel was the focus of these campaigns.)

2. **Increase membership in the hotel company's loyalty program** to both drive future bookings and improve the guest experience for more consumers.

3. **Reduce acquisition costs** for hotels by increasing the percentage of business booked through the lower cost direct channels.

4. Convey the message to consumers that **Brand.com websites will have the best price available** in the market.

The campaigns were launched in Q1 2016 and continued through 2018. Related questions revolve around topics of channel usage, rates paid, cost of acquisition, loyalty growth and overall benefit of the loyalty consumer in comparison to the consumer delivered by a third party. Consumers will always make their own choice about the channel they prefer but the 2017 Book Direct study proved that consumer decisions can be influenced. Whether by incentives and explicit or implicit benefits that accrue from the channel a consumer opts to use, there is evidence that hotels or OTAs can create a bias for one booking path over another. Two years on from the original analysis, the data points to revisit are:

- how the ROI on loyalty Brand.com bookings compares to the ROI on OTA bookings
- whether the Brand.com channel maintained a higher % of business compared to the OTA channel
- whether the Brand.com channel is growing faster, slower or maintaining the same rate of growth as the OTA channel
- if the hotel received a premium on loyalty Brand.com bookings compared to OTA bookings when compared net of acquisition costs
- how quickly the loyalty base has grown for the major chains in the U.S. since the Book Direct campaigns entered the market.

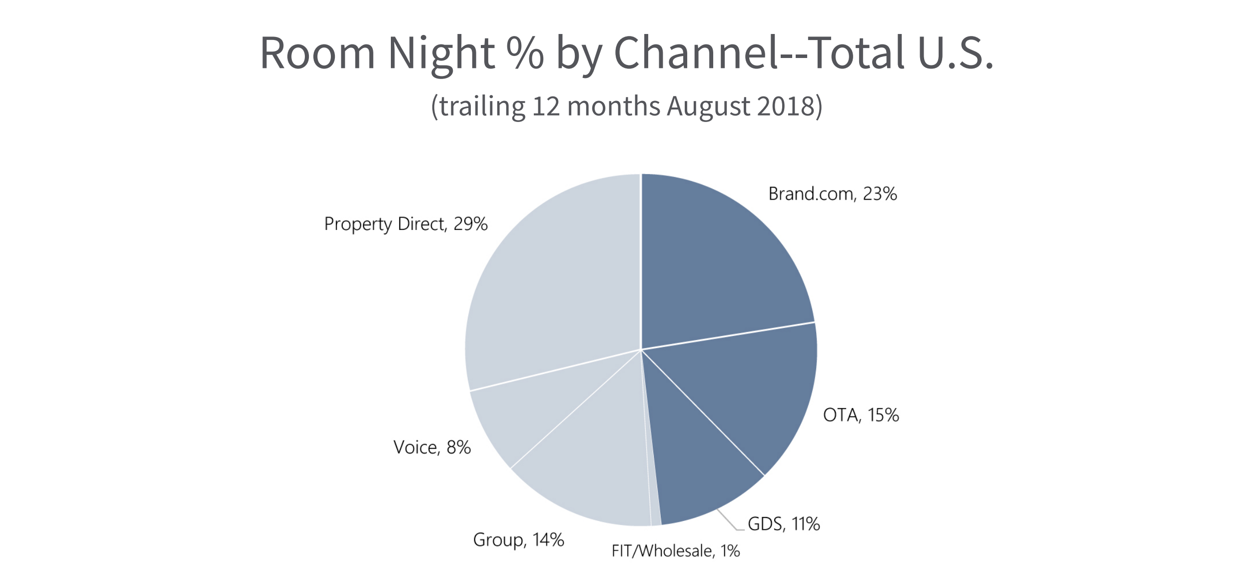
Summary of Findings

OVERALL HOTEL PERFORMANCE

In the 12 months ending August 2018, the U.S. hotel industry receives just about half of its room nights (49%) through digital channels (shaded dark blue below): Brand.com, OTA and GDS. When examining the split between direct and indirect channels, direct still dominates with 6 in 10 room nights coming through one of the direct channels: Brand.com, Voice or Property Direct.*

