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Case Study: Hostelworld.com

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Abstract

The case describes the market growth of Web Reservation International an Irish SME company, which is a market leader in the Budget, Independent and Youth Travel (BIYT) market through its online reservation system. The case describes the development of the company through organic growth and acquisitions. The case raises four main questions. Is the WRI domination position sustainable in the long term? Is WRI business and revenue model transferable into other sectors of the travel industry? Does WRI have the management capability to transition to a post-entrepreneurial phase? What is the most appropriate option to develop the business?

1. Introduction

"Never in our wildest dreams could we have expected this kind of growth, for two guys in Ireland to own a whole sector" Nolan. (2002)

The world of independent travelling using hostels offers great expectations, new life experiences and opportunities to make new friends. Independent travellers have to deal with balancing spontaneity with the desire to have certainty about travel and accommodation information. For the independent traveller hostels provide low cost accommodation which are used as key staging bases for exploring new countries. Hostels in addition to accommodation can provide a range of services including bar, bike hire, common room, free airport pick up, guest kitchens, internal access, luggage storage and travel information desk. Independent travellers exchange information about the best

hostels to stay at, the tourist attractions to see and what fellow travelling partners to avoid on their travels. Colm Hanratty is one of these independent travellers but the difference is that he works for hostelworld.com who are a global provider of online reservations to the budget, youth and independent travel (BYIT), which is estimated to be worth \$4.5 billion annually. Colm spent a year backpacking around Australia and has 'acquired a certain knack of hunting out bargains not matter how long it takes to sniff out, I will find them.' He regales readers on hostelworld.com with tales of where to go and what to see and where is the best nightlife and doing so on a low budget, for example a three-day trip to London for stg£119.36.

2. Company Background

Tom Kennedy owned the Avalon House Hostel in Dublin. In the mid 1990's in an effort to make the business more efficient he contracted Ray Nolan an IT specialist, a self-taught computer programmer and owner of Raven Computing to develop software programme which would allow the hostel to manage the check-in and out process. After a successful installation of the software at Avalon House Hostel Nolan resold the reservations management system as *Backpack* to a number of hostels.

In 1999 Ray Nolan and Tom Kennedy founded Web Reservations International (WRI) and created an online reservation site for hostel bookings - www.hostelworld.com. The *backpack* software was modified to enable hostels to seamlessly integrated with the online booking system at www.hostelworld.com. Ten copies of *backpack* were sold in 1999 and this figure had reached one hundred by 2001. They both decided to leave their respective jobs and WRI now employs 31 people. The company's revenue grew by 1,436 per cent from 2000 to 2002 compared to the industry average of 269 per cent for the top 50 technology companies in Ireland. The management team consists of Nolan as CEO, Kennedy as president, Ní Mhir as Director of Marketing and Mooney as Chief Operations Officer (see Exhibit 1). Nolan and Kennedy own 90 per cent of the business and the minority private investors are U2 manager Paul McGuinness and Paddy Holohan entrepreneur and a former executive of Baltimore Technologies. WRI's multicultural staff work in a variety of roles including programming, content, sales and customer service and all have experience of the budget travel industry from both business and pleasure perspectives. The combined travel experiences encompass over 75 countries. For customer relation staff positions, candidates must possess fluency in a number of languages, previous experience in the hospitality industry and have good administration skills, telephone, keyboard and computer skills.

Ray Nolan, CEO & Founder

A seasoned entrepreneur and IT professional Ray is CEO of Web Reservations International. He has been responsible for growth strategy, using his experience in several facets of the software industry to implement business models, which are both highly functional and profitable. Ray teams his market knowledge with core development skills to ensure projects deliver on their promise. Having successfully driven hostelworld.com to a dominant market position, Ray spends much of his time replicating the methodologies employed across the entire budget travel sector.

Tom Kennedy- President & Founder

Tom's years of industry experience are key to the success of the company. Accredited with helping the sector in Ireland to a new level, his position as president allows him apply his knowledge on the world stage. With Ray, Tom realised that existing business processes could not be effectively applied to global distribution of budget product. A new model led to the birth of Web Reservations International. Tom spends his time strengthening relationships whilst continually refining the business model to create a win-win-win scenario for the company, the supplier and the consumer.

