A KALIBRI LABS SPECIAL REPORT

Demystifying the Digital Marketplace: Spotlight on the Hospitality Industry

CINDY ESTIS GREEN & MARK V. LOMANNO
WITH MATT CARRIER

AHLA AMERICAN HOTEL & LODGING ASSOCIATION

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Part 3

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The sponsors and data providers were supportive in both study execution and provision of data but did not participate in the analysis and the findings do not necessarily reflect their opinions on the subjects conveyed in the study. The various data sources were synthesized and analyzed by the authors to develop the themes that are reflected in the book.

Welcome

Dear Fellow Hotel Industry Stakeholders,

If we could choose one word to describe the current state of the hotel industry, that word would be dynamic. Not only is the industry benefiting from some really favorable tailwinds and consumer trends, but it is also energized by the multitude of opportunities for sustaining growth, generating new levels of customer loyalty and using digital innovation to improve the guest experience from the start of the booking process through guests' stay and beyond.

It's also a diverse industry, particularly when you look at the broader accommodation space we operate in. Hotels are by far the largest segment, with branded hotels continuing to generate the fastest revenue growth of all. But of course, it has always been a competitive industry, with a host of booking options, hotel types and lodging options and new business models entering the market.

At the Consumer Innovation Forum (CIF), an American Hotel & Lodging Association committee of which I am a member, we have been dedicated to providing research and education to the hospitality industry on matters relating to digital and distribution issues. Our main goal is to raise awareness of how the digital marketplace impacts the broader hotel industry.

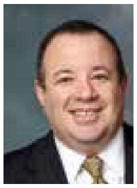
To support the industry in addressing digital distribution evolution, Kalibri Labs has continued to track industry undercurrents to help reveal what hotel brands, owners and operators can do to embrace the changes and position the business for competitive success. The key to greater opportunities is market intelligence, which is why we are proud to present *Demystifying the Digital Marketplace*, a report that builds on the landmark 2012 study. Unprecedented in scope and scale, the rich insights and data provide a framework for understanding market realities as well as embracing opportunities to manage costs and optimize profit contribution.

We could not have reached this point without the support of a strong coalition of partners, including, first and foremost, the American Hotel & Lodging Association (AH&LA) and the American Hotel and Lodging Educational Foundation (AH&LEF), along with the HSMAI Foundation, the Asian American Hotel Owners Association (AAHOA), the Hospitality Asset Managers Association (HAMA), the Hospitality Financial and Technology Professionals (HFTP), and the IHG Owners Association.

The coalition of sponsors is broad and truly reflects a collaborative search for the insights, metrics and strategies to assist decision makers. We encourage our readers to use this research to help make more informed decisions in this dynamic marketplace.

Best Regards,

Andrew Rubinacci
Chair, Research and Education work stream
AH&LA's Consumer Innovation Forum
AMR Hospitality Consulting



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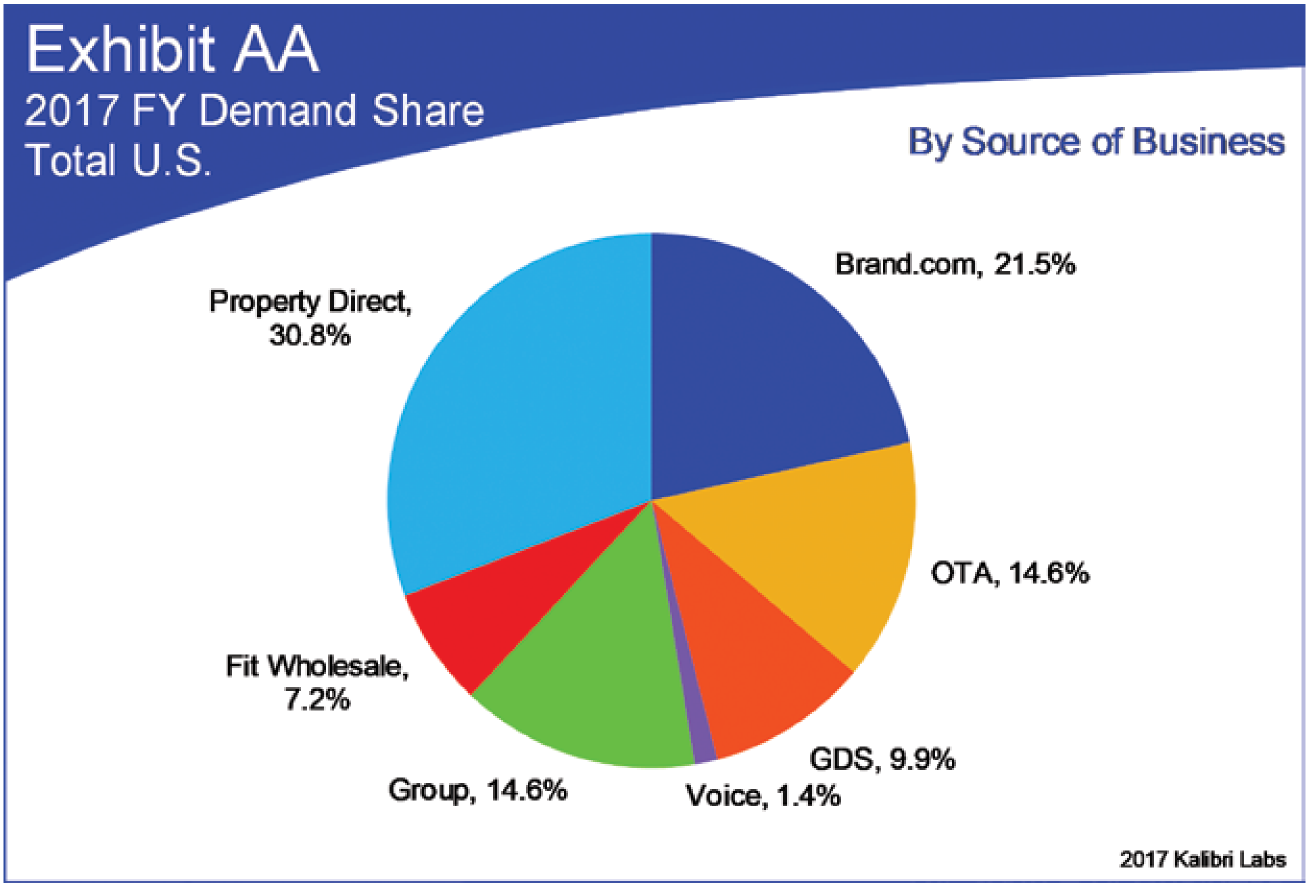
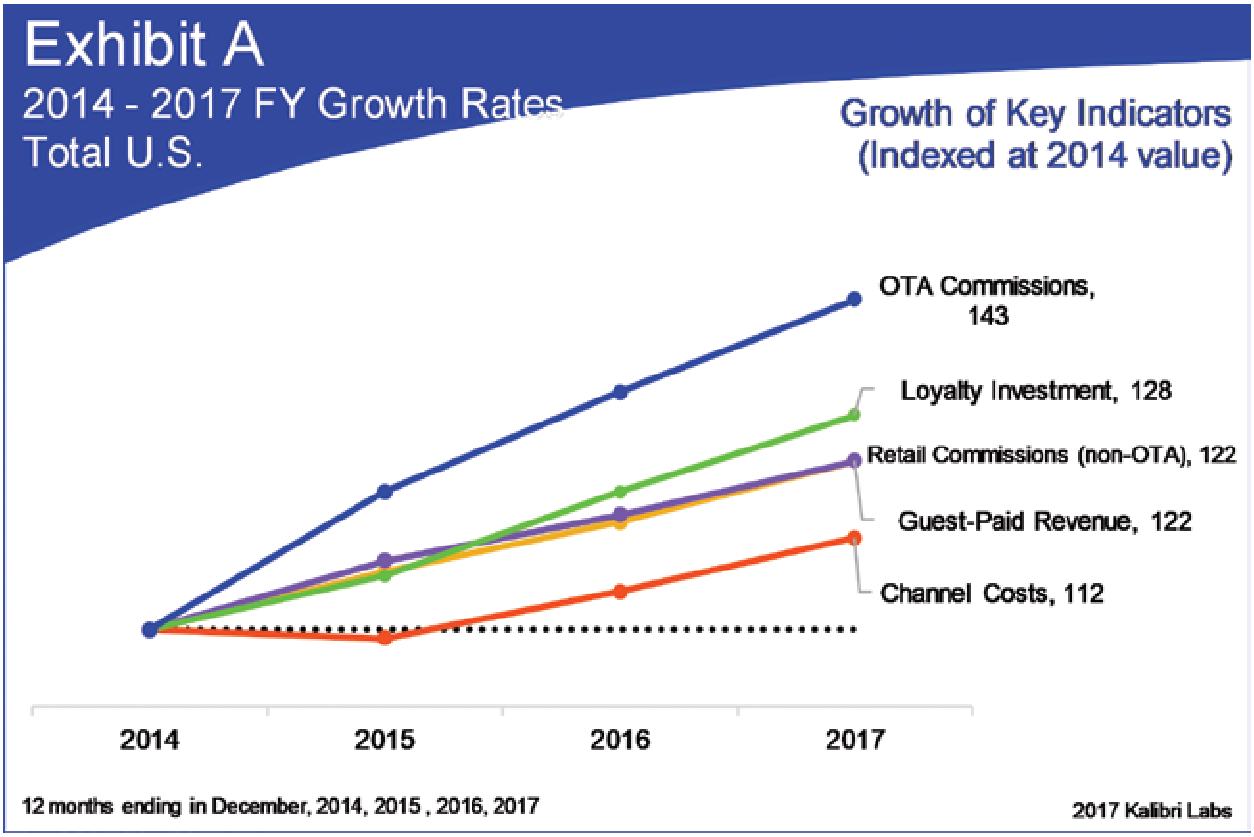
Executive Summary

The evaluation of hotel revenue performance has evolved with the expansion of the hotel digital marketplace. *Part III of Demystifying the Digital Marketplace* offers various types of analyses to enable hotels to be proactive about improving their profit contribution. In a world where many third parties operate and costs are high, this guide will provide some analytical models for managing cost of acquisition and assessing opportunities in multiple channels.



Almost half of all bookings in the U.S. market were consummated online in 2017. Over 22%of room nights were booked through hotel's own websites, with OTA bookings at about 15% and GDS bookings representing 10%.

Originally thought to be a great leveler between large vs. small and independent vs. chain hotels, the digital marketplace has proven to be an expensive and complex ecosystem. It has developed with many new global scale marketing platforms aggregating much of the consumer traffic without materially adding to the overall demand resulting in diversion from the traditional direct-to-hotel channels. Hotels in the U.S. are spending 15-25% of Guest-Paid Revenue to acquire their customers. That is, between commissions, transaction/channel fees and loyalty costs along with sales and marketing spend, the U.S. hotels Revenue Capture, or percentage of revenue they keep after paying all costs of acquisition, is 75-85%.



OTA costs have risen 2x as fast as Guest Paid Revenue and 1.5x the rise in Loyalty costs.

The wealth of available data and myriad of challenges to profitably operating a hotel have necessitated different analyses to understand hotel performance with a focus on how and where to apply limited resources. This calls for a determination of a hotel's **Optimal Business Mix** for hotels to target business more realistically and managing a previously unmonitored new cost category: customer acquisition costs. Several analyses are reviewed in this section exploring the ways a hotel can move to management based on **revenue *net* of customer acquisition costs** (also known as Net Revenue) and provide tools for hoteliers to take action to improve their profit contribution.

THE IMPACT OF WHOLESALE AND NET (PRE-PAID) COMMISSION MODELS

Given the growth in third party commissions and other acquisition costs, it behooves hotel operators to keep a careful eye on costs that have not been systematically managed, and in fact, may not even appear on a hotel's P&L. For bookings where the revenue is collected by third parties, such as wholesale, opaque and merchant model OTA, the commission is taken "off the top" which means that only the portion paid to the hotel by the third party is recorded on the P&L, but not the fees paid that were included in the total rate the guest paid to the third party. Since the commissions are taken out of the rates paid by the guest, these mark-up commissions represent a customer acquisition cost from the hotel's perspective and must be tracked and considered. The analysis illustrates how to understand and measure these costs.

PROFIT CONTRIBUTION BY SOURCE OF BUSINESS

Another key factor for hoteliers to consider in the increasingly digital distribution environment, is the different net revenue value provided by different types of guests. This section contains three different analyses focused on this topic.

1. Flow-through Analysis

The first breaks down the different "flow-through", or amount of contribution to profit down to a gross operating profit (GOP) level on a stay basis, for different sources of business that guests book through. Different sources have different typical average rates (ADRs), lengths of stay and cost structures associated with them. It is vital to understand the profitability of guests coming through different channels or sources of business. For example, the per booking GOP from direct channels, Voice and Brand.com, is significantly higher than that from third-parties.

2. Lifetime Value Analysis

The next analysis builds on the idea of looking at the value of recurring guests, sometimes called "lifetime value" of different types of guests based on how they book and whether or not they are part of a loyalty program. This refers to the overall value a guest brings based on recurring stays over a certain period, which may be for a year or several years depending on the typical or average recurrence rate of a hotel's roster of guests. Typically, guests who are loyalty members booking through direct sources have a significantly higher lifetime value, based on revenue contribution as well as lower costs, than guests booking through third-parties.

3. Ancillary Spend

The final analysis in this section looks at another important component of guest value, the "ancillary spend," or the spending in other revenue centers beyond room revenue. Different types of guests spend different amounts in food and beverage or in other revenue centers in the hotel. Again, like the other analyses, the study found that loyalty guests who book directly tend to spend more in total revenue, including ancillary spending, than guests coming from third party sources.

As the costs associated with acquiring guests continue to rise faster than guest-paid revenue, it's vital that hotels understand the different profit contribution driven by different guests coming through different channels or sources.