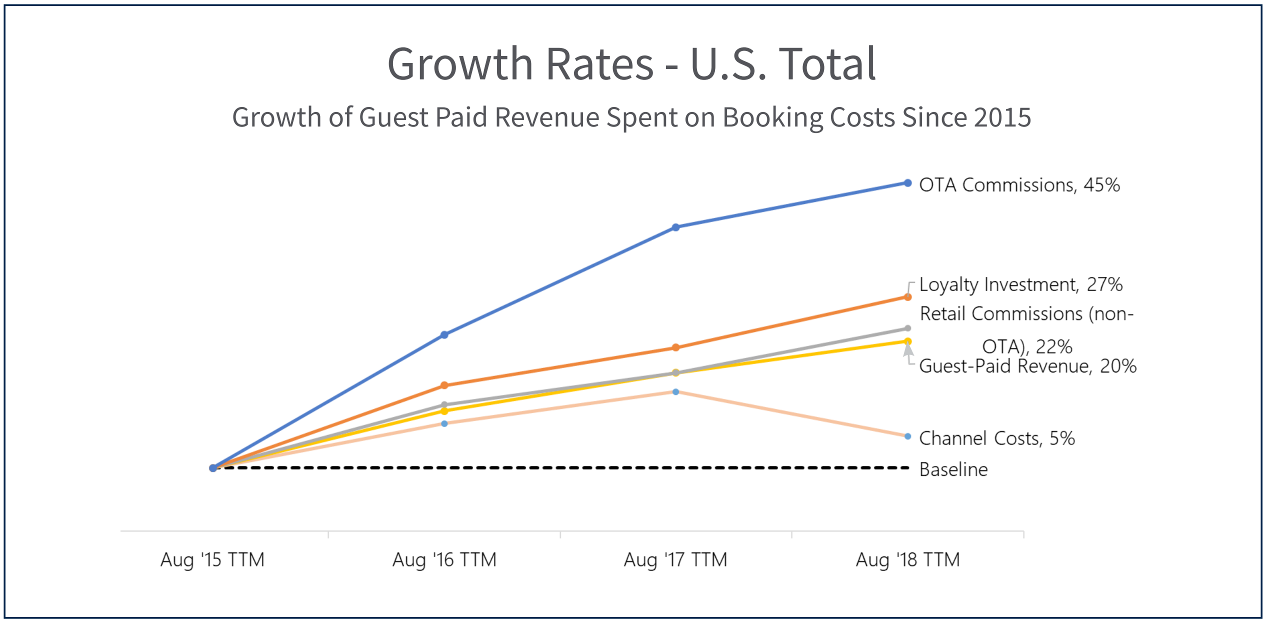
*Property direct does not include group or FIT; only walk-in, call in to hotel or drive up; Voice is call center

FIGURE 2



The hotel industry fundamentals are strong as reflected in high levels of demand as well as Guest Paid Revenue which has grown by 20% from its base level in 2015 to 2018 (using a trailing 12 months through August). However, when indexed against the 2015 value, the overall cost to the hotel industry of OTA commissions has well outpaced that growth rising at more than twice that rate (45%) during the same period. The commission rates may be lower per transaction for many branded hotels, however the volume of business has risen causing the overall industry cost to be considerably higher. In spite of the adoption of loyalty membership, the total OTA commission costs are still growing well over 60% faster than loyalty costs which also grew, but only by 27%.

FIGURE 3



ROI: DIRECT LOYALTY VS. OTA BOOKINGS

Looking more broadly than the 19,000 hotels in the study, the overall U.S. market of hotels with loyalty programs was evaluated in terms of revenue and costs associated with the direct bookings in comparison to third-party business through OTAs. An analysis was conducted to examine revenue net of booking costs and the results indicate that **Loyalty bookings direct through the hotels' websites generate an ROI that is almost double that of revenue coming through the OTA channel.**

Loyalty bookings through Brand.com generate an ROI that is nearly 2X that of an OTA.