Niamh Ní Mhir - Marketing Director

Web Reservations International relies on three sources for customer acquisition; Its own web presence, those of its partners, and those of its suppliers. Niamh has created a marketing strategy that has made WRI sites the most popular in their sector. Meanwhile she ensures that partner sites get the product they need, delivered as they would like. Niamh keeps WRI alert to new opportunities in a market which is fast evolving since the companies appearance in the budget sector.

Feargal Mooney - COO

Companies experiencing the hyper growth that has applied to WRI need to deliver on their promise. As Chief of Operations, Feargal ensures that correct procedures are in place, and the dreams of the entrepreneurs see profitable conclusion. His multinational finance experience additionally provides WRI with the metrics against which it constantly compares itself. The company can thus rely on sound financials, backed up by a comprehensive implementation team.

Exhibit 1: Management Team (Source www.webresin.com/about.html)

3. BIYT Market

According to industry forecasts the Budget, Independent and Youth Travel market BIYT will represent more than 25 per cent of all travel by 2005. The BIYT market comprises of students, youths, backpackers and independent travellers. They typically are web-savvy, value conscious and tend to take extended vacations and set the travel trends for the business travellers of the future. Nolan (2002) describes this market "...as the most web-friendly segment of the market. Web Reservations International is already the leader in technology and booking revenue in this market and we intend to grow even faster in the future."

Online travel companies because of the low prices, low commission and margins and the high cost of traditional booking systems have neglected the BIYT sector. These traditional booking systems, called Global Distribution Systems (GDS), provide pre-Internet travel booking systems. However, the high cost of installing and using GDS systems makes them unsuitable for both BIYT product providers and travel companies. In comparison, WRI's online booking system provides a web only, low cost booking system, effectively becoming the GDS of the BIYT sector.

Traditionally, the value of the market was vastly underestimated as hostel bookings value ranged from €10 to €20 with a number of people sharing a room, but as Nolan highlights "It's one of the hidden facts about the tourist industry. Hostels are a very profitable business." The entire market has changed in many ways making the internet an obvious tool for reaching this market. No longer is the BIYT market consisting of poor students checking out the cheapest possible holidays. Nowadays, hostellers and budget travellers are often older people or families with hostels now offering single and family rooms to

cater to this market, in addition to multi-bed dormitories. Hostellers and backpackers carry credit cards and typically go online daily in internet cafes, making online booking a cinch. Moreover, they demand a more structured travel experience, seeking outdoor adventure or cultural activities and tours. WRIs online reservation system and websites cater for this demand. In addition, they spend plenty of money in restaurants rather than cooking in a communal hostel kitchen. Reflecting on these market changes Kennedy a co-founder of WRI notes "A few years ago, a hostel would have been full of people cooking their pasta or lentils, and they would all arrive by bike. Now everyone arrives by taxi from the ferry or airport and they all head into town for dinner."

3.1 Creating the Electronic Marketplace

The changes in the BIYT market coupled with the successful redevelopment of the Backpack software and the hostelworld.com website afforded WRI a dominant position in this market. Both Nolan, and Kennedy who ran Avalon House Hostel in Dublin realised that, while it was time-consuming and labour-intensive for an individual hostel to deal with e-mails and booking software - Kennedy had two people doing nothing but that - an automated booking service for hundreds or thousands of hostels could be the basis of a solid business. As Nolan states: "Budget tourism was totally bypassed by technology until we came along. .. It did was not serviced online before we existed. We created the industry." In the early 1990s the 15,000 hostels worldwide generally ran their own individual websites, with no credit care booking facilities. Typically hostel users may spend less per night but go away for longer periods of time, but spend more money than average travellers. By 2003 WRI had built relationships with 5,000 hostels and was selling rooms on their behalf through an integrated Internet reservation system.