SALES AND MARKETING EFFICIENCY

In addition to the costs associated with transaction-related costs such as commissions, loyalty and transaction fees, Part III of Demystifying the Digital Marketplace also explores how to evaluate the efficacy of a hotel's sales and marketing budget deployment. The sole purpose of sales and marketing spend is to generate revenue, both directly and indirectly, so a **Sales and Marketing Efficiency** analysis centers around how well the sales and marketing spend pays off for the hotel over time. It calculates how much Net Revenue* is generated for every dollar spent in sales and marketing with a longer-term trend analysis to allow results to be reflected from both direct spending on sales or CPA advertising as well as indirect initiatives like social media and trade shows. As some sales and marketing investments can take months to deliver revenue, this metric may fluctuate over time but careful tracking will allow a hotelier to better understand the real, net returns generated by their total sales and marketing efforts

* Net Revenue is revenue net of commissions, channel/transaction fees and loyalty costs

NEW APPROACHES TO BENCHMARKING IN THE DIGITAL AGE

While the digital marketplace calls for a new way of evaluating revenue in light of profit contribution, it also calls for a new way of evaluating a hotel's performance against its competitors. Comparing a hotel to an arithmetic average of a group of nearby hotels' aggregated occupancy and rate rarely reflects the "best" a hotel can achieve and thus what it should target. By trying to emulate a market average, this can create a competitive dynamic that may cause a hotel to mistakenly set its target either much higher or much lower than it's optimal, resulting in over- or under-spending against channel targets or customer segments that are not aligned with realistic objectives. Given the data available in today's market and the rise in online and third-party bookings, examining the competitive market at a more granular level is now possible and enables a hotel to look at comparable hotels by customer segment and week part along with other salient factors such as cost by channel, loyalty contribution, meeting space-to-guest room ratios and consumer review scores. In a world of high costs and limited resources, understanding the demand that exists in a market by channel and rate category along with the costs associated with acquiring that demand can help a hotel align its spending more accurately against the demand it is most likely to acquire.

A hotel's **Optimal Business Mix** is the best a hotel can achieve in terms of net revenue and profit contribution based on a realistic view of the business available in the market that is suitable for the hotel to acquire. A hotel may compete with certain hotels for certain types of business during particular week parts and seasons and not in others. An average of a comp set's performance won't capture this, but an Optimal Business Mix will take those different competitors for different business into account. When focusing on evaluating performance against a hotel's Optimal Business Mix as opposed to traditional comp sets, a hotel can minimize its acquisition costs by surgically targeting against realistic demand drivers. The digital market calls for a move past the old days of unmanaged spending on commissions and transaction fees with a need to right-size sales and marketing spend by keeping it tethered to the actual market demand of a given hotel.

CASE STUDIES

Layered throughout Part III of *Demystifying the Digital Marketplace* are real-life, data driven examples of how hotels are tackling these issues, re-evaluating their business and making different decisions with the new information and analyses available to them. These are centered on accounting for customer acquisition costs and making better decisions based on Net Revenue and Optimal Business Mix.

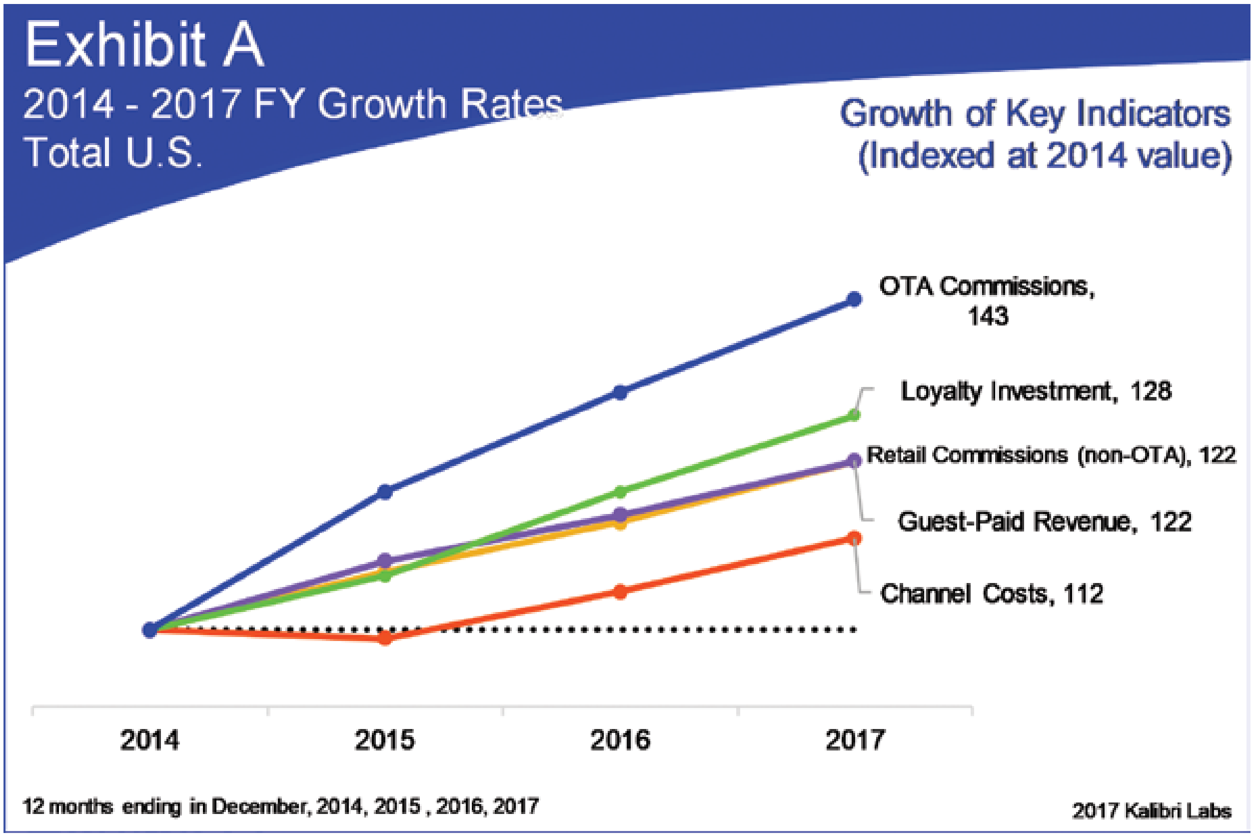
Hotels have a wealth of new information and tools at their disposal but are challenged in turning those into action. Using data and cost analysis, there are a variety of ways that hoteliers can better understand their business, their customers and ultimately their hotels to ensure a focus on profit contribution.

Distribution Channel Costs and Benefits

As explored in Parts I and II of *Demystifying the Digital Marketplace*, the costs to deliver a guest to a hotel have grown dramatically. Online Travel Agency commissions have grown at twice the rate of Guest-Paid Revenue and 1.5x the growth of loyalty expenses while traditional travel agency commissions and other channel costs have grown at about the same rate or slower.

The explosion in the amount and variety of digital marketing and acquisition costs in recent years has further complicated an already difficult accounting and allocation task. It's a challenge for any hotelier to accurately determine the cost of any given booking. Some questions that arise:

- Should search engine expenses be allocated against individual bookings or should they be treated more like a distributed marketing cost since they are not always tied to a specific transaction?
- Where on the P&L are the various travel agency commissions, assuming they show up there at all (which Merchant [Net] booking commissions will not in many cases[1])?
- Are TA commissions being tied back to the bookings that incurred them?
- How do we evaluate truly incremental revenue and the costs associated with it?
- Where are the discretionary funds best deployed and how can a hotel get the most return on its investment?



[1]http://www.hotelnewsnow.com/Articles/238065/New-accounting-standards-call-attention-to-OTA-revenue

There are a wide variety of factors to consider when evaluating costs and benefits by Channel or Source of Business. In this report, the Source of Business refers to channels such as Brand.com, Voice, GDS, OTA and Property Direct in addition to FIT and Groups & Meetings. The costs include all those related to **direct** booking charges discussed in Part II of Demystifying the Digital Marketplace, such as commissions, transaction costs and loyalty expenses as well as **indirect** sales and marketing expenses that support more general efforts at attracting guests. A hotelier must determine the effectiveness of each type of spending utilized to acquire guests. This section will lay out several case studies that provide examples of how a hotelier might approach this task. The case studies are based on actual data from the Kalibri Labs database intended to represent hotel examples so that the reader may apply these cases to their own situation. Each hotel will have to conduct these analyses with their own data to determine the best courses of action related to customer acquisition.

This section will show illustrations and/or case studies of the following types of analyses:

- Merchant (Net) and Opaque OTA commissions
- Flow-through analysis by Source of Business and Segment
- Lifetime value analysis
- Ancillary spend analysis
- Sales and Marketing Efficiency analysis

Merchant (Net) and Opaque OTA Commissions

Clearly itemized and allocated reservation costs are vital to conducting a cost comparison by Source of Business. However, most of the costs associated with one of the largest overall reservation cost drivers, Merchant (Net) and Opaque OTA commissions, do not appear on the profit and loss statement making this exercise more difficult. Within these models, the OTA collects the guest's payment up front and then remits a net rate back to the hotel. Technically the hotel never directly pays a commission on that rate but the difference between what the guest pays the OTA and what the OTA remits to the hotel as a net rate is effectively a commission that is collected in advance by the vendor since they are the entity that collects the revenue*.

**Note: there are changes in effect as of January 2018 as outlined in this article that may allow hotels to report revenue in certain cases that is collected by third parties even when a commission is withheld by the third party before a hotel gets paid.(for more information: http://www.hotelnewsnow.com/Articles/238065/New-accounting-standards-callattention-to-OTA-revenue)*

To truly evaluate the cost structure and profitability of different Sources of Business these commission costs must be visible to the management team. Exhibit B below illustrates the impact that these costs would have on the P&L if they were treated the same as the traditional retail commission. The model assumes a commission rate of 18% based on a typical blend of room-only, package and opaque business fromMerchant (Net) and Opaque model OTAs.

These different types of business come with different commission rates with room-only typically around 15%, package around 25% and opaque closer to 35%.

Incorporating this cost into monthly budget review sessions will facilitate a more thorough examination of acquisition cost by channel and drive the determination of an optimal channel mix by the manage-

Upscale Full Service Hotel Example OTA Commission Models

Upscale, Full Service Hotel	Retail Model OTA	Merchant Model OTA	Opaque Model OTA
Guest-Paid ADR	$150	$150	$100
Wholesale Commission	$0	$27	$35
Hotel-Collected ADR	**$150**	**$123**	**$65**
Channel/Transaction Fees	$5	$5	$5
Retail Commission Expense	$27	$0	$0
Total Acquisition Cost	**$32**	**$32**	**$40**
COPE* ADR	$118	$118	$60

**COPE = Contribution to Operating Profit and Expense*

FEW HOTELIERS WOULD IGNORE A P&L EXPENSE ITEM THAT EQUALS 15–35% OF WHAT THE GUEST PAID FOR THE ROOM WITHOUT CAREFULLY EXAMINING HOW TO LOWER IT OR HOW TO INCREASE THE ASSOCIATED REVENUE.

COPE REVENUE MEASURES THE REVENUE THAT REMAINS FROM THE AMOUNT PAID BY THE GUEST AFTER DIRECT ACQUISITION COSTS, SUCH AS COMMISSIONS, LOYALTY COSTS AND TRANSACTION FEES, ARE REMOVED. THIS TYPE OF REVENUE CAN BE APPLIED TO TRADITIONAL ADR AND REVPAR CALCULATIONS.

ment team of the hotel. While some of the OTA commission rates are not directly negotiated by the hotel and therefore, seemingly outside of their control, the mix of business of the hotel is within their control and therefore, should be the area of focus for management. Monitoring these costs will enable management to help determine that optimal mix across all channels and to determine the ideal proportion for the higher cost OTA business.

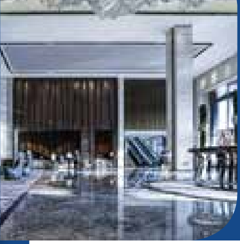
On top of these costs the hotel must consider the impact of additional, optional marketing spend or performance-based commissions that they may decide to pay out to Online Travel Agents (OTAs). This can include an additional commission on top of the base rate for better placement during need periods or ad buys on certain pages of the site. These additional costs can increase the cost paid for OTA bookings by several percentage points based on Guest-Paid Revenue.

It is vital that hoteliers recognize the costs, whether on the P&L statement or not, that come along with the various types of OTA bookings. The next section will analyze the flow-through and profitability of bookings through different Sources of Business and segments to put these OTA costs into context.

Exhibit C below illustrates the P&L impact of recognizing the Wholesale Commissions from Merchant and Opaque model OTA bookings as a true cost. The same conservative blended commission rate of 18% is applied along with realistic room counts, occupancies, ADRs and room night shares based on Kalibri Labs data from 2016. For the most part, these costs are not accounted for on the P&L, but if they were, this is a typical amount a hotel would incur. The perils of ignoring these costs become even more stark when put into context as an annual cost that would hit the P&L.

Sample OTA Commission Costs by Chain Scale

Chain Scale	Room Count	Occupancy %	Guest-Paid ADR	% Net and Merchant OTA Room Nights	Blended OTA Commission	OTA Guest-Paid Revenue	OTA COPE Revenue	**OTA Commission Cost**
Economy	75	55%	$ 66	14%	18%	$ 134,380	$ 108,176	**$ 24,188**
Midscale	100	60%	$ 84	10%	18%	$ 177,315	$ 142,739	**$ 31,917**
Upper Midscale	110	65%	$ 114	9%	18%	$ 256,309	$ 206,329	**$ 46,136**
Upscale	150	70%	$ 137	8%	18%	$ 404,645	$ 325,739	**$ 72,836**
Upper Upscale	250	70%	$ 185	7%	18%	$ 795,148	$ 640,094	**$ 143,127**
Luxury	300	75%	$ 303	10%	18%	$ 2,385,566	$ 1,920,380	**$ 429,402**



Flow-Through Analysis by Source of Business

The analysis in this section will examine the Guest-Paid Room Revenue "flow-through" by Source of Business after reservation costs as well as distributed and undistributed operating expenses are removed. This analysis will lead to an estimate of the contribution to Gross Operating Profit (GOP) for each Source of Business. Since the revenue is based on what the guests pay, (Guest-Paid Room Revenue), whether they pay the hotel directly or a third party vendor, the revenue will include Merchant (Net) and Opaque commission costs as well as traditional commission costs and other transaction-related fees. By evaluating the performance using Guest-Paid Revenue, the true profitability of each Source will be more clearly illustrated.