ROI ON DIRECT LOYALTY BOOKINGS IS ALMOST 2X OTA

NET REVENUE EARNED FOR EVERY $1 SPENT IN ACQUISITION COSTS
OCT 2017-SEP 2018

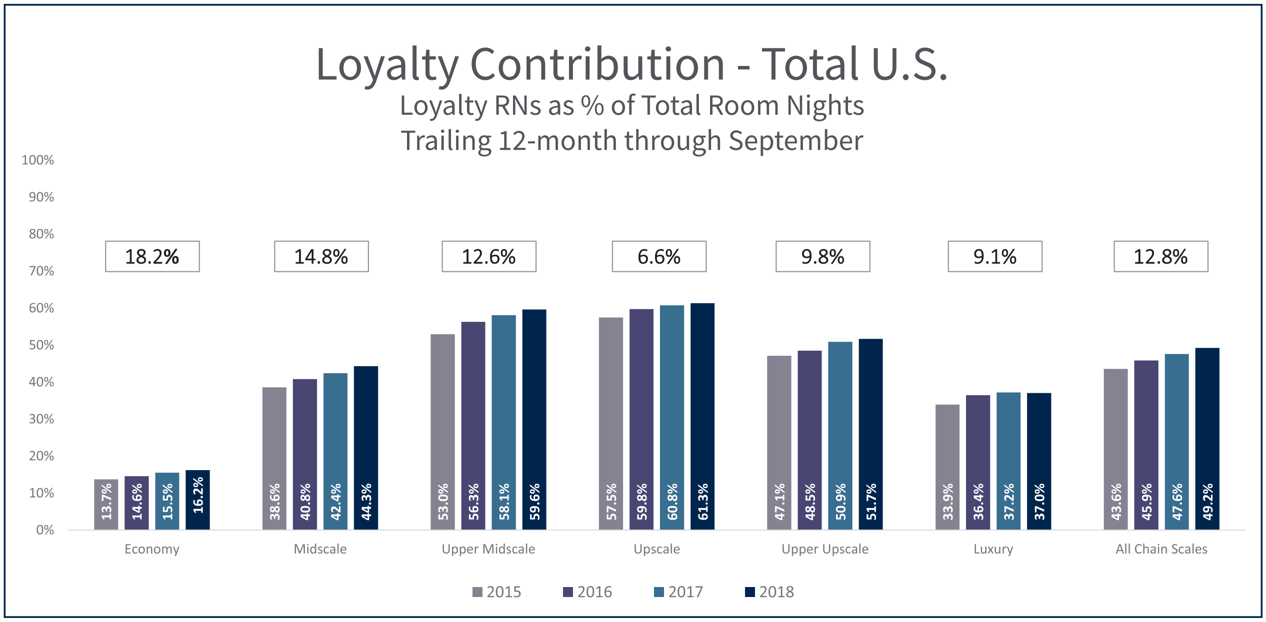
	Net Revenue Earned	Investment Made In 2016	Net Revenue Generated for every $1 of Investment
Direct Loyalty Bookings	$54.3 B	$6.52 B	$8.33
OTA Bookings	$22.0 B	$4.62 B	$4.77

Note: based on projections for the full hotel census in the U.S., investment costs for direct channel loyalty bookings include: channel costs, commissions and a factor associated with incremental Brand.com search marketing fees. OTA investment includes commission costs and any other channel or transaction fees.

LOYALTY GROWTH

The loyalty base for the U.S. hotel industry runs on average 40-60% which means that about half of all room nights are associated with a loyalty member, including all channels and rate categories. This base has quickly become the primary foundation of contribution for a hotel from its brand. Upon examination of the average loyalty rooms sold per day in January 2016, before the earliest campaigns compared to almost two years later in January 2018, the hotel industry sold on average 100,000 more loyalty rooms per day.

FIGURE 4



Economy, midscale and upper midscale hotels all enjoyed double-digit growth in loyalty contribution with steady gains since the Book Direct campaigns were launched. Upper upscale and luxury branded hotels come in just under 10% growth and although the rate of growth for Upscale hotels is lower at 7%, they have the largest base of loyalty bookings with over 61% of the total base of these hotel room nights.

SOME HIGHLIGHTS BY CHAIN SCALE

- Notably, economy hotels had the greatest rate of growth for loyalty contribution of all chain scales at over 18%. Although these hotels were starting at a lower base, they are quickly moving to a point where almost one in five room nights is booked by a loyalty member.

- Midscale brands had a high growth rate jumping from the inception of the program rising almost 6 points from a low of 38% to a high of 44%.

