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WILL OTAS' EXPANSION BE A THREAT TO THE HOTEL INDUSTRY?

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## **Abstract**

This dissertation studies essentially how Airbnb and Google could change the current paradigm of online travel agents' industry (OTAs), in the sense that, these entrances would erode the duopoly from *Booking.com* and *Expedia*, a duopoly that has been increasing the commissions percentage and controlling the hotel booking process. With the OTAs market gaining relevance and representing more than 50% of total hotel revenue in 2019, this is a sensible market for the hotel industry.

To measure the direct effects of these OTAs' market expansion on hotel industry, specifically on *NH Hotel Group*'s value drivers three cases were analyzed: Scenario 1a, where Airbnb would enter in the market with reduced commissions (4%) and gaining 10% of OTAs' market share; Scenario 1b, where Airbnb would enter in the same conditions but now gaining 25% of OTAs' market share; Scenario 2, where Google would enter in the market and reduce commissions absolute amount in 25%.

I concluded that the direct effects of any of these scenarios would not be a threat to *NH* since it leads to a better position of *NH* versus OTAs' market, revealing an increase in the return to *NH Hotel Group*'s shareholders from the previously expected 19.9% (base case) to 66.3%.

**Keywords:** NH Hotel Group, Online Travel Agents, Airbnb, Google

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## INTRODUCTION

The goal of the dissertation is to analyze the *NH Hotel Group SA* share price in December 2020 having in mind the impact of the possible changes in the online travel agents (OTAs) environment. It starts by identifying the nature of OTAs as well as the models used by them. Secondly, the entrance of major disruptive companies like *Airbnb* and *Google* in the hotel booking market. To finalize, three cases were taken into consideration to evaluate the direct impact of the OTAs' market changes in *NH Hotel Group's* share price and shareholder's return.

## LITERATURE REVIEW

Online travel agents, in other words, OTAs, was a concept firstly developed by *Microsoft* with the creation of *Expedia Travel Services* in the US in 1996. Just after that, Europe reply to that creation and in 1997 *Priceline* was created.

Initially created as a benefit for hotel companies, OTAs would buy a bulk of rooms and guide reservations. It is a very useful tool for hoteliers since during off-peak seasons the rooms were not empty. To be able to manage it, OTAs engaged in one of the following models<sup>1</sup>. Merchant Model: OTAs previously acquire the set of rooms with an average discount between 25 to 30 percent of the usual selling price. Afterwards, they would sell it, making a profit out of it and ensuring higher occupation for hotel companies. Agent Model: This model, contrary to the previous one, is based on a success fee to be paid to OTAs over each reservation that would be made through their platforms.

Initially, the "Merchant model" was the most common but it is less flexible for both OTAs and hotel chains in terms of the number of rooms in the agreement, another aspect is that statistically, it decreases average daily rate (ADR) of the hotel company since the rooms

are being sold at lower rates<sup>2</sup>. Thus, the majority of OTAs companies, such as *Priceline* changed to the “Agent Model” and started charging commissions based on market share and market exposure they could provide to the hospitality company. Conversely, hotels with a higher presence in the market would have higher bargaining power, thus lower commissions to pay. On average the commissions charged by OTAs were between 5 to 10 percent.

According to Francesca Lepori, Revenue Manager of *Eastern Canada*, for *Realstar Hospitality*, whose portfolio includes *Days Inn* and *Motel 6*, “OTAs are an excellent virtual ‘shelf,’ which enables any property to be featured when users search the destination”. Additionally, OTAs also allowed the hotel companies to sell packages when no one was even thinking about it. Even though, parity agreements (strictly legislated) and commissions (reducing hotel operating profit) were some challenges that hotel companies were facing.

The online travel agent market starts to grow and in 2013, according to *Euromonitor*, travel sales generated by OTAs accounted for 45% of European total travel sales revenue. From this 45%, *Booking.com* (Previously named as *Priceline*) and *Expedia* represented 76%<sup>3</sup>. With this favorable scenario, OTAs gained importance in the market and increased their commissions.

According to *Forbes* (2017), the commissions charged went up to 30% and created dissatisfaction among hoteliers. Two of the major hotel chains in the world, *Marriott International* and *Hilton Worldwide*, launched campaigns to drive direct booking through companies’ website. As a result, *Hilton Worldwide* saw its loyalty customers’ base increasing from 51 million to 85 million<sup>4</sup>. This had repercussions and as *D-edge hospitality solutions* show in one of its studies, website direct was able to recover some market share in Europe as percentage of reservation revenue after cancellation, moving from 19.3% in 2017 to 20.9%

in 2018, important switching point after consecutive decreases for more than 4 years in a row<sup>5</sup>.

## DISCUSSION

The current duopoly formed by *Expedia* and *Booking* can be close to the end. On April 15<sup>th</sup>, 2019, *Airbnb* had officially completed its acquisition of *HotelTonight* app with a price tag of more than \$400 billion. The reason for *Airbnb* to enter in this specific market was explained by its CEO, Brian Chesky: “We’ve done a lot of surveys with hotels, and many of them are not incredibly happy about the commissions they’re paying. If we can be an alternative, we’ll be there for them”. Thus, they start practicing commissions of 3 to 5 percent, compared to OTAs with commissions over 15 percent.

