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THE IMPACT OF SHIFTING FROM "TRANSACTIONAL" TO "EMOTIONAL" LOYALTY PROGRAMS IN THE HOTEL INDUSTRY

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Abstract

The purpose of this research is to understand how loyalty programs are changing in response to the change in customer's preferences and their impact in the hotel industry, more specifically in the case of *NH Hotel Group*. The impact on *NH's* value drivers, the share price and shareholders' return were analyzed based on two different scenarios: one that reveals the positive impact of loyalty programs on customer retention and other that assumes that loyalty programs have no importance among travelers. These scenarios were applied to the DCF model constructed for the equity research of *NH Hotel Group*. This investment in loyalty programs is expected to lead to a *NH Hotel Group's* target share price in December 2020 of €6.67 and net transactions with shareholders of €0.23, resulting in a total shareholders' return of 47.5%. Having said this, the recommendation is to buy *NH Hotel Group* shares.

Keywords: NH Hotel Group, Loyalty Program, Generational Preferences, Technology

Introduction

The aim of this paper is to reach an estimate of *NH Hotel Group's* share price in December 2020 based on the impact of the investment in loyalty programs in this hotel chain. The dissertation begins by identifying the emerging trends and customer preferences related to loyalty programs and then measures the impacts of those trends in the valuation of *NH Hotel Group*. The major direct impacts of the investment in new and modern loyalty programs are on hotel occupancy and operating costs, such as the commissions paid to OTAs, technology and marketing costs.

Literature Review

Loyalty programs are changing. Customers no longer want "points" to be discounted in their following purchase; they want not only "on-the-spot" rewards, but also to have more interaction with the brands. In fact, daily and weekly interactions with the customers allow for a bigger and stronger connection with them. These interactions are becoming a lot more technology-based, since, according to GSMA real-time intelligence data, more than 5.15 billion people possess a smartphone or a similar device across the globe and there are nowadays more cellphones than the number of people in the world (Murphy, 2019)[i]. Various companies are creating mobile applications solely to offer a digital and convenient way for people to access their rewards. Offering omnichannel loyalty programs enable companies to reach the customer more easily in the rapidly growing competitive environment.

As aforementioned, customers are seeking to have more interaction with the brands and 90% of them state that they would buy again from a brand in the case they were given an excellent service and experience. Moreover, they want to receive prizes for their actions for instance in social media, such as liking or sharing a post, instead of only by purchasing. Offering this type of loyalty programs is a way to attract younger people. For instance, in the hotel sector,

Marriott provides non-travel rewards to youngsters as a way to make them engage with the company even before starting to travel more (Carmody, 2017)[ii].

According to a HubSpot study, the top 10% customers are expected to spend three times more than the rest of the clients[iii]. Offering premium loyalty programs to those of the top tier is also an emerging trend.

An Innovation Group's study from 2018 notes that 79% of millennials and Generation Xers and 74% of baby boomers look for strong loyalty programs[iv]. So, the importance of these programs is, in fact, increasing with the generations. Hotel chains should not disregard this importance and should continue to develop their loyalty programs to keep up with the recent trends.

Discussion

Some hotel chains are, in fact, adopting loyalty programs that are convenient to the users and are getting some positive results. For instance, due to the strong loyalty programs that *Marriott International* offers to its clients, the company registered a revenue increase in the second quarter of 2018 (Jelski, 2018)[v]. This rise was mainly due to the fact that their loyal customers booked their rooms via the direct channel of the firm and, hence, lower commissions had to be paid to the Online Travel Agencies (OTAs). To be more precise, direct bookings accounted for 70% of *Marriott*'s bookings and 50% of those represent reservations through the hotel's digital platforms, such as its website and mobile app (Jelski, 2018). *Marriott*'s example is a good one in the sense that it suggests that loyal customers are a lot less likely to book their trips using an OTA and, consequently, the company has lower costs with those clients. More generally, and, according to a study conducted by the *US Hotel Lodging Intermediaries Rise Again* report, 43% of travelers that are part of a hotel loyalty program will book directly from the company's website, saving money to the hotel. Additionally, 80% of the guests not enrolled