- Upper midscale hotels have the highest absolute growth with an almost 7 point rise and therefore, have both a strong rate of growth in loyalty contribution as well as one of the highest % of room nights booked by loyalty members rising to a high of about 60%.

- Upscale brands have the highest loyalty contribution overall of all hotel segments; while it slowed in the latter part of 2017, growth reaccelerated in 2018 to a range between 61-62%.

- Upper upscale brands have grown by close to 10% since Book Direct campaigns began with over half of the room nights booked by a loyalty member.

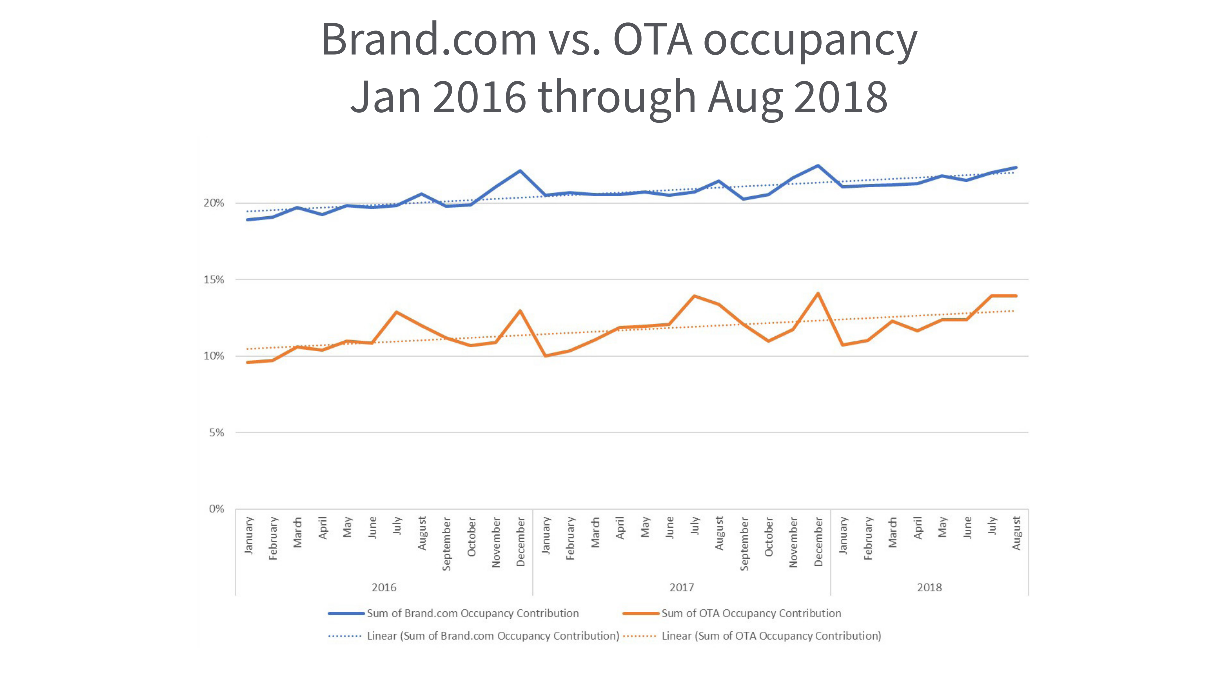
- Although steadily climbing, luxury hotels had just under a 10% growth rate but tend to operate with a lower base of loyalty members reflecting just over one-third of their business coming from the loyalty member base.

ROOM NIGHT DEMAND BY CHANNEL

The room night demand through Brand.com in the U.S. has been running on average about 50% higher than the OTA room night demand. The shift in channel mix by hotels away from the traditional Property Direct and toward the digital channels has been a significant driver of the rise of customer acquisition costs. When examining the pattern of business for the loyalty offers through Brand.com compared to the OTA bookings, it appears that Brand.com is either growing at a similar or faster pace. In looking at the number of rooms sold through Property Direct from 2015 to 2018, it has declined by 150,000 rooms sold per day while most of that drop has been picked up in a split between OTA and Brand.com. The Book Direct campaigns appear to have kept the contest relatively evenly split; while both are growing, due to the lower base of OTA business (i.e., the overall OTA demand share is 50% lower than Brand.com—reference Demand Share in Figure 2), the rate of growth appears higher, but the volume of rooms sold through direct channels far outpaces daily room night counts through OTAs.