At the same time, also the giant technological *Google* entered in the industry, with the launch of *Google Hotels*. By *Google*, this is a sensitive situation that has to be managed carefully, since currently, it is enjoying a very profitable relationship with OTAs (estimated \$12 Billion from travel revenue in 2016)<sup>6</sup>. Traditional OTAs are aware of these emerging companies. For instance, by enjoying from the emerging mass markets coming from Asia and after buying *FareHarbor*, a local activities and experiences booking software provider for \$250 Million (Skift, 2019), *Booking.com* is already starting to diversify its risk.

In practical terms, and looking closely to *NH Hotel Group*, maintaining the market as it is, commissions will keep increasing mainly in the next 4-5 years due to the still existent market exposure of *Booking.com* in Europe (and also *Expedia*). That effect should, afterwards, be lowered by these major disruptions caused by both *Airbnb* and *Google*.

Two scenarios will be tested to verify the incremental direct effects on a change of the current context of the duopoly in the online travel agents' market<sup>1</sup>.

### **SCENARIO 1: *Airbnb emerges as a major force in the market***

It is expected for *NH Hotels* that the accumulated commissions for the next 10 years horizon account for €1.29 Billion.<sup>2</sup> With commissions charged by *Airbnb* around 3 to 5 percent, *NH's* current commissions from OTAs (between 11% and 14% over the next 10 years) will certainly decrease. Two cases will be considered: if *Airbnb* will represent 10% of total OTAs' share on average across these 10 years (shifting demand from other OTAs) the *NH Hotel's* commission costs will be reduced in €89 Million.<sup>3</sup> In a second case, if *Airbnb* will represent 33% of OTAs' share on average over the next 10 years, the cost savings will be €298 Million<sup>4</sup>.

In the first case, *NH Hotel* share price in Dec 2020 would increase from 5.69€ (expected base case in equity report)<sup>5</sup> to €7.12. In the second case, the share price of the company would increase €8.35. After being applied the minority discount and the net transactions in 2020 with shareholders, these cases would represent returns of 48.2% and 73.9% respectively, see figure nr.1.

### **SCENARIO 2: *Google emerges as a major force in the market***

Figure nr. 1: *Expected Outcomes*

	SCENARIO 1a	SCENARIO 1b	SCENARIO 2
	Airbnb 10%	Airbnb 33%	Google (-25% abs)
Expected Accumulated Commissions (k€)	1,290,257	1,290,257	1,290,257
Savings (k€)	89,325	297,752	322,564
New Accumulated commissions (k€)	1,200,932	992,505	967,693
Share price before discount (€)	7.12	8.35	8.50
Share price after discount (€)	6.75	7.92	8.05
Share price after discount + NTS (€)	6.94	8.14	8.28
Return (%)	48.2%	73.9%	76.9%

If, instead, *Google*, is the major disruption of the current market, OTAs will suffer the most since *Google's* platform give the user the freedom to select where he/she wants to make a reservation, and most users will probably go directly to the hotels' website<sup>7</sup>.

<sup>1</sup> These scenarios will be compared with the expected scenario (outcome of equity report)

<sup>2</sup> Team analysis in the NH Hotels Equity Research

<sup>3</sup> Knowing that on average OTAs commission is expected to be 13%, if 10% of commissions instead of 13% will be charged at 4%, it means that instead of €1.29 billion, commissions will be €1.2 billion.  $[\frac{1.29 \times \frac{1}{10}}{13\%} * 4\% + 1.29 * \frac{9}{10} = 1.20]$ .

<sup>4</sup> If 33% of commissions instead of 13% will be charged as 4%, it means that instead of €1.29 billion, commissions will be €0.99 billion.  $[\frac{1.29 \times \frac{1}{3}}{13\%} * 4\% + 1.29 * \frac{2}{3} = 0.99]$ .

<sup>5</sup> Team analysis in the NH Hotels Equity Research

Even though this effect is more difficult to preview directly on hotels, it is expected that online travel agents' bookings will decrease as a consequence of direct bookings increase. Applying the same logic as before, commissions here will decrease (in absolute terms rather than in percentage terms). If, for instance, *Google* decreases OTAs volume to 25% of its current volume (keeping the total revenue amount), the share price of *NH Hotels* will increase to values of about €8.5 per share. After applying the 5.21% of minority discount and sum the net transactions with shareholders the return would be 76.9% vs. the expected 19.9%.

## CONCLUSION

With the expectancy around the entrance of *Airbnb* and *Google* in OTAs market, the hotel industry booking process would become more competitive than ever, in the first case due to lower commissions in the second one due to lower volume.

For *NH Hotel Group* the direct impact of these happenings would be positive, with a higher expected return to shareholders [48.2% ; 76.9%] rather than the expected base case presented as the output of the equity research (19.9%). Assuming an equal probability for each one of the three cases the final return is 66.3%, therefore OTAs' expansion would not be a threat and the investment recommendation would always be the same: BUY.

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