in those programs book their trips via an OTA. Cornell University, referring to the impact of the loyalty programs, goes a little bit further and states that "the number of annual room-nights for each guest increased by nearly 50%" (published on an article from Trivago Business, 2017)[vi]. This study suggests that loyal customers book more than non-loyal customers and that the occupancy rates are expected to increase when the number of loyal clients increases. Apart from all these benefits to the hotel, loyalty programs also provide important information and insights about their guests, such as their country of birth and their preferences. Adding to that, the same research found out that after signing for the loyalty program, the guest's frequency to book rooms from that hotel increases by 49% (McEvilly, 2015). The programs are also responsible for about 57% of the increase in bedroom's revenue[vii].

NH Hotel Group's loyalty programs are based on agreements with external partners. Currently, the hotel chain has agreements with Iberia (the client can show its Iberia Plus card at the front desk and have the opportunity to earn or redeem "points"), with AirEuropa (works in a similar format as Iberia Plus), AeroMexico (possibility of earning KPMs during the stay in the hotel) and Alitalia (earn points when staying at a *NH Hotel Group* property)[viii]. Apart from these agreements, *NH Hotel Group* also offers the *NH* Rewards' program to its clients. In 2019, this membership was even recognized as the winner of the *210 Award*[1] from Freddie Awards, which is the "most prestigious frequent travelers' programs award worldwide"[ix]. This *NH* program offers a value proposition in terms of loyalty that is very much appreciated by its customers. Some of the features of this program are the welcoming gift for new members that consists in 10 points after the first stay, the 5 extra points in the case the customer books its stay via *NH* Web & App and at least 5 points when staying at a *NH Collection* or *nhow* hotel. These features made *NH* Rewards the winner of the above-mentioned prize, however, it is expected

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[1] The 210 Award is given to the best scoring program that is ranked by fewer than 10% of voters. It's meant to recognize an up and coming program delivering value to members that may not yet be on the radar of as many frequent travelers.

that, in the future, with the evolution of the consumer's preferences regarding loyalty programs, their current program is not going to be enough.

Knowing this, I am expecting that *NH Hotel Group* will start modifying its reward program to remain competitive in this industry. In order to evaluate this impact, I conducted an optimistic scenario and a scenario where the customers do not adhere to the new investment in the loyalty program. The optimistic scenario is expected to have a probability of occurrence of 75% and the other a probability of 25%. In fact, a study conducted by Deloitte states that, from a population of 2,164 people, only 20% never use loyalty programs or can't recall using one[x], which means that it is likely that customers will adhere to *NH Hotel Group*'s loyalty program. In the optimistic scenario, it is expected that the absolute amount of commissions paid to OTAs will decrease 20% compared to the base case, representing 5.8% of revenues in the long-term, versus 7.3%. This is possible due to *NH*'s ability to increase direct bookings leading to the decrease of bookings via OTAs. The real change in occupancy is also expected to increase 15% in every business unit, since loyal customers book rooms more frequently, as stated before. However, in order to reach that outcome, *NH Hotel Group* will also invest and, consequently, increase its costs. I believe *NH Hotel Group* technology costs are expected to be 10% higher than in the base case scenario and marketing and merchandising costs 10% higher as well. In this scenario, the share price after the minority discount (5.21%) is €7.25. Adding the net transactions with shareholders (€0.25), the total return is 60.1%. In the scenario where customers do not adhere, the costs in technology and marketing still exist, however, there is no impact in the occupancy and commissions to OTAs. This scenario translates in a share price after discount of €4.94, which represents a total return of 10.0% having in mind a value of transactions with shareholders of €0.21.

Conclusion

If *NH Hotel Group* decides to invest in more modern loyalty programs, which is likely, the expected capital gain and dividend yield in December 2020 is €6.90[2] and total shareholders' return is 47.5%. Having said this, the share price of €4.68 in 30-Dec-2019 is considered to be undervalued and, hence, there is a strong BUY recommendation regarding *NH Hotel Group's* shares.

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[2] (7.25+0.25)*75%+(4.94+0.21)*25%