ROOM NIGHT DEMAND: LOYALTY BRAND.COM VS. OTA

The growth of Brand.com has continued at a healthy pace and maintained a range between 20% to 23% of total room night demand. OTA business has also grown, albeit on a smaller base, and has gone from about 10% to almost 15% for the period of January 2016 through August 2018. The increase for Brand.com is 50% more incremental rooms sold per month on average compared to the incremental OTA rooms sold per month.



While the pattern was consistent across all U.S. hotels, there were some differences by chain scale. Upper upscale had the strongest growth rate by Brand.com relative to the OTA growth. Midscale hotels had the largest OTA base ranging from 10-15% but their Brand.com contribution surged in 2018.

NET ADR*

Many questions have been raised in evaluating the business to determine if the loyalty revenue ***net of acquisition cost*** for a Brand.com guest is worth more than the OTA revenue, on the same basis, ***net of acquisition cost***. In order to test this, costs were removed from the rates paid by the guest for this study to include commissions, channel or transaction fees, loyalty costs and a provision for brand-paid search.

To keep the comparison more precise, the Brand.com bookings examined are only those involving a Member Rate or special loyalty offering; other rates booked through Brand.com were not included and the OTA rates are only those purchased on a merchant and retail basis; because opaque bookings are often deeply discounted, they are not included. Merchant or net rate OTA bookings are those where the guest pays the OTA upfront upon making the reservation and retains their compensation rather than having the hotel send compensation later. Retail bookings are those where the guest pays at the hotel and the hotel sends compensation to the OTA vendor after the guest departure.

**the Net ADR reflects the ADR after direct booking costs are removed and is also referred to as "COPE ADR", an acronym for Contribution to Operating Profit and Expense.*

NET ADR PREMIUM -- LOYALTY MEMBER VS. OTA

OCT 2017 - SEP 2018

The largest premium is in Upper Upscale hotels and the lowest is in Upper Midscale but the average is a healthy premium of 9% in net ADR.

Net ADR -- Loyalty Member vs. Net ADR -- OTA*
+9.0%

**OTA Net/Merchant + OTA Retail; OTA Opaque is excluded.*

LIFETIME VALUE ANALYSIS

The concept behind hotel brand loyalty and member programs is to encourage consumers to return to a brand thereby increasing spend, getting greater customer engagement and lowering the cost of subsequent visits over time. The longstanding marketing concept of "lifetime value" spans many industries and indicates that loyal customers generate a value to the business based on the cumulative revenue they generate over multiple purchases. Repeat customers generate more revenue because of their inclination to come back more often, spend more money and refer friends and family to a brand. This means that the value of each recurring customer over time has been documented to be much greater than the value they bring the first time they buy a product or service.[1] This does not mean a hotel or brand can limit focus only on the small population of frequent travelers with 15-20 visits a year, but rather can broaden that focus to guests who come back two times or more. If one only counts the cost and benefit of the first visit, for every guest, every time, and ignores the fact that they return, then there is no value attributed to retaining customers. However, this philosophy around the value of customer retention is the driving force behind all loyalty programs, those of the hotel brands as well as the OTAs, and the value of recurring customers is widely accepted.

One might ask what the likelihood of returning to the same hotel or brand is for an OTA channel customer vs. for a Brand.com customer who has signed up for a loyalty program. Given their business model, it is reasonable to assume that the OTAs are agnostic as to which hotel or brand the customer books so long as that customer books through the OTA site. In contrast, the hotel brand business model calls for creating incentives to get the customer to rebook the same brand and so efforts are made to offer compelling benefits toward this objective. From the hoteliers' point of view, recognizing the power of guest retention, success would include both higher customer engagement, i.e., an emphasis on better guest experience to encourage return visits, and higher profitability of a hotel's overall client base.