3.2 The Backpack Software

The core product offered to individual hostels is *Backpack* – a reservation management system for the youth hostels and budget accommodation. The software integrates fully with WRI websites. It allows hostel owners to upload and download bookings, browse for availability, search for guests, review pending arrivals and set room accommodation allocations. Users can set room allocations for the accommodation. When a booking occurs the budget accommodation owner can view and print invoices, letters and vouchers and any field within the guest booking can be changed. The software generates several reports that assist in the management of the accommodation centre. These reports include end of shift payment analysis, bookings by booking source, income analysis, stock analysis and credit card pre-authorisation.

3.3 WRI Website

WRI main site – www.hosteworld.com - allows visitors to choose a destination or hostel, select an arrival date and the duration of their stay and quotes prices in whichever currency they wish to use making the booking procedure extremely straightforward. Once a hostel has been selected, detailed information is available on the hostels location, photographs of the exterior and interior, currency converter room reviews and all other relevant information for the chosen accommodation. As well as the booking facility, WRI provide guides to the various continents, countries and cities where hostels are located. City guides provide lists of pubs, clubs, attractions and provide an interactive map to locate each one and contain information on transport, weather, opening hours, public holidays, tourist offices etc. In essence WRI websites provide all the necessary information traveller need to know before booking accommodation.

WRI's best know and flagship website www.hostelworld.com is aimed at the backpacker and student market and attracts over 12 million visitors annually. However, this is not the company's only site. It also operates and runs a number of hotel sites for city, country and continent sites, such as hosteldublin.com, hosteleurope.com. Another website is trav.com which offers budget accommodation, tours, activities, transport, travel insurance and ancillary products for the BIYT market. [Things2do.com](http://things2do.com) a recent addition to WRI provides online booking and information for adventure activities, sightseeing tours, events and transport as well as accommodation including hostels, budget hotels and guesthouses. Linked to the BIYT market focus WRI runs www.insureandtravel.com that sells online insurance policies for backpackers and student travellers. WRI runs 500 websites targeted at BIYT market (see Exhibit 2). The online service confirms online reservations for budget accommodation and other complementary travel products.

<p>Flagship Websites</p> <p><u>www.hostelworld.com</u></p> <p><u>www.trav.com</u></p> <p><u>www.things2do.com</u></p> <p><u>www.discount-hotels-world.com</u></p> <p><u>www.insureandtravel.com</u></p> <p><u>www.hostels.com</u></p>
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Exhibit 2: Sample of WRI Websites (Source: WRI)

The purpose of having 500 individual sites is to ensure that anybody searching for a hostel will ultimately land on a WRI site. The success of this strategy can be seen in the fact that sites controlled by WRI dominate any Google search for hostel accommodation in any major town or city in the world. This Internet based marketing strategy is consistent with the emphasis of being a low cost operator. WRI uses search engine optimisation and they present the same information in different format depending on the website. So if a online users is were looking for hostel accommodation in South Africa, a search engine might direct you to any one of four sites that they own, namely, Hosteljohanesburg.com, hostelsouthafrica.com and hostelafrica.com

In 2003, WRI generated more than 3 million bed/night bookings and attracted over 30 millions visitors to its various websites. Fifty per cent of the WRIs revenue is generated from its own websites.

4. The Revenue Model

When using WRI's websites travellers are told immediately if a hostel has space, which they can then book and reserve right away by having a 10 per cent deposit and small booking fee charged to a credit card. WRI offers the rooms at the price the hostel charges, making its money by keeping the 10 per cent charge and the fee. The margins may be very small on a typical €10 hostel bed, but with 6,000 hostels in nearly 130 countries and 460 cities, WRI does very well on volume. WRI have not altered the revenue model for industry participants, but have provided a dominant electronic market forum for this international market. Coupled with international coverage as Nolan (2003) describes, "When we sell a ticket, we are automatically out of the game and because we have hostels in both the southern and the northern hemispheres, we don't have a slow season" This has resulted in profits of 400 per cent in 2003 with forecasts for similar performances in the

next four years. Central to this is WRI's ability to keep the cost base low and communications to a minimum. The business is entirely Internet based, and the premise is that if an employee has to lay a finger on a booking, WRI loses money. Given this premise and the increase in sales volume since 2000, the cost of making €1 revenue has fallen from €2.56 to 41 cent.