The reservation costs included in this analysis consist of the following:

- **Retail Commissions** — include fees paid to retail or traditional travel agencies. In this commission model, the hotel pays a percentage of the room revenue for each booking made by the intermediary, usually after the stay has occurred.
- **Wholesale Commissions** — discussed above as Merchant (Net) and Opaque commissions, these include fees paid to net, merchant, opaque, or wholesale third parties. These commissions are used to gross up Hotel-Collected Revenue to calculate Guest-Paid Revenue and may be referred to as pre-paid commissions..
- **Channel Cost** — includes costs to connect to a given booking channel. These fees can be applied as a flat fee and/or a percentage of the booking revenue and while they may apply to all channels, they are most commonly incurred for voice, GDS or Brand.com bookings.
- **Loyalty Costs** — includes costs incurred for bookings made by loyalty guests. These costs typically include the cost of loyalty points, loyalty amenities, and loyalty services. These perks can include additional airline points, free water bottles and welcome gifts among other items. Loyalty Investment can be a percentage of room revenue or total revenue, and can vary based on the loyalty member tier; this cost is not applied when the booking is loyalty ineligible (e.g. a loyalty member books through an OTA).

Each Source of Business will have a variety of costs associated with it. Every Source of Business will incur a channel cost such as those associated with a brand recovery cost or a technology connection fee, while only loyalty bookings will carry a loyalty investment cost. Every OTA and most traditional travel agent bookings will incur a commission expense of some kind while some Brand.com bookings may also incur costs due to meta-search or performance marketing campaigns. The model below will include these examples.

In addition to the reservation costs this model incorporates both distributed and undistributed operating costs for a hotel. This analysis was approached with a full-cost analysis in mind, meaning that rooms division as well as undistributed operating expenses are applied to the sample shown in accordance with their average length of stay. Due to the differences in length of stay, the booking costs for each Source of Business and Channel may vary quite a bit.

The goal of the analysis is to evaluate different pieces of business in relation to one another to glean insights into relative profitability. This differs from the marginal approach which defines "incremental rooms" as those sold after the hotel's occupancy is high enough to cover fixed costs; therefore, low rates or high acquisition costs are irrelevant. This marginal approach is focused on putting heads in beds and adheres to the philosophy that any revenue is better than no revenue.

Distributed costs in this example include channel and transaction fees, commissions, loyalty expenses as well as rooms and other incremental costs while undistributed costs include IT, sales and marketing, G&A and other general expenses.

The model breaks down the remaining Guest-Paid Revenue after each of reservation costs, distributed operating expenses and undistributed operating expenses are removed to give a full picture for profitability by Source of Business at each level.
To examine the profit contribution of each booking by channel, a full cost approach flow-through analysis was conducted for hotels in two Chain Scales, Midscale limited service and Upscale full service including all significant transient booking channels. The examples below outline the typical performance, based on 2016 Kalibri Labs calculated data along with corresponding operating expense information from CBRE's 2016 Trends in the Hotel Industry report. Examples of Midscale limited-service hotels include Candlewood Suites, Best Western and Sleep Inns while the Upscale full-service hotels include Radisson, Hotel Indigo and Aloft. The examples below represent a composite of 2016 data from the Kalibri Labs database in each of these categories.

There are very few occasions where a hotel will be able to sell every one of its rooms at the highest possible price through the most profitable channel. It is necessary for hotels to take a wide mix of business even in relatively high-demand periods while at the same time working to maximize their Guest-Paid Revenue flow-through and overall profitability. The hotel has to take into consideration all room and rate types and work to blend them together through the various Sources of Business to achieve an "Optimal Business Mix" at any given point in time.
There are inevitably lower demand periods where a hotel must take business that will have a lower profit contribution (COPE) % and may ultimately be less profitable than what they would take during higher demand periods.

Exhibits 1 and 2 outline the hotel examples while Exhibit 3 breaks down each of the costs that factor into this analysis.

Exhibit 1 focuses on an example midscale, limited-service hotel with average Guest-Paid rates in the $80-$90 range. This example keenly illustrates the effect that acquisition costs have on a hotel property's bottom line. Bookings that may appear to have a high room revenue may appear quite different after costs are applied and when examined at the Gross Operating Profit (GOP) level.

Given the typical weekday/weekend and corporate/leisure split seen in these channels it is possible that OTA leisure guests may have a higher top-line ADR when examined in aggregate. Even with the direct channels at a slightly lower Guest-Paid ADR on average, though a longer length of stay, it's clear that the costs of acquisition are having a significant impact on net profitability.

Midscale, Limited Service Hotel Example Full Cost Analysis by Channel

Midscale, Limited Service	Brand.com	GDS	OTA-Merchant	OTA-Opaque	Property Direct	Voice
Average Guest-Paid Daily Rate	**$84**	**$89**	**$91**	**$86**	**$71**	**$80**
Average Length of Stay	1.8	3	1.7	1.6	2.2	1.7
Room Revenue per booking	**$151**	**$266**	**$155**	**$137**	**$156**	**$135**
Channel/Transaction Fees	$2	$7	$2	$4	$2	$3
Loyalty Investment	$4	$3	$0	$0	$2	$4
Retail Commission Expense	$4	$26	$0	$0	$0	$2
Wholesale Commission	$2	$2	$30	$42	$0	$0
Total Acquisition Cost	**$12**	**$38**	**$32**	**$46**	**$4**	**$9**
Other Room Expenses	$44	$73	$41	$39	$53	$41
Income Before Fixed Charges	**$95**	**$155**	**$82**	**$52**	**$99**	**$85**
Undistributed Expenses	$52	$86	$49	$46	$63	$49
Gross Operating Profit (GOP) Per Booking	**$44**	**$69**	**$33**	**$6**	**$35**	**$37**
Gross Operating Profit (GOP) Per Room Night	**$24**	**$23**	**$19**	**$4**	**$16**	**$22**

In this example, the profit contribution for a Brand.com booking is $44 while the profit contribution for a similar OTA-Merchant booking is only $33 despite the slightly higher Guest-Paid ADR due to the additional commission expenses. While the OTA Merchant model has a higher average rate, it is outweighed by the high commission for the customer acquisition. That $11 difference on a per-booking basis can be hugely important for a hotel looking to retain every dollar possible for reinvestment. This is brought into even sharper contrast when the GOP per OTA-Opaque booking for this example hotel is revealed to be only $7. While of course there are times where it's important for a hotel to put heads in beds, a frank examination of the profitability of certain types of business highlights these issues.

The GDS channel comes in with the highest GOP per booking at $69 due in large part to an extended length of stay associated with each booking. This helps offset the additional acquisition costs paid out in commissions for this type of business. Hotels are likely to drop their rate for last minute guests, which leads to a low average rate for property direct customers, but with low customer acquisition costs, much of this revenue is able to flow to the bottom line. When examining the GOP per room night, it's clear that Brand.com, Voice and GDS bookings contribute far more than the OTA bookings.

This model illustrates an average midscale, limited service property. For a hotel to derive its own flow-through results, it would need to apply its own revenue and expenses that may vary based on specific hotel type and location.

Exhibit 2 below focuses on a sample upscale, full-service hotel analysis with average rates in the $150 range. Compared to the limited-service hotel, the impact of guest acquisition costs on profitability is more pronounced. Much like the example above the third-party leisure-oriented sources can have a higher Guest-Paid rate compared to direct channels due to their specific business mix and when it's coming. Even with this in mind, the GOP per booking of the direct channels clarifies their higher levels of profitability when compared to business coming from third-party sources.

Upscale, Full Service Hotel Example Full Cost Analysis by Channel

Upscale, Full Service	Brand.com	GDS	OTA-Merchant	OTA-Opaque	Property Direct	Voice	FIT/Wholesale
Average Guest-Paid Daily Rate	$150	$145	$154	$100	$119	$148	$156
Average length of Stay	1.6	2	1.5	1.4	2	1.7	2.5
Room Revenue per booking	**$240**	**$289**	**$232**	**$139**	**$238**	**$251**	**$391**
Channel/Transaction Fees	$4	$4	$5	$6	$4	$4	$5
Loyalty Investment	$8	$8	$0	$0	$5	$10	$0
Retail Commission Expense	$10	$27	$0	$0	$0	$1	$10
Wholesale Commission	$0	$0	$35	$39	$0	$0	$82
Total Acquisition Cost	**$15**	**$40**	**$40**	**$45**	**$10**	**$15**	**$97**
Other Room Expenses	$58	$73	$54	$51	$73	$62	$91
Income Before Fixed Charges	**$167**	**$177**	**$138**	**$44**	**$155**	**$174**	**$204**
Undistributed Expenses	$89	$111	$83	$77	$111	$94	$138
GOP* Per Booking	**$72**	**$66**	**$55**	**($34)**	**$45**	**$80**	**$65**
GOP Per Room Night	**$45**	**$33**	**$37**	**($24)**	**$23**	**$47**	**$26**

**GOP = Gross Operating Profit*

BRAND.COM AND VOICE HAVE THE HIGHEST GOP PER BOOKING MEASURES FOR THIS EXAMPLE HOTEL AT $72 AND $80 RESPECTIVELY AND $45 AND $47 WHEN EXAMINED ON A PER ROOM NIGHT BASIS.

This is true even when the Retail Commission expense associated with performance marketing campaigns for Brand.com is incorporated.
GDS and FIT/Wholesale are close behind with contributions of $66 and $65, respectively, due in large part to their extended lengths of stay compared to other channels. Again, property direct channel profits are brought down by low last-minute rates and the merchant model reflect high commissions paid to online travel agencies.

With an average daily rate of $100, the OTA-Opaque channel results in a loss of $34 to the hotel's bottom line after full costs are applied. This loss would have to be overcome by the high profit margins of an upscale property's direct channels to avoid an overall loss for the period.

This analysis is a model designed to illustrate a full cost flow-through analysis; it is based on the averages of revenue and expenses for an upscale, full-service hotel. In order for a hotel to derive its own flow-through results, it would need to apply its own revenue and expenses that may vary widely by hotel type and location.

Exhibit 3 below details the specific costs that go into a booking for each of the channels outlined above along with the other room expenses and various undistributed expenses used to calculate the flow-through analyses.

After a hotel team performs their own flow-through analyses based on the above outlines they will likely want to establish guidelines around how deeply they

<table>
<tr><th colspan="4">Channel Specific Costs in Detail</th></tr>
<tr><th>Channel</th><th>Channel-Specific Cost</th><th>Other Room Expenses</th><th>Undistributed Expenses</th></tr>
<tr><td>Brand.com</td><td>·Direct charges from website vendor
·Search Engine marketing (SEM) costs
·Labor if directly attributed to website
·Loyalty fees (if applicable)</td><td rowspan="6">Rooms, food and beverage and other departmental expenses</td><td rowspan="6">G&A, IT systems, sales and marketing, utilities and other property expenses</td></tr>
<tr><td>GDS</td><td>·Connectivity/transaction fee
·Travel Agency Commission
·Loyalty fees (if applicable)
·Credit card fees</td></tr>
<tr><td>OTA -Merchant and Opaque</td><td>·Commission or discount
·Connectivity/transaction fee
·One-time use credit card fee</td></tr>
<tr><td>Property Direct</td><td>·Labor
·Loyalty fees (if applicable)
·Credit card fees</td></tr>
<tr><td>Voice</td><td>·Labor
·Technical transaction fee (if any)
·Loyalty fees (if applicable)
·Credit card fees</td></tr>
<tr><td>FIT/Wholesale</td><td>·Commission or discount
·Connectivity/transaction fee</td></tr>
</table>

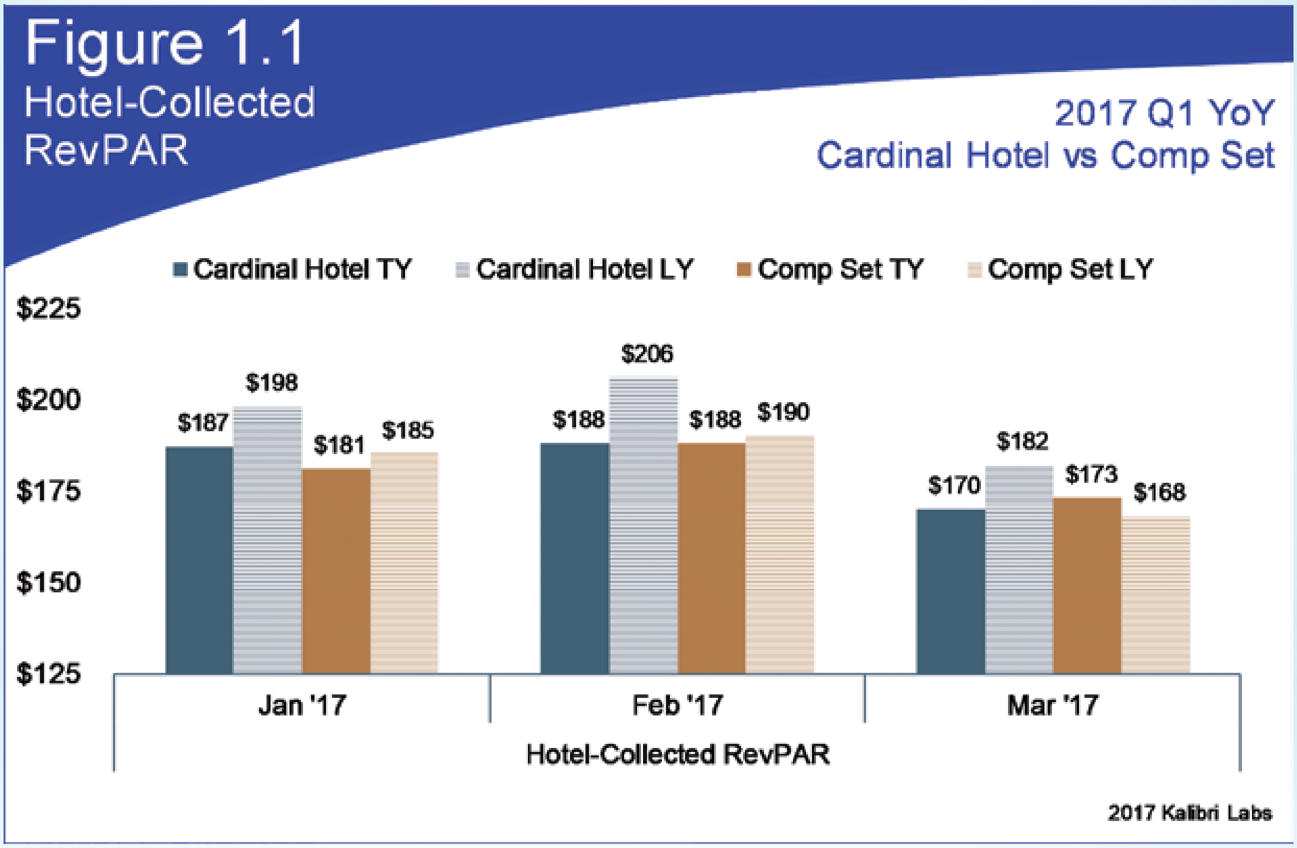
are willing to discount business in order to prevent erosion in profitability. While rooms and undistributed costs have frequently been taken into account in evaluating the profitability of a room, it is clear that a key component of that is also the notable addition of customer acquisition cost.