To borrow further from the Harvard Business Review case study on Lifetime Value (LTV), the formula would be:

LTV = m * V – AC[2]

m= average contribution margin for each stay*
V= number of visits expected
AC = upfront cost of acquisition

$150.50 * 4 stays - $15 = $587

**since the basic costs of stay will be similar through all channels (check in/check out, housekeeping), the contribution margin for each channel will be calculated based on costs incurred directly related to the booking transaction through that channel*

[1] *Steenburgh, Thomas, and Jill Avery. "Marketing Analysis Toolkit: Customer Lifetime Value Analysis." Harvard Business School Background Note 511-029, July 2010. (Revised January 2017.)*

[2] *Ibid.*

This is illustrated below for the Book Direct/Member Rate analysis. Originally conducted in 2016, the example is based on an updated data set of the average revenue and costs from the sample of 19,000 hotels from the period of August 2017-July 2018. The model for the Loyalty member includes an upfront cost to acquire the guest the first time along with a slight increase in rate generated either through successful upselling or by offering premium products that better match known guest preferences learned through hotel and brand engagement with the guest. The data from the Book Direct study sample shows that the Brand.com Guest Paid ADR is higher than the OTA Guest Paid ADR so this rate gap is reflected in the Lifetime Value Analysis.

LOYALTY BOOKING

Loyalty Booking (through Brand.com)	Guest Paid ADR	Upfront Acquisition Cost**	Routine Booking Cost (8%)[3]	Net Contribution
Guest #1	$160.37	$15	$12.83	$132.54
Visit #2	$160.37	--	$12.83	$147.54
Visit #3*	$165.37	--	$13.23	$152.14
Visit #4*	$165.37		$13.23	$152.14
Total Net Benefit				$584.36 (avg $146.09)

**assuming some guests choose premium products offered up based on preferences learned by the hotel; the model uses a conservative rate increase of 3% by visits 3 and 4*
***assumes a discount and operational amenity costs adding up to almost 10%*
Note: Brand.com costs include loyalty fees plus channel and transation fees based on the Kalibri Labs database cost information.

OTA BOOKING

OTA Booking	Guest Paid ADR	Upfront Acquisition Cost	Routine Booking Cost (15%)[4]	Net Contribution
Guest #1	$158	--	$23.70	$134.30
Guest #2	$158	$10*	$22.20	$125.80
Guest #3	$158	--	$23.70	$134.30
Guest #4	$158	$10*	$22.20	$125.80
Total Net Benefit				$520.20 (avg $130.05)

**assumes new customers each time that often require discounts to attract consumers on a competitive site; many hotels agree to being featured with deeper discounts to gain share for limited time periods.*
Note: OTA costs include commissions, channel and transaction fees based on Kalibri Labs database cost information.

[3] *Estis Green, Lomanno and Carrier, Demystifying the Digital Marketplace 2017*
[4] *Estis Green, Lomanno and Carrier, Demystifying the Digital Marketplace 2017*

Loyalty Booking vs. OTA Booking

For the OTA channel, a hotel is often cycling through new guests each time; a hotel may have the same basic rate but the OTA will frequently offer discounts to attract new guests. The basic, or routine booking costs will remain the same no matter how many guests a hotel attracts. The amount shown here is the typical commission rate of 15% paid by hotel brands that also have loyalty programs. For the same four stays, the hotel only nets $520.20. Additionally and of great importance for sustainable profit contribution, the hotel has gained no residual benefit related to the customer relationship to drive advantages in upselling, engagement or preference knowledge to enhance customer service.

The differential between the Brand.com Loyalty and an OTA booking value of almost 12.5% or $65 can accumulate a sizeable gap over time. If a hotel has a 55% Loyalty contribution, then a higher percentage of its stays will benefit from the higher contribution amounts.

> *Applying an 8% cap rate on this $200,000 differential equates to an improved asset value for Hotel A of $2.5MM.*

Consider the two hotels below. They each have significantly different proportions of business. The loyalty contribution is worth over $1M more to Hotel A and, even when all low profit margin business is combined, the same number of stays ends up at $200k less in terms of profit contribution based only on rooms revenue. For those hotels with ancillary revenue opportunities, the contribution from F&B, parking, spa or other services often vary with recurring and loyalty members typically outspending the one-time guest booked through a third party.[5] For the same effort and wear and tear on the hotel, there may be a substantial differential in profit. **Applying an 8% capitalization rate ("8-cap")* on this $200,000 differential equates to an improved asset value for Hotel A of $2.5MM.**

**an "8-cap" is a conservative capitalization rate that may be applied when deriving a hotel's asset value i.e., the value of the hotel in a real estate transaction.*

Hotel A benefited from its higher value loyalty business with a higher profit contribution as well as building a base of recurring customers enabling improved guest experience.