5. Affiliate Sites

In pursuing its dominance of the BYIT market WRI licences its reservation technology to a wide range of affiliate travel websites (Exhibit 3). The number of affiliates using WRI's online booking technology reached 700 by early 2004. WRI has targeted the travel agent market overlooked by many industry players in the dot.com rush. WRI have established a Travel Agent Extranet System for this market coupled with a loyalty card. This means that travel agents do not have to contract individual rates, invoice the providers and they have direct access to worldwide budget accommodation. As Kennedy (2003) states: "We have developed the software to benefit travel agents and affiliates such as Rough Guide and Time Out, which can offer a worldwide reach to accommodation and share in the commission we can generate."

<p>Affiliate Licences</p> <p><u>www.studentuniverse.com</u></p> <p><u>www.lonelyplanet.com</u></p> <p><u>www.ryanair.com</u></p> <p><u>www.letsgo.com</u></p> <p><u>www.raileurope.com</u></p> <p><u>www.kasbah.com</u></p> <p><u>www.ebookers.com</u></p>
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Exhibit 3: Sample of WRI Affiliate Licences (Source: WRI)

WRI's internet reservation system is being used by customers to book not just their hostel room, but also other elements of their holiday. Such activities may include museum tickets, exhibitions, city tours, bungee jumping, rafting, abseiling, skydiving etc. For example, Nolan (2003) states that 'some 40 per cent of people booking a Dublin stay through a WRI site also book Aircoach tickets.' WRI takes an annual fee (\$500 per year for one listing, \$800 per year for two to four listings and \$1,000 for 5+ tours) and 10 per cent reservation fee from tour operators for complementary products they sell through its websites.

6. Market Expansion and Growth

"We see Travelocity and Expedia as our peers. We are not afraid of them. They are huge billion dollar companies but our technology is every bit as good as theirs. In fact, our booking process is probably simpler," he said. (April, 2003)

Expedia and Travelocity were ranked number 1 and 2 respectively by hitwise.com in terms of travel agency sites visited in the U.S. in December 2003. Expedia had 22.82% market share and Travelocity had 16.35%.

(http://www.clickz.com/stats/markets/travel/article.php/6071_3304691). Expedia's gross bookings for the first quarter of 2004 were \$2,672m, while Travelocity had sales of \$394.5m in 2003. WRI expects to sell more than €100 million worth of accommodation by the end of 2004.

Nolan and Kennedy since the foundation of the business were keen to become a dominant player in the BIYT market through organic growth and acquisitions. Hostels.com has been in operation since 1994 and had a well-established brand name in the market, listing over 6,000 hostels worldwide. Hostels.com received numerous industry awards (Yahoo Internet Life, CNET EZ Connect) and had over 10 million page requests per month for a variety of services including hostel accommodation, rail and airline tickets, car hire and travel guidebooks.

In a bold strategic move WRI acquired hostels.com in January 2003. It was a key player in the BIYT market and was a good fit with WRI in relation to market and product fit. Commenting on the acquisition Nolan (2003) stated "We put our money where our mouth was, because it was more cash than we had available to us. If anyone wanted to compete against us, the purchase of Hostels.com set them back years." Kennedy co-founder of WRI stated "The purchase of Hostels.com is an important strategic move for us - it gives us more hostel booking, more hostel product and an unrivalled brand name that is synonymous with our business of hostel reservations. In a single deal we have doubled our property base from which we can grow revenue streams even faster than previously." Industry analysts estimated that this acquisition had the potential to treble WRI's turnover to €65 million and would see them out booking their combined competitors by a ratio of ten to one. Over a year later WRI acquired Hostels of Europe which provided marketing support and operated a website featuring 450 hostels throughout Europe. Ni Mhir (2004) commented that "The purchase of Hostels of Europe strengthens our position as the main distribution channel for hostel beds worldwide. Europe is our largest market for hostel booking and is a dynamic sector."