If a hotel's standard break-even demand level is achieved with too much heavily discounted business, the hotel will likely be unable to achieve its Net Revenue goals. A balanced mix, with room for heavily discounted business as a supplement when necessary, is key to sustaining profitability in the ever-evolving digital marketplace. Each hotel must calculate the rates and volume thresholds that will result in positive Net Revenue outcomes by keeping all the different cost categories in mind. Once objectives are established, they must be tethered to incentives for management to ensure that those goals are met.

Case Study 1 – Minimizing RevPAR Decline

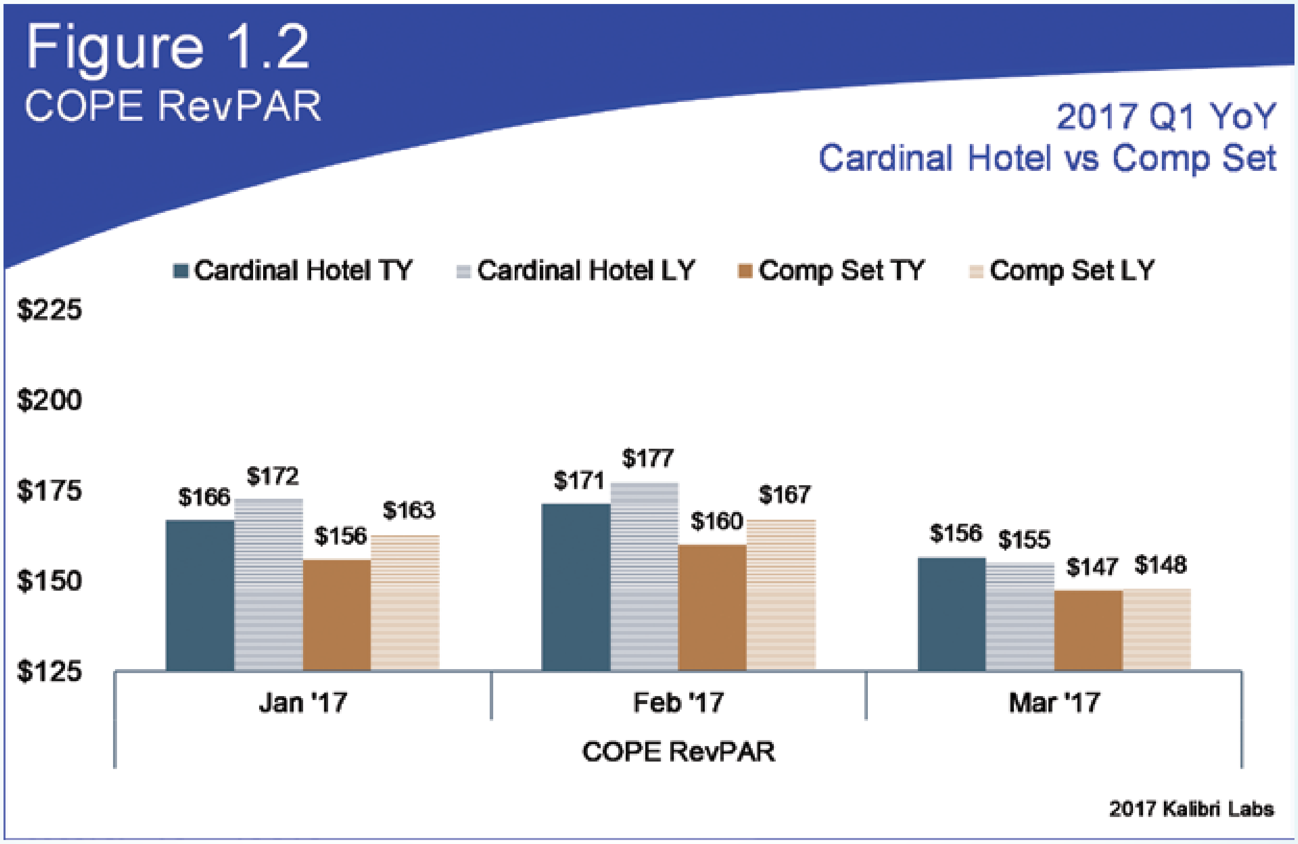
Hotel Cardinal, a member of a soft brand of a major hotel chain, noticed that its Hotel-Collected RevPAR (the traditionally reported RevPAR) was slipping in Q1 compared to last year. Although the competitive set's RevPAR was declining as well, Hotel Cardinal's was declining faster. As such, the hotel's penetration of the market was decreasing. Knowing this trend would likely continue, management had to act fast.

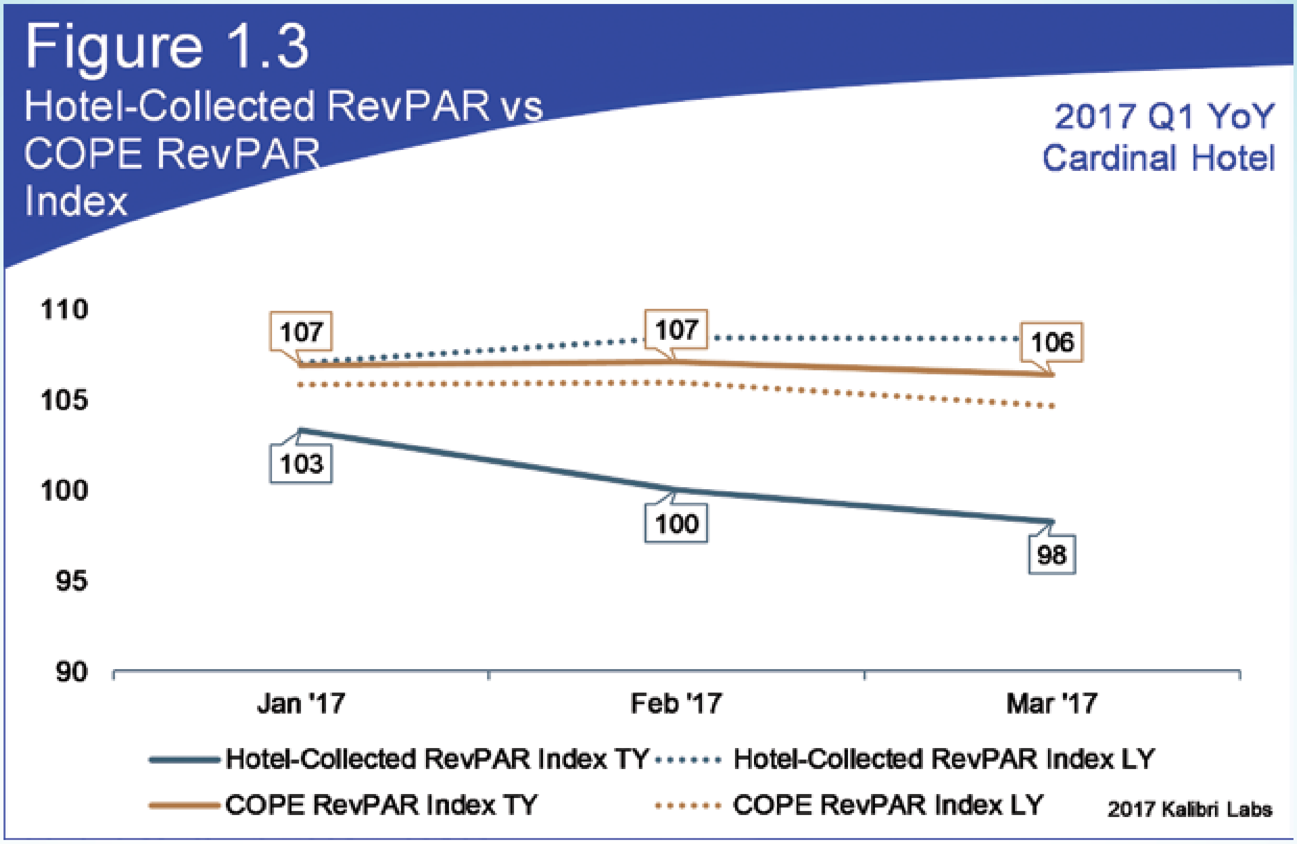
What the chart below demonstrates is how the Hotel Cardinal, as well as its competitive set, experienced Hotel-Collected RevPAR declines throughout Q1. It highlights how Hotel Cardinal experienced sharper declines in this metric compared to the competitive set, particularly in March where the competitive set actually saw an increase.



Their first step was to unpack that RevPAR decline and look at their hotel's COPE RevPAR performance versus the comp set benchmark. What they found surprised them. As shown in the exhibit below, their COPE RevPAR performance was significantly better relative to the benchmark than their Hotel-Collected RevPAR performance. Even though their COPE RevPAR was declining YOY, it was declining less than the group of comparative hotels. In sharp contrast to the traditional RevPAR result, while the Cardinal still declined on a net RevPAR basis (COPE) in January and February, it's decline was not as much as the benchmark group and it actually increased in March, while the benchmark group of hotels dropped slightly.

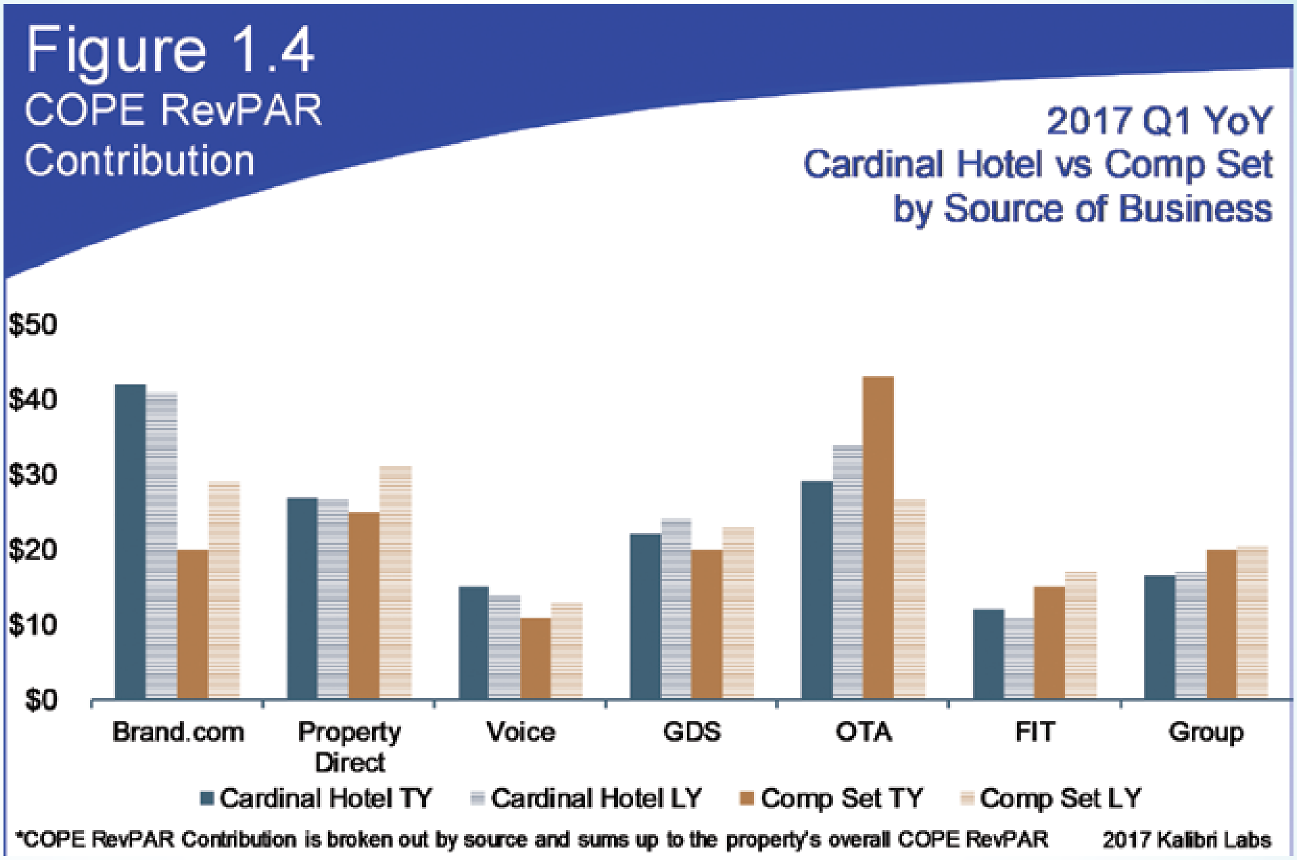
When examined on an index basis, it was clear that the hotel was performing better than they thought. The steady decline they saw in Hotel-Collected RevPAR Index was not reflected in the COPE RevPAR Index. After acquisition costs were accounted for they were performing significantly better than their comp set and had improved compared to the prior year. The Cardinal grew slightly over last year in COPE RevPAR Index to 106 when taking costs into account in comparison to a drop to 98 in traditional RevPAR Index.





Continuing their analysis, they wanted to figure out what they were doing right. Further investigation into the channel performance revealed that the competitive set, in response to declining direct business occupancy in the market, had aggressively targeted OTA business through rate promotions and marketing campaigns. Some of Hotel Cardinal's OTA business shifted to the competitive set, contributing to their RevPAR declines, but a strong base of direct business compensated and allowed them to drive their profit contribution as evidenced by their increase in COPE RevPAR index.