200 room hotel with 30,000 stays (average net ADR per stay)	Hotel A	Hotel B
Brand.com Loyalty $146.09/stay	**$2.41M** (55%)	**$1.1M** (25%)
Other $135/stay	**$810k** (20%)	**$810k** (20%)
OTA $135.05/stay	$975k (25%)	$2.1M (55%)
Total	$4.2M	$4.0M

[5] *Estis Green and Lomanno, Distribution Channel Analysis: A Guide for Hotels, 2012, page 156*

However, the benefits of loyalty and affinity programs yield far more than the straightforward profit contribution. There are at least three other highly valuable factors that play into the equation.

1. The ability to **know the consumer preferences** through loyalty program participation enables a hotel to deliver a better experience by offering more appropriate products and services to meet the guest's needs. This is good for both the hotel and the consumer.

   One of the most important factors in selling to consumers in the digital marketplace is the ability to anticipate needs and customize to their preferences for a superior guest experience that is smoother, easier and friction-free for the traveler. When hotels receive third party bookings, it is the third party who retains the preference data. For loyalty members or guests who come through direct channels, including independents or small chains that gather and retain a guest's personal preferences, this information is owned by and readily available for use to the hotel and the brand. Ultimately, high service levels to the guests may be hard to maintain as a result of lower rates and less funding for reinvestment in staffing and property improvements.

2. Third party sellers that have aggregated a large amount of demand tend to commoditize the products in the market by emphasizing differentiation based on the rate alone as opposed to the stay experience. When selling a large percentage of business through these sites such as metasearch and OTAs, **hotels risk becoming commoditized where the message is all about finding the lowest rate,** not matching value to a guest's needs. Emphasizing business sources that feature a hotel's differentiated product and services makes for a more stable and healthy business mix overall.

   This is a threat to individual hotels and brands alike. Both OTAs and metasearch sites are largely viewed by consumers as "price comparison" sites. For channel vendors that are discounters, with rooms offered that are merchandised similarly, travel shoppers are more likely to discriminate on cost. Too much reliance on these channels increases the population of commodity shoppers thereby weakening a hotel's ability to alter its mix which is the primary path to improved profit contribution. Ultimately, high service levels to the guests may be hard to maintain as a result of lower rates and less funding for reinvestment in staffing and property improvements.

3. Loyalty members can function as **an insurance policy during down cycles.** A larger member base that is more likely to recur creates a more resilient business foundation to weather difficult economic times. Some third-party vendors will command higher commissions from hotels when faced with shrinking demand. With a larger base of business booked directly, an operator would rely less on these high cost channels to fill and be less vulnerable to rising commissions such as the levels imposed by third parties in the 2009 recession.

In the Book Direct campaigns of 2016, most hotels accepted a discounted Member Rate and reduced third party business in the name of acquiring more loyalty members booking directly. The ultimate calculation to assess those campaigns is determining how many loyalty members a hotel needs to acquire to pay back any trade down or other type of upfront investment. However, in 2018 and going forward, the benefit to travelers is evolving from a simple discount to benefits related to "creature comfort" and convenience. For example, a loyalty member can download the app that enables many services such as mobile check in, keyless entry, choose-your-own-room and unlocks other benefits that will not accrue to non-members. These benefits remove friction on a traveler's journey and along with some modest discount may minimize costs to the hotel while creating a better experience for the guest.

For each hotel's internal assessment, the question is neither (1) "How much did I make on the initiative?" nor (2) "How much did it cost my hotel?". The question to ask is: "Did I add enough recurring loyalty members to the base of my business to make the initial investment worthwhile?" At the outset, the hotel brands drove member enrollment growth of roughly 30% to 40% year over year, which in some cases doubled the prior year's growth rate. For the U.S. industry as a whole this growth meant that in the range of 6 to 8 million new members signed up when the campaigns were initially launched.