7. Industry Awards

WRI kept a low profile until 2002 when it recorded its one millionth hostel bed night sale and as Nolan (2003) puts it "People started to notice the small Dublin company that was attracting more than two million visitors a month to its website. ... Like it or not, the limelight has started to find Nolan and Kennedy." WRI won many industry accolades. The first award that catapulted Hostelworld.com into the limelight was when it received the best e-commerce award and the overall EsatBT Award at the 2002 Golden Spiders Internet Awards ceremony. Being short-listed for the United National Industrial Development Organization (UNIDO) followed, where the judging panel praised the company for its combination of innovation, clarity, spectacular growth and its profitable business model. Hostelworld.com was selected from more than 800 entries from over 136 countries and was named as one of forty of the world's best content websites by the World Summit Award Grand Jury. Another accolade followed for hostelworld.com when it was short-listed for the Ernst and Young Entrepreneur of the Year Award 2003. The company won the Emerging Entrepreneur of the Year Award. In October 2003 the company was awarded second place at the Deloitte and Technology Fast 50 Awards ceremony. Nolan reflecting on the award stated "This award reflects revenue growth, but here at WRI we have always focused, not just on growing revenues but on growing profits. WRI from the outset has been doing what dotcom companies originally set out to do -- to utilise technology to rapidly grow their business."

8. Future Challenges

Since the acquisition of hostels.com in January 2003 speculation surrounded the future direction of WRI and whether Nolan and Kennedy would sell the business. In early 2004 WRI had received informal sounds from Summit Partners (www.summitpartners.com) a leading private equity and venture capital firms that has a capital base in excess of \$5.5 Billion. Summit has a proven track record of providing equity to high growth firms since its foundation in 1984 and has successfully managed over 100 public offerings and 80 strategic mergers or sales. Typically, its equity/debt investments span a range of growing industries and ranges from \$2million to \$250 million. Their tentative interest in WRI comes at a time when the company faced a number of significant challenges that would ultimately set the future direction of the company and its thirty-one employees. Travelling home to Clontarf on his Piaggio 180 scooter Nolan thought about whether the company should explore the Summit Partners tentative interest in WRI. WRI's strategy is further dominance and defence of its market position of the BYIT sector. Further organic growth and acquisitions outside hostel and budget accommodation were considered as the most likely strategic options to growth the business.

An earlier management meeting generated a lot of discussion about the future direction of the company. The main issue is how would WRI continue to main its dominant position in the BYIT market and transfer its technology and business model to the low cost hotels market or other sector of the travel industry. The issue of further investment in development of new products and further online functionality was also discussed at length. The issue of trust and security in relation to its 500 websites and affiliate programmes could become an issue in the future given the lack of an overall brand for WRI. Summit Partners valued WRI at about €100 million. The cost of making one euro of revenue had fallen from €2.56 in 1999 to 41 cent in 2003 and forecasted to drop by another 20 cent in the next few years.

The company had survived 9/11 and Sars and made significant acquisitions in hostel.com and hostels of Europe without outside financial investment. Currently, with its technology and through targeting a disparate group of sellers, some 7,000 hostels in over 45 countries avail of its websites. In order to compete with peer competitors such as expedia.com from an Irish base Nolan realised the company would need to continue to expand rapidly to ensure its dominance strategy and to replicate its business model into other growing sectors of the travel industry. Approaching home the question that kept nagging Nolan given the challenges that WRI faces was how best to pursue a dominant and expansion strategy. Should the company pursue the venture capitalist route or continue to grow the business through internal financing?

9. Teaching Note

The company has been successful to date, but the issue of business growth is a key consideration for it. As part of the future financing of the business there will be a need to look at how the company can grow its sales. One avenue for such growth is a movement into the hotel booking market. A class discussion could centre around how transferable the existing competencies that the company has built up are to the hotel booking market.

This case study presents an example of a company which has used the technology of the e-commerce to create a profitable business out of what was traditionally seen as an unprofitable area. As such, the case study presents a rich avenue for class discussion on how e-commerce technologies provide opportunities to be innovative in the way one approaches a market.

This case study contains detailed examples of the multiple mechanisms used to increase the dominance of web reservation international booking engine for hostel rooms. The use of these multiple methods provides an illustration of how achieving market dominance in a niche Internet market requires different strategies than traditional methods.