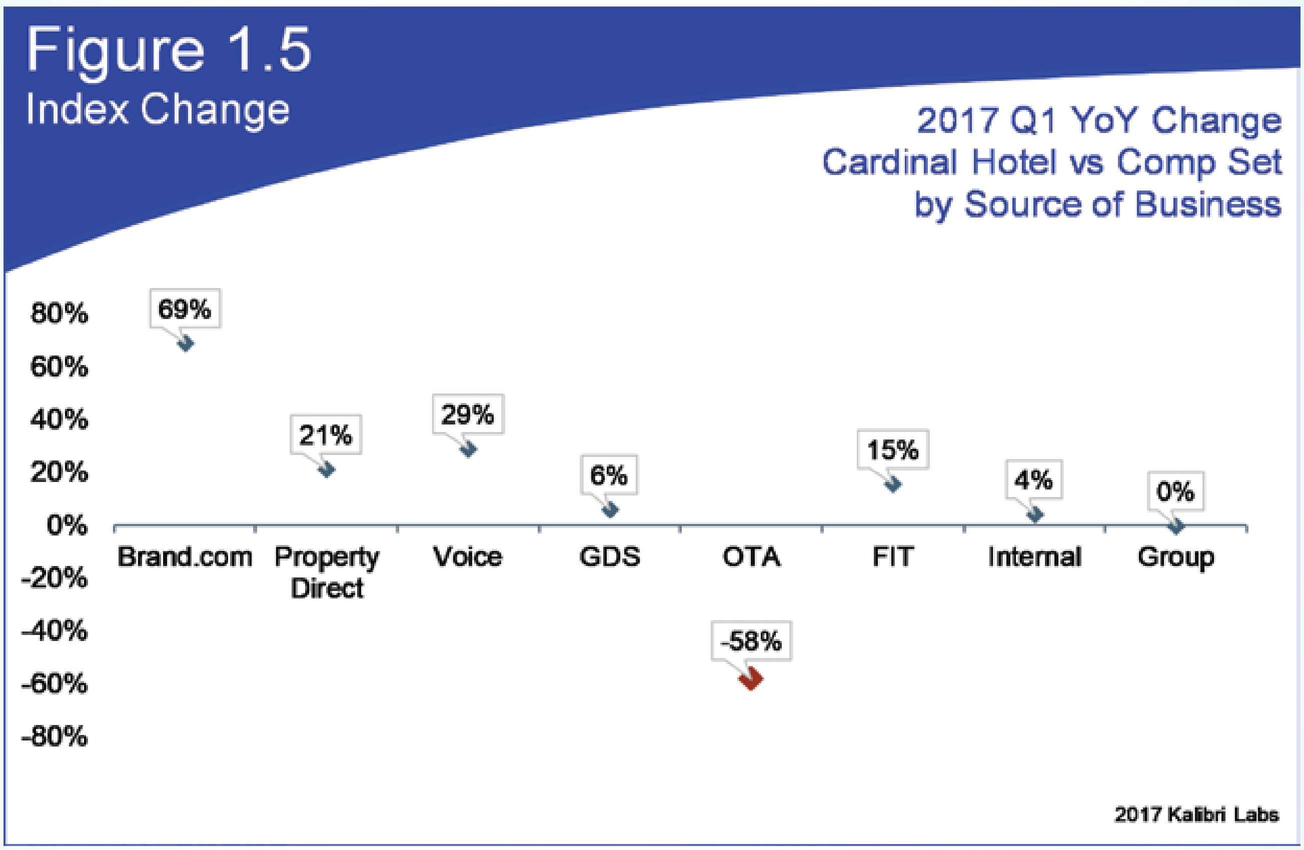
The chart below shows the changes in COPE RevPAR contribution by source of business for the hotel as well as its comp set. This metric illustrates which portion of total COPE RevPAR is driven by each source of business; when each COPE RevPAR contribution by source is added up it will total the total COPE RevPAR performance for the property. It's also illuminating as it provides a true picture of Hotel Cardinal's and the comp set's performances over Q1 of 2017.



The hotel team believed initially that they had lost RevPAR share year over year. When they dug into their performance on a COPE RevPAR basis and looked at the individual channel performance, as illustrated above, they found that their strategies to mitigate a soft market had paid off. They were able to weather a declining overall market by investing in brand.com marketing efforts and call center training.

The chart below shows the change by source of business in Hotel Cardinal's COPE RevPAR penetration.

What this illustrates is that, while the property's overall direct channel business remained relatively flat to last year on a COPE RevPAR basis, they were able to increase relative share. They were in a tough market in Q1 where their competitors made hasty decisions. By examining their performance net of acquisition costs and down to the source of business/channel level, they realized that they were on a solid path forward.



SO WHEN SHOULD A HOTEL TAKE LOW PROFIT MARGIN BUSINESS?

In spite of these many types of analyses, it is still a reality that a hotel has to fill with many types of business. A marketer may be inclined to assume it is best to choose channels in order of cost, but there are other variables to consider.

It is rare that a hotel can sell all room demand volume at top price. Hotels have to layer in their business to try to find the highest-rated demand at any given time. Hotel management needs to identify all the demand available in a market and figure out how much they want from each demand driver and how much they can afford to acquire the share they want. The hotel needs to consider all of its room and rate types and match them with the types of business available at any given time.

There will always be lean times when it is only possible to fill a hotel with business that may be lower profit than a hotel would usually like to take. Therefore, in spite of higher acquisition costs, if the room is being sold at a profit, even a small profit, and there is no business flowing through higher value channels, then it may be worth using the higher cost distribution channel. If there is no profit from a particular type of business, then in most cases, this practice may not be worthwhile. It is management's role to decide how many rooms should be available through each channel based on daily demand forecasting for each part of the week and each season of the year. If a hotel is obliged to sell through marginal channels during high demand times, in order to gain access to those channels during need periods, a cost/benefit analysis would be in order to assure management that there is a net benefit overall after analyzing the composite of all demand periods.

There are other times when a low-margin source of business can be worthwhile.

1. Create a base for compression

If low margin room nights can be laid in early enough to add to a base that creates a higher level of compression in the market in which the hotel is operating, then it can serve as a springboard to yield higher rates from other channels during the peak booking time. For example, if there is a way to stimulate low-rate paying customers to book in the 21-40 day lead time window, then it can prove valuable to a hotel by enabling higher rates for business booked within two weeks of the arrival date. Many hotels can make the mistake of using low-profit channels without regard for lead time and end up filling in with low rates closer to arrival; this contributes to the impression by consumers in the marketplace that you can get a better rate if you wait until the last minute. This behavior has been reinforced by media messaging where waiting for a lower last-minute rate is the explicit theme.

Traditionally, hotels would be best served by booking their lower rated business further out so higher rates can be activated closer to arrival when demand is likely to be highest. If a hotel takes lower rated business earlier for fear it won't fill, and then offers last-minute low rates in the last week or two before arrival there can be two outcomes, both of which may contribute to sluggish rate growth: (1) the percentage of higher rated business will decline overall and (2) travelers learn that waiting can guarantee lower rates so the consumer is less inclined to book early even when lower rates are available.

2. Bring business you cannot bring yourself

Assuming the rates yield a contribution to profit, low-margin business is worthwhile if the hotel benefits from a valuable market it is not capable of tapping itself, either due to technical issues or access. If it diverts business that would come otherwise through a hotel's own website or call center, then it may not be worth incurring a higher cost. However, as an example, for those hotels in a market that is attractive to international feeder markets, or to fly-in markets in which air/hotel packaging is a major source of demand, then third-party intermediaries specializing in packaging can be a valuable channels of choice, provided there is no feasible alternative to getting that business through a higher margin channel.

3. When ancillary spend is high

For hotels with strong potential for ancillary spending beyond the room rate, (i.e., revenue centers such as parking, premium internet services, golf), and that ancillary spend carries a high profit margin, the full benefit of that booking should be considered when evaluating the business. Even if the contribution to profit from the room rate is small, if the ancillary spend yields a substantial profit contribution, then low margin business can be an attractive option for a hotel. However, it should be compared to alternatives to determine if it is still more beneficial than other demand streams available in the same time period.

4. Hit the threshold

Some hotel brands set threshold occupancy levels that trip a premium in reimbursement to hotels for loyalty point redemption. When a hotel is near that threshold (e.g., 95% occupancy), it chooses to top off and hit that mark by taking the lower rated and marginally profitable business, often through the OTA channel, in order to qualify for the much higher reimbursement from the brand loyalty program. Feeling like a game of "whack-a-mole," where a wide range of demand may pop up in a few channels given a busy period in a particular market, this short-term quick fill may sometimes be a diversion of bookings that would have come through brand.com. Although not ideal, being a quick fix and a reliable way to siphon off any last-minute demand coming into a market by the hotel that wants to hit the threshold, it works.

5. Fill a hole

When a large group cancels or a citywide event does not fill a hotel as expected, the mass marketing benefit of a third-party intermediary can be highly effective at plugging those holes for a given hotel, especially when they are unexpected and/or offer little lead time to launch other marketing initiatives to a large audience. The third-party sites are adept at share shifting and one needy hotel may turn on the spigot that will direct much of the demand for a comp set to it during these need periods.

6. Cover cash flow

If a hotel is in a desperate situation in which it cannot reach its threshold of daily operating expenses, then lower margin business can still serve as "fast cash" to cover cash flow needs. This is not often a sustainable situation, but it is a method that a hotel can utilize when no other option exists, either because it does not have the internal skills to stimulate other demand sources, or because the market is so economically depressed that there is no other option to shift the limited existing demand. However, it is often a case where one hotel in a comp set gains volume, but due to limited demand, all of them rarely do. The tendency is for the hotel taking the lead in the market to lower rates, followed by the others in the comp set who feel they have to drop rates to avoid loss of market share. In the worst case, when all hotels have lowered rates, the only method to gain the limited demand in the comp set requires continual rate reductions and all hotels have to operate at lower margins; some call this a "race to the bottom."

Over time, without adequate business that yields a positive contribution to profit, the owner may end up with a shortfall precluding the ability to meet debt service, tax obligations, or to have any funds to reinvest. A disproportionate share of low margin business can cause excessive wear and tear on the building and in short order, in a downward spiral, the hotel will not be able to justify high enough rates to deliver a profit even when the economy improves. This situation requires careful consideration by management and tight controls so that as soon as more profitable channels are flowing, the hotel can widen the range of channels from which it fills the hotel.

Low-profit Business — How Much Should A Hotel Take?

But how much of the mix should the low-profit business be? Exhibits 1 and 2 above illustrate example profitability calculations by guest type. The hotel has to be cautious about volumes so it does not displace full-rated business by selling too large a base at low rates months before arrival. There is also a question as to whether a hotel can fill the same rooms with other demand that contributes more to NOI. If not, when the hotel has achieved its break-even point with a sufficient volume of rates close to a targeted best available rate (BAR), then some contribution can be better than none. Low-value business may become a detriment to the hotel's achievement of an optimal business mix if it:

(1) Becomes too large a percentage of the hotel's overall channel mix.

(2) Diverts financial or staff time and resources from seeking higher profit business.

(3) Erodes the overall rate strategy of the hotel.

(4) Feeds a downward price spiral in the comp set that reduces rates for all and does not bring in enough incremental demand to compensate for the reductions in rate.

(5) Diverts customers who would otherwise book through higher value channels.

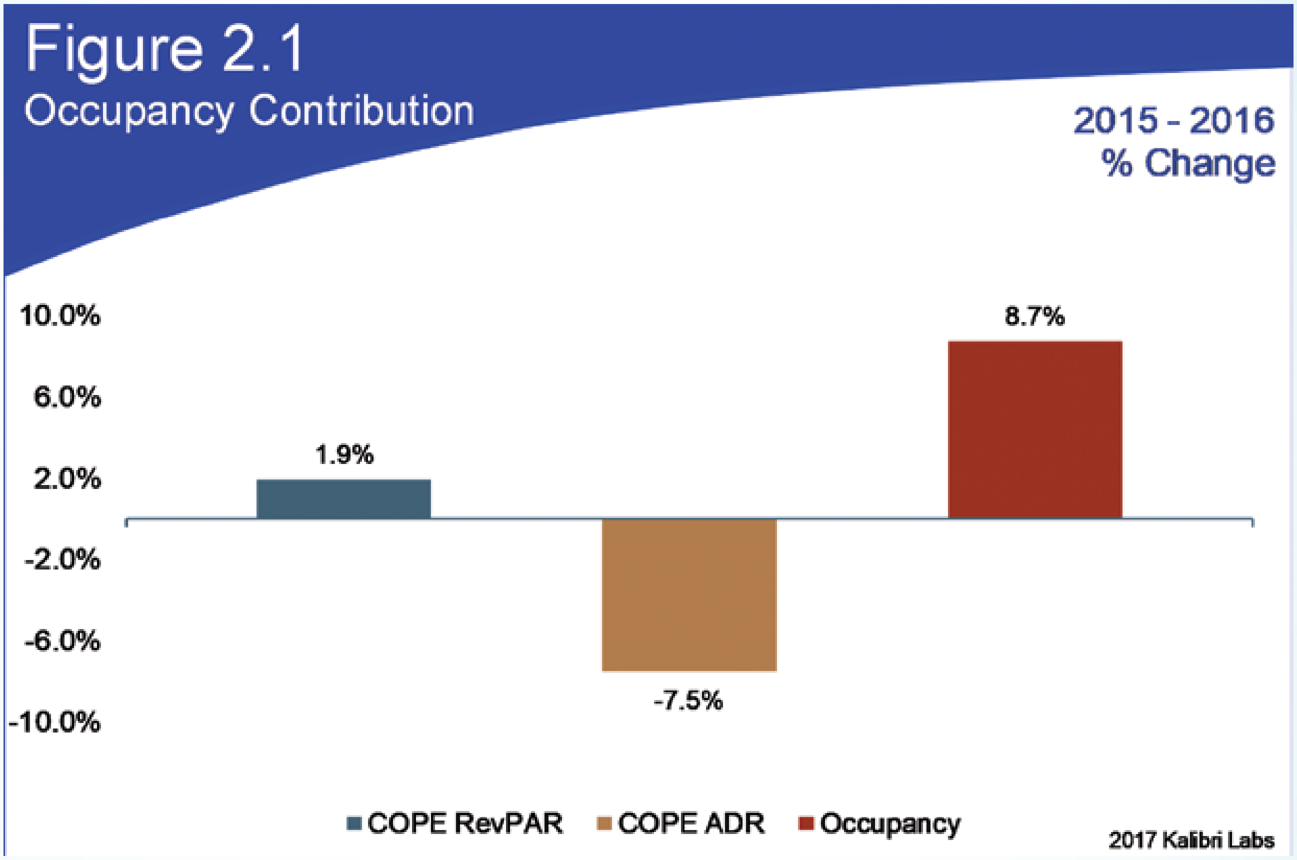
(6) Is promoted close to arrival and trains consumers to wait until the last minute for the best deal, undermining the potential for high rates that may be booked at the same time.

A more granular way to conduct this analysis could be to examine a hotel's revenue stream by day of week. A comparison of residual profit at different ratios of low- and high-value business could help determine the extent to which the hotel would benefit overall from some percentage of low-rated business used to "top off" during the high occupancy days. The danger is consistently taking too much low-profit business as part of the break-even base and undermining the hotel profit.

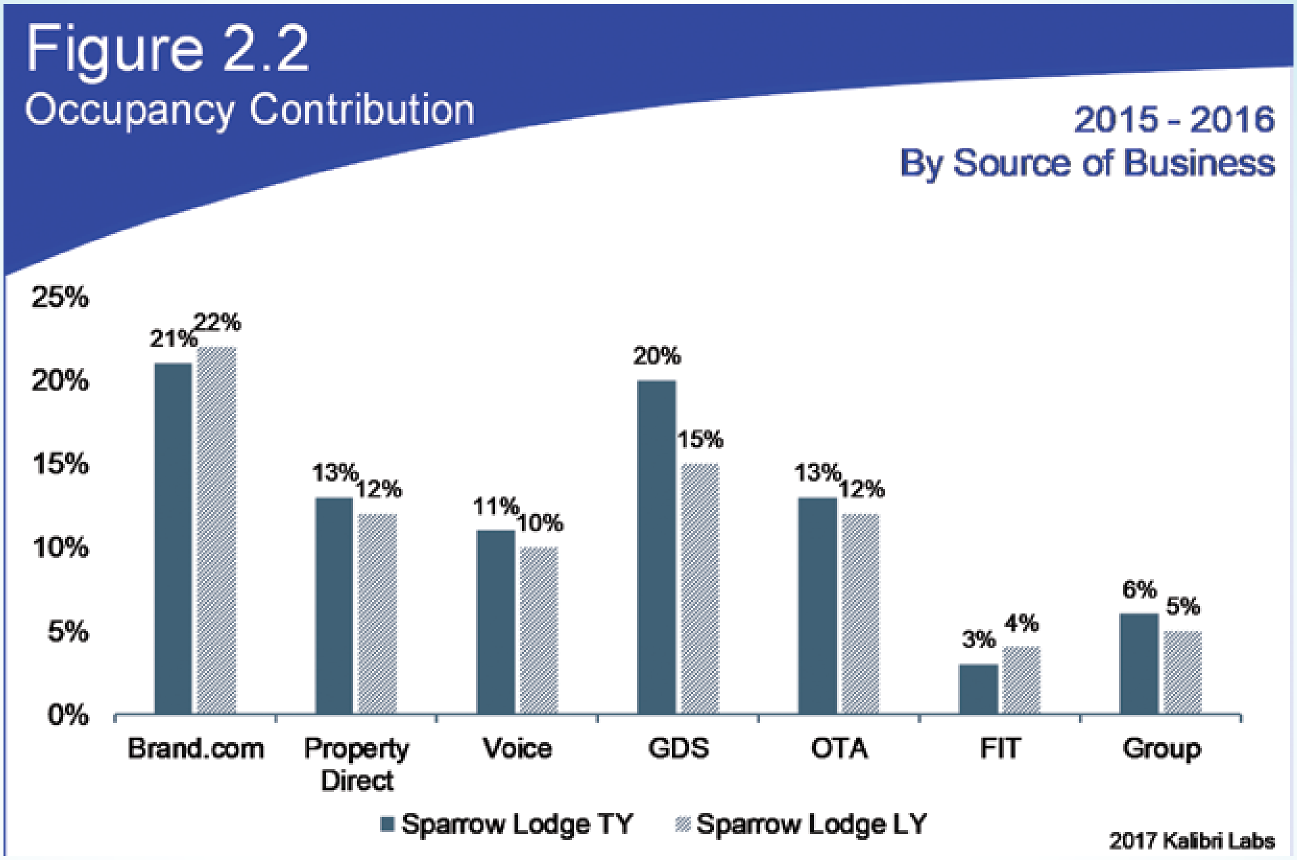
If a hotel has no last room availability (LRA) commitments, base allocations, or conditions connected to low-value business that would be detrimental to revenue during peak times, accepting a wide range of rates to take advantage of the demand in the market may prove beneficial to optimize revenue. However, if there are restrictions on inventory or if a particular type of business demand is not contributing to profit at all, a cost/benefit analysis would be appropriate to factor in the rate erosion during peak times as a deduction from the benefit gained during periods of weak demand.

Case Study 2 – Turning Around a Declining Rate

The Sparrow Lodge has enjoyed consistent year-over-year Hotel-Collected RevPAR growth since 2013. However, the flow-through to their profit was not telling the same story. Upon considering their performance based on COPE RevPAR, or on a profit contribution basis, it was clear that they were losing rate at the expense of occupancy, which cost the hotel more and was compounded by variable expenses such as amenities, labor, and utilities. They thought that by re-examining some of their decisions they could grow COPE RevPAR more effectively.

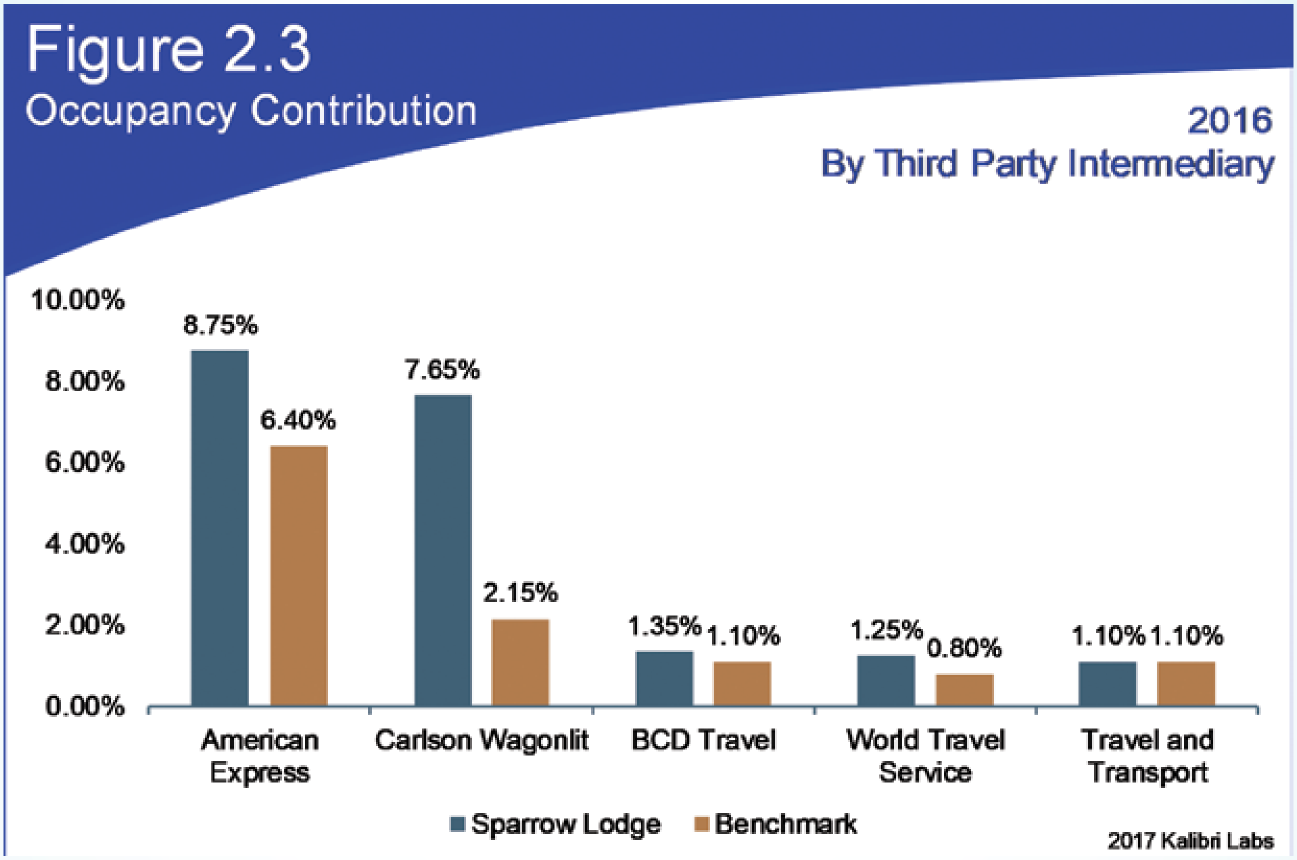


The property team's next step was to understand what was driving that occupancy growth. The chart below outlines the shift in occupancy contribution from 2015 to 2016 for the Sparrow Lodge.

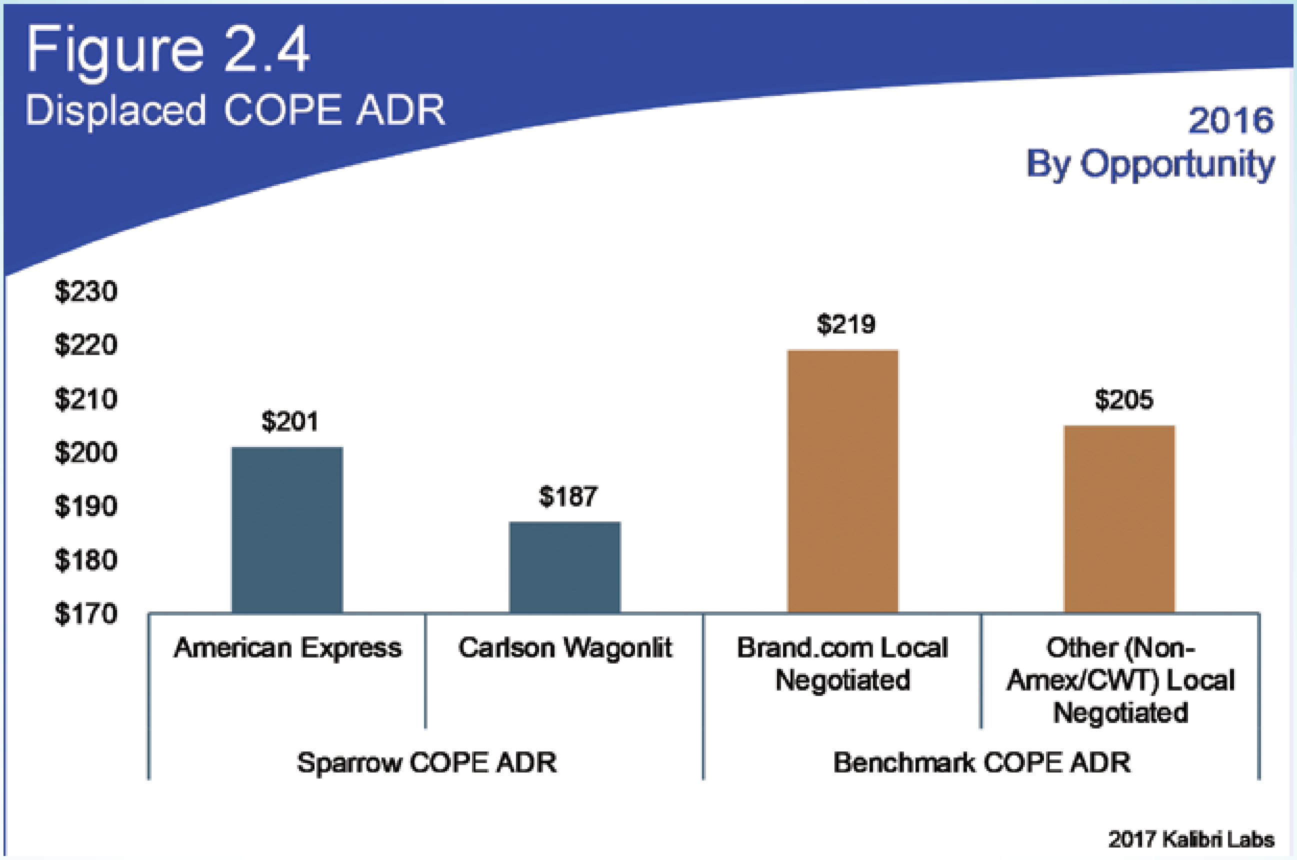


The main driver for the property's occupancy growth from year to year was an increase in GDS business. This was due to a concerted effort on the part of the sales team to more aggressively target the agencies with strong local negotiated account production in the market. This was now an opportunity for the property to evaluate the efficacy of that plan and decide how to proceed.

The next step was to examine which agencies were driving this increase. The chart below looks at the occupancy contribution by major travel agencies for the Sparrow Lodge as well as its benchmark competitive group.

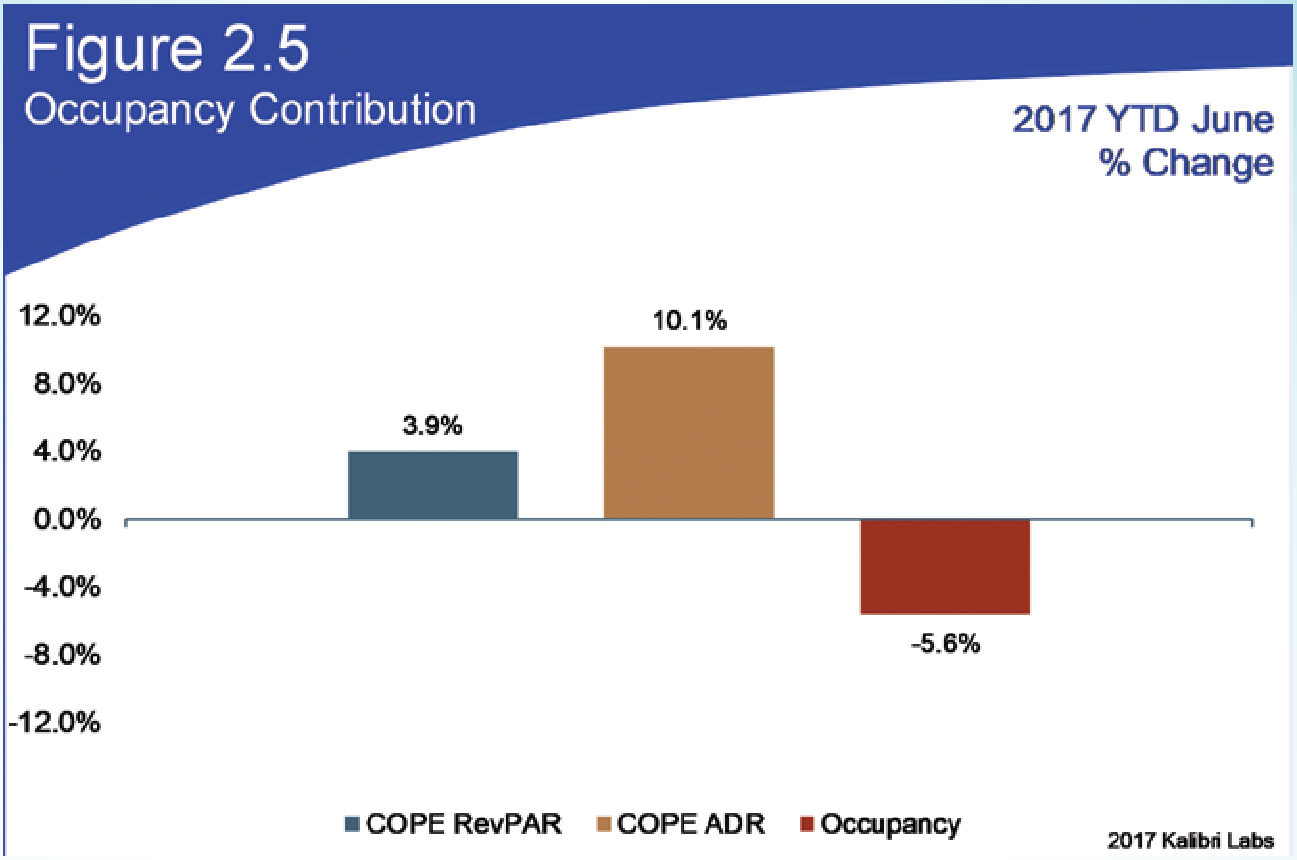


The main contributors to this increase and to occupancy through the GDS source were American Express and Carlson Wagonlit. The next step for the property team was to examine the COPE ADRs that were being achieved through those players in the context of other types of business they felt it might be displacing. The chart below breaks out the COPE ADRs for the Sparrow's business in those accounts compared to the rates in the market for other pieces of potentially displaced business.

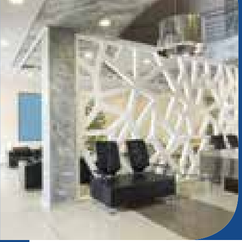


This analysis revealed that they had been a bit too aggressive in filling the hotel with local negotiated business through high commission GDS agaencies and could stand to re-diversify their mix. The property team elected to cut back on Carlson Wagonlit, and instead offer local negotiated accounts slightly more favorable rates to book directly through Brand.com instead of via GDS vendors. In addition, they retargeted their 2017 sales efforts around local accounts they were not penetrating that booked through lower rated travel agencies.

For the first half of 2017, the property team enacted those changes. They consciously transitioned corporate accounts to brand.com and signed several new accounts yielding higher net rates.



As the chart above shows, they dropped occupancy during this period but were able to drive COPE ADR to lead to a positive COPE RevPAR outcome and to reduce operating expenses.



Lifetime Value Analysis

Lifetime Value for each customer is an important concept for a hotelier making decisions about investments in pursuing repeat guests. It can be difficult to quantify but an analysis around this metric attempts to predict the Net Revenue attributed to both the initial visit and subsequent repeat visits of each guest. Understanding the lifetime value of various types of guests coming through different channels will necessarily influence a hotel's deployment of marketing resources along with ancillary revenue programs, forecasting, retention efforts and segmentation.

One thing that is clear is that there is a significant value to engendering repeat visits amongst guests. Acquisition costs decrease as guests become more loyal and return through direct channels to the hotel. An emerging trend in the digital market is for members of loyalty programs to use the apps of their preferred supplier when making bookings, thereby increasing the proportion of direct bookings.

Repeat customers continue to contribute to the hotel's revenue at a lower cost and there is a smaller base of guests requiring the hotel to pay the first time guest premium. Some frequent guests may spend more and others may return more often. In all cases, the overall value of the guest and the funds needed to trigger those returns are most often less than those required to attract the guest for their first visit.

Customers who return frequently and remain loyal, either to a brand or to an individual hotel, can provide significant value above and beyond their direct revenue contributions. Their informal influence within their circles along with their propensity to provide online reviews and commentary carries weight and can positively impact the subject hotel. A slice of this positive review influence is illustrated on Page 39 in *Part II of Demystifying the Digital Marketplace*. The analysis in that section, conducted by Professor Cathy Enz of Cornell University, examines the relationship between positive reviews and positive COPE RevPAR performance. Whether a guest returns to a hotel only once or twice or continues to stay at a specific property over decades, there is value in that relationship and a hotel can better inform decision-making and resource deployment by calculating their own lifetime value analysis similar to what is shown in Exhibit 4.

In addition to the determination of whether or not a guest is loyal, the key metric to determining the true lifetime value of a guest is through assessing actual repeat usage. As guests return more than once their value increases over time and therefore channels with guests that have a higher propensity to return carry additional value. Knowing the channels that carry the highest value guests will certainly guide the application of limited marketing resources by the hotel. If a channel or segment yields customers with which the hotel can develop a relationship or are more likely to return, then a booking through that source has a higher value to a hotel. Likewise, channels that deliver customers that are "one and done" are of diminishing value to the hotel over time.

Lifetime value analysis informs decision-making for channel and marketing investment over the long-term. If a specific source or provider is likely to provide repeat guests to the hotel it may be worth a more expensive upfront investment to acquire them. If a channel has few repeat guests it may be of value in need periods but will have a limited, long-term, sustained value.

With the large proportion of repeat guests booking via phone, the Voice channel has a 27% higher COPE ADR than the OTA channel and a 5.3% higher ADR than Brand.com based on Kalibri Labs data. Guests who book through the Voice channel also contribute 37.8% more in total guest spend over their OTA counterparts, and 8.6% over those booking on Brand.com based on a sample of Upper Upscale hotels from the Kalibri Labs database. According to a study conducted by Navis in further support of this point, from a pure revenue perspective, repeat guests spend from 13-29% more than new guests[2].

[2]https://learn.thenavisway.com/blog/the-extraordinary-value-of-the-repeat-guest

The example outlined in Exhibit 4 puts this in relatively simple terms for a hypothetical hotel developed based on the Kalibri Labs database. In this example 150-room full-service hotel, a customer who comes in only once contributes a value of the Revenue less direct transaction costs (COPE Revenue or COPE ADR) for that first one-night stay. The differences in ADR and acquisition cost would contribute to determining the value of that guest's stay. However, when a hotel layers in the likelihood of a guest returning through any given channel the value of attracting loyal guests through direct channels becomes even more clear.

In this example, a loyalty member booking through Brand.com will spend slightly more in rate while also tending to stay an additional .4 nights on average. These factors taken together lead to a lifetime value nearly 20% higher for a loyalty member coming through Brand.com. When that same guest is compared against a one-and-done customer coming through a third-party intermediary, the premium jumps to 167% given the increased COPE ADR as well as a higher number of average stays. When the generally longer length of stay is factored into the equation there is even further benefit to business through the direct channels of the hotel.

Not every hotel will see exactly the same results and market and property factors will contribute to these differences. It is important for every hotel to perform a similar analysis to determine its own lifetime value by channel and segment to inform marketing and revenue management decisions.

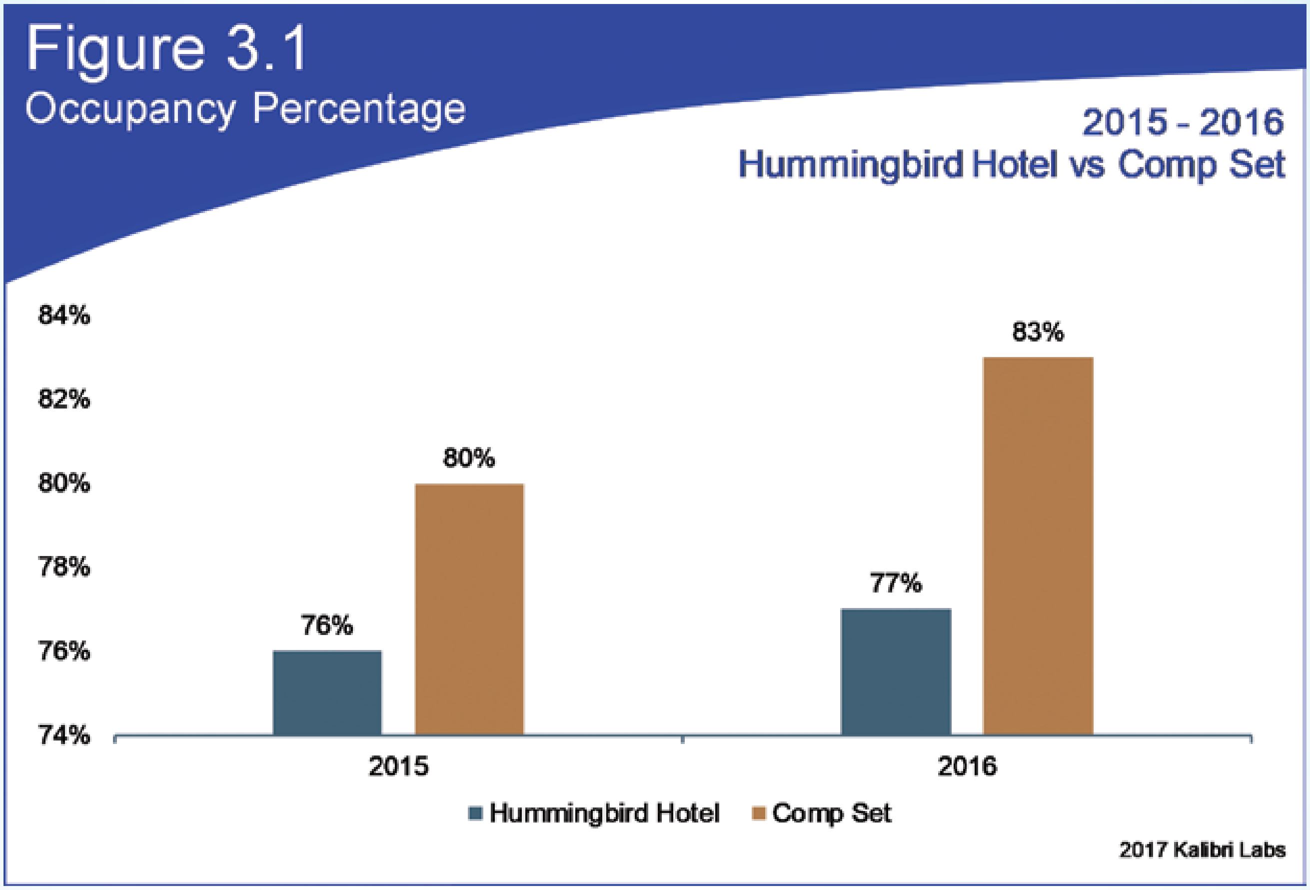
For more information on Lifetime Value Analysis, download the Kalibri Labs Special Report, *Book Direct Campaigns: Costs and Benefits of Loyalty Programs* pages 22-29. www.kalibrilabs.com/bookdirect

Loyalty Member Lifetime Value Analysis

	Brand.com		Voice		GDS		OTA
Loyalty Member?	Yes	No	Yes	No	Yes	No	No
COPE ADR	$160.00	$157.00	$158.00	$165.00	$140.00	$138.00	$140.00
Average Stay Frequency	2.8	2.4	3	2.7	2.5	2	1.2
Lifetime Value	**$448.00**	**$376.80**	**$474.00**	**$445.50**	**$350.00**	**$276.00**	**$168.00**

Case Study 3 – Incremental Occupancy Opportunities

The Hummingbird Hotel, a mid-tier big brand downtown property, had been under-indexed against its competitive set in Net RevPAR two years in a row, driven by an occupancy that was consistently far lower than its competition, demonstrated in the chart below.



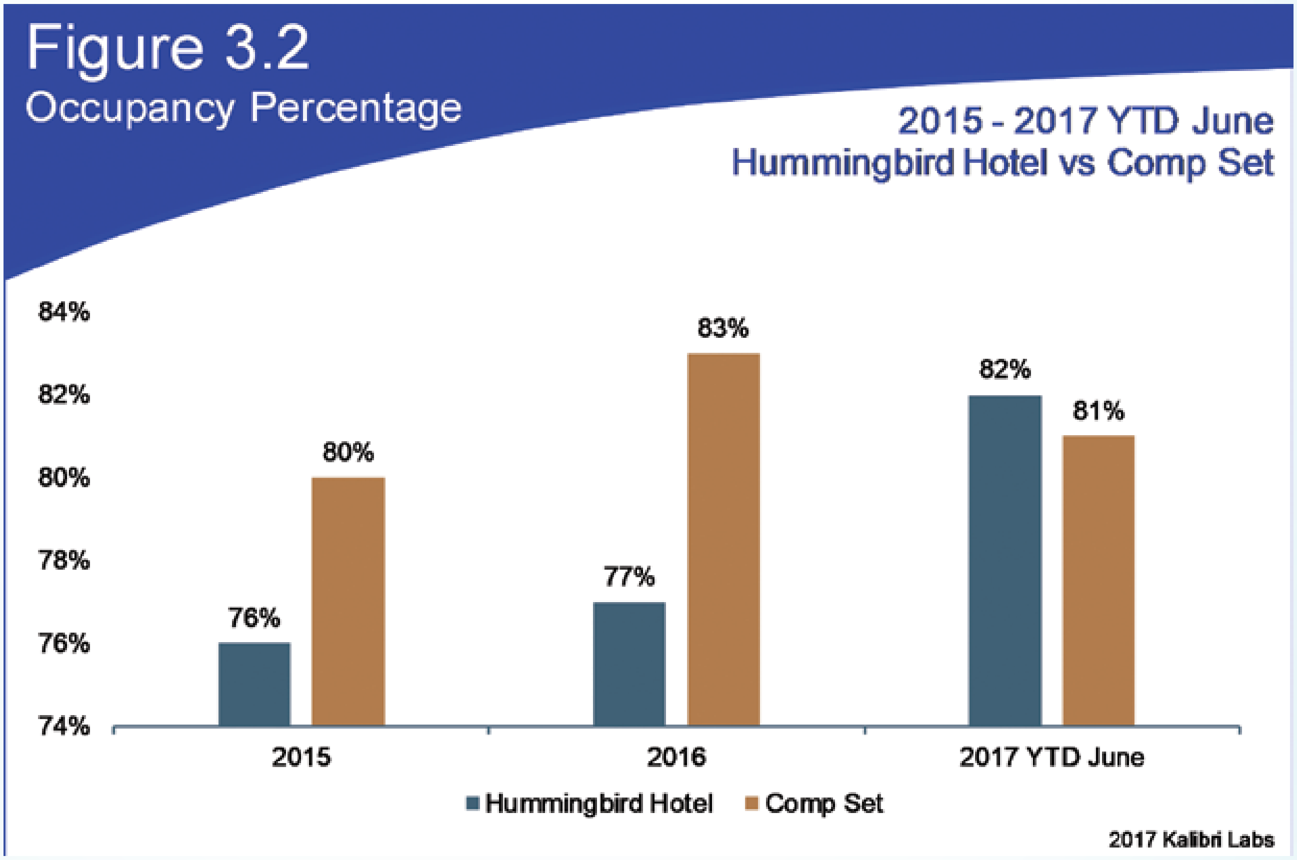
Given that this hotel had a rate premium during 2016, it could potentially have benefited from additional lower-rated business. As such, management began investigating the other business in the market that they could target to shore up the occupancy shortfall.

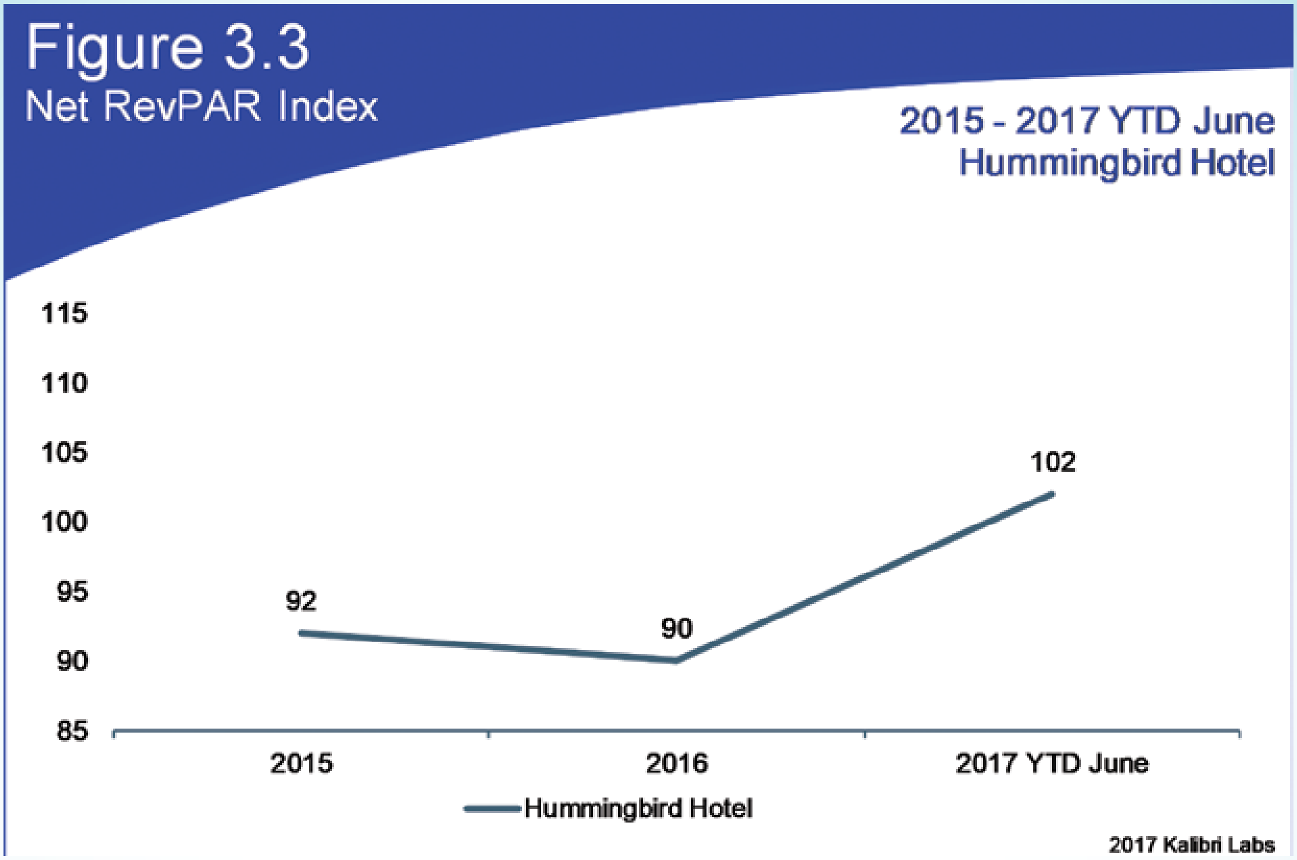
Diving into historical rate category performance in the direct channels, the hotel team found that the property was heavily under-indexed in AAA and Government business. These types of business do not generally drive an ADR premium, but the team had to consider (1) the relatively high COPE %, or profit contribution, for them given that customers booking these rate categories tend to book directly and (2) the fact that the hotel had capacity for incremental room nights.

To test their theory about this business being predominantly booked directly, the team looked at the Source of Business mix for both AAA and Government business in their market. What they found was that, while 30% of AAA and 45% of Government came through the somewhat more expensive GDS channel, the majority of these room nights were being booked through higher profit margin direct channels, i.e. Voice and Brand.com.

As a result, management decided to more aggressively target AAA and Government business in those direct sources. They kept these rate categories open during all time periods and made the options to book these special rates more prominent on their website and within the booking engine funnel. They ran training sessions for their reservation agents in the call center to drive this new strategy of offering those rates when applicable.

By implementing this strategy, they drove incremental room nights, improved occupancy, and saw better Net RevPAR performance compared to the competitive set for the first half of 2017 as shown below.





The hotel team identified a general area of opportunity for the property and directed resources towards it. They were able to evaluate the rate they would retain after acquisition costs for the business they targeted, allowing them to make an informed decision on taking lower rated business that was less costly to acquire. They positively impacted the COPE RevPAR index for the property, driving it above 100 for the first time in three years.

Ancillary Spend Analysis

Many hotels, not only those exclusively in the full-service arena, may have an opportunity to generate additional revenue through 'ancillary spend' by guests. This includes food and beverage, retail, parking, premium Internet, or other recreation outlets like spa and golf, all of which may contribute significantly to overall guest revenue. Hotels will rely on these revenue streams to varying degrees but nearly all will benefit from an internal analysis of the potential ancillary spend by guests from different channels and segments.

Based on analysis of the Kalibri Labs database, it is clear that different booking channels and market segments have dramatically different spending patterns. It's frequently difficult for hotels to accurately catalog and assign this spending to channel and segment but this is an important exercise to support the application of marketing resources and complete the picture of potential guest profitability. Each channel and segment must be evaluated with the potential ancillary revenue in mind.

Full-service hotels will have a large variety of ancillary revenue opportunities available to them while limited-service properties may have a smaller, though still important, set. There are expanded services such as room selection, snack boxes, upgraded amenities, tiered internet access and other similar options for a hotel without significant revenue generating outlets to increase the revenue generated by each guest who chooses to opt into them.

Tracking this spend by channel and segment can provide intelligence to strategically differentiate offerings and price accordingly to attract the types of guests who will add value through ancillary spend.

DIRECT CHANNELS AS A WHOLE, WHICH INCLUDE PROPERTY DIRECT, BRAND.COM AND VOICE, YIELDED $110-125 MORE IN COPE REVENUE PER STAY THAN OTA MERCHANT MODEL AND GDS BOOKINGS, WHICH EQUATES TO A 23-35% DIFFERENCE.

Exhibits 5 and 6 below outline case studies based on a composite of actual hotel data from the Kalibri Labs database in which ancillary revenue

Ancillary Revenue by Channel for Upper Upscale Sample

Revenue Center	Brand.com-Loyalty Member	All Direct Bookings	OTA-Merchant	OTA-Opaque	GDS
COPE ADR	$268	$255	$199	$125	$239
F&B Revenue/Night	$26	$23	$18	$7	$11
Other Revenue/Night	$24	$20	$26	$18	$12
Average Length of Stay	2	2	2	1.6	1.8
Total Revenue	**$636**	**$595**	**$485**	**$240**	**$470**

was calculated by revenue center, distribution channel and segment. This sample provides a guide for a hotel to perform its own internal analysis to drive decision-making.

The analysis in Exhibit 5, based on a sample of Upper Upscale hotels using Kalibri Labs data for 2016 in the U.S., shows that the average booking via direct channels yields significantly more revenue than the OTA-Merchant, Opaque and GDS bookings depicted in the study.

This is driven by a higher COPE ADR along with the ancillary spend.

When Brand.com Loyalty Member ancillary spend is singled out from that group there is a much larger difference when ancillary spend is incorporated. That total difference rises to over 31%. Additionally, this sample of data shows that OTA-Opaque guests spend by far the least amount on ancillary revenue streams in the hotel.

Exhibit 6 below outlines an ancillary spend analysis by channel and market segment for a 2016 data sample of more than 50 full-service upper upscale hotels in the U.S. It is clear that the major market segments for both of the direct channels, Brand.com and Voice, yielded the most ancillary spend per room night as well as the most total revenue, with Voice customers producing $57 of ancillary revenue and Brand.com customers producing $54. Even though OTA customers yielded the third highest ancillary revenue, their overall revenue was the lowest out of all five market segments because of the significantly lower ADR from this channel.

This, much like the other analyses outlined here that a hotel can perform, will inform the decisions made on which types of business to spend money to acquire. If funds are spent to attract and solidify demand that will return several times and spend incrementally more throughout the hotel, that is likely to be a more effective use of funds than a shorter-term effort through a channel where guests are less likely to spend more or repeat. As a hotel assesses the value of each channel and segment, these types of analyses will support more informed decisions.

In considering opportunities to increase ancillary revenue, both full service and limited service hotels have some good options. Snack boxes during early morning or late-night timeframes, premium bath and bed amenities, gift cards, preferred rooms, flexible arrival and departure times, convenient parking spaces, and stratified high-speed Internet access are all examples of ways to improve margins on business through all channels.

Ancillary Revenue by Source of Business and Market Segment

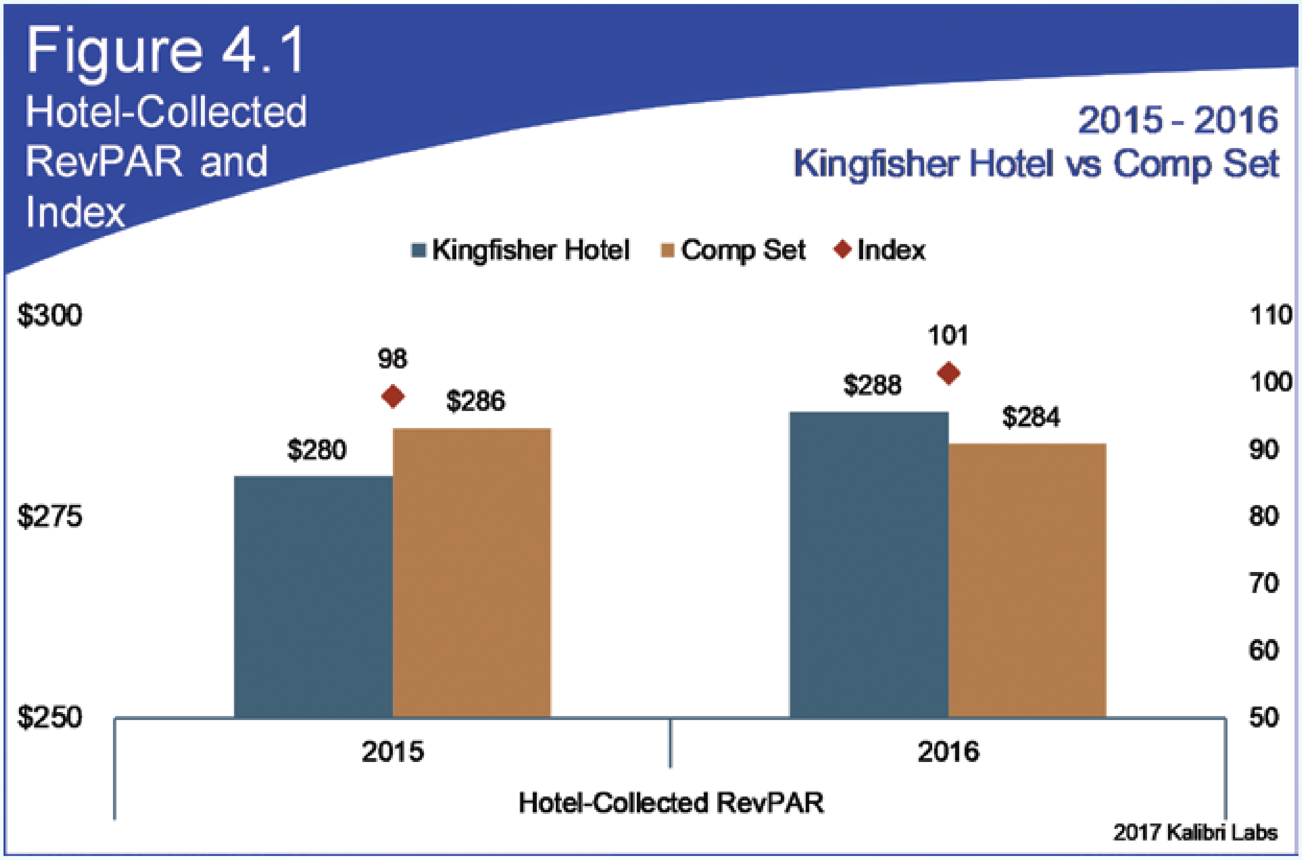
Source of Business	Market Segment	COPE ADR	Total Ancillary Spend	Total Revenue
Brand.com	Transient - Other	$281	$54	$335
GDS	Transient - Corporate	$239	$23	$261
Group	Group - SMERF/Other	$217	$25	$242
OTA	Transient - OTA	$192	$41	$233
Voice	Transient - Other	$282	$57	$340

NOTES