Since the loyalty room night contribution for the branded hotels has been strong, ranging from 40-60% of total brand hotel room nights, this contribution creates an important base for the hotels that reduces the amount of business needed from costlier third-party sources. As loyalty program members tend to come more often and/or refer friends and family, as well as spend more money in room and ancillary revenue centers, the residual benefit can be even greater than the direct revenue from each stay.

SUMMARY OF LIFETIME VALUE ANALYSIS

In examining the Book Direct campaigns through the longer time horizon lens of a Lifetime Value Analysis, the main question is whether the incentives to join the loyalty programs will add meaningful numbers of new recurring guests to the base of a hotel's revenue foundation. Evaluation of the Book Direct initiatives requires a calculation to determine if the revenue generated over multiple visits to a hotel is greater than the combined costs of the initial visit and retention fees, with the improved ability of the hotel to deliver superior customer service as a residual benefit to the consumer.

For most hotels in both the 2016 and 2018 sample for this study, the relatively low net cost of shifting consumers to the direct channels along with the security of building a sounder business base was a clear win. However, while a growing base of recurring guests is an attractive outcome, every hotel must run this calculation to determine their own direct costs of acquisition relative to their potential to grow a larger loyalty base. Adding loyalty members does not guarantee that all will recur, and the ultimate commitment of owners, operators and brands to ensure the best guest experience is often the key to maximize the number that will return. Those that can build a substantial base of recurring guests will reinforce their position in good times and will be well prepared for times when economic headwinds reduce demand and increase acquisition costs, challenging profitability in the future.

Value Proposition of Loyalty: What do you want to acquire?

Upfront costs

PAY TO ACQUIRE A ONE-TIME TRANSACTION

- ✓ *Repeating, iterative costs*
- ✓ *Discounts and trade downs*

Number of new members

PAY TO ACQUIRE RECURRING GUEST

- ✓ *Is Lifetime Value > cost of 1st visit*
- ✓ *Better customer engagement*
- ✓ *Diversify sources of business*
- ✓ *More control in down cycles*

When a hotel builds their business around one-time transactions they incur the same costs each time with limited long-term benefit. They offer discounts or pay override commissions to gain advantage in that channel and do so every time no matter how much volume is generated. In contrast, recurring guests may cost more the first time but the overall cost savings in subsequent stays and building a more stable and profitable base is a net positive for the hotel.

Conclusion

Almost three years after the launch of the first industry Book Direct loyalty member programs, a study sample of 19,000 hotels and 80 million transactions provides conclusive evidence with some variation between hotels but a common pattern. The loyalty member campaigns have either strengthened or stabilized the growth rate of bookings through Brand.com while the OTA channel has either held steady or has somewhat decelerated. Both online channels are growing, but Brand.com is growing at a stable rate or faster maintaining the current position across the U.S. industry where Brand.com generates 50% more bookings on average to U.S. hotels than the OTA channel.

The Loyalty member rates through Brand.com deliver a 9% premium to OTA bookings across U.S. hotels in terms of ADR net of booking costs (compared to 8.6% in 2016). Therefore, in most cases, Loyalty member bookings through Brand.com represent a more desirable opportunity than an OTA booking when a hotel is determining its Optimal Business Mix. The member discounts offered as incentives over the last three years have declined from 5-10% when initiated in 2016 to closer to 2-5% in 2018. Even more fundamental to the sustainable profitability of the hotel industry, the purpose of the campaigns to grow a hotel's loyalty base appears to have been achieved as the current average base of loyalty contribution is between 40-60% and is growing 2-5x faster than before these campaigns were introduced.

Beyond the transactional benefits of the programs in an initial stay, building this powerful base of recurring guests leads to lower acquisition costs in subsequent stays. Since 2016, the benefits to loyalty club members have also expanded notably from rate discounts to conveniences through the brand mobile apps enabling services such as mobile check in, choose-your-own-room, keyless entry and other guest services. This results in higher profit margins to hotels with less reliance on discounting and a higher proportion of direct bookings through the hotel apps with fewer bookings through metasearch. These digital services which continue to expand with a focus on improved guest experience offer the potential for recurrence to the same or sister hotels within a brand further reducing the appeal of third-party booking vendors who cannot enhance the guest experience while on site. It appears likely that these digitally delivered convenience-based services will play a significant role in the ongoing competition for the traveler's attention during the shopping, buying and stay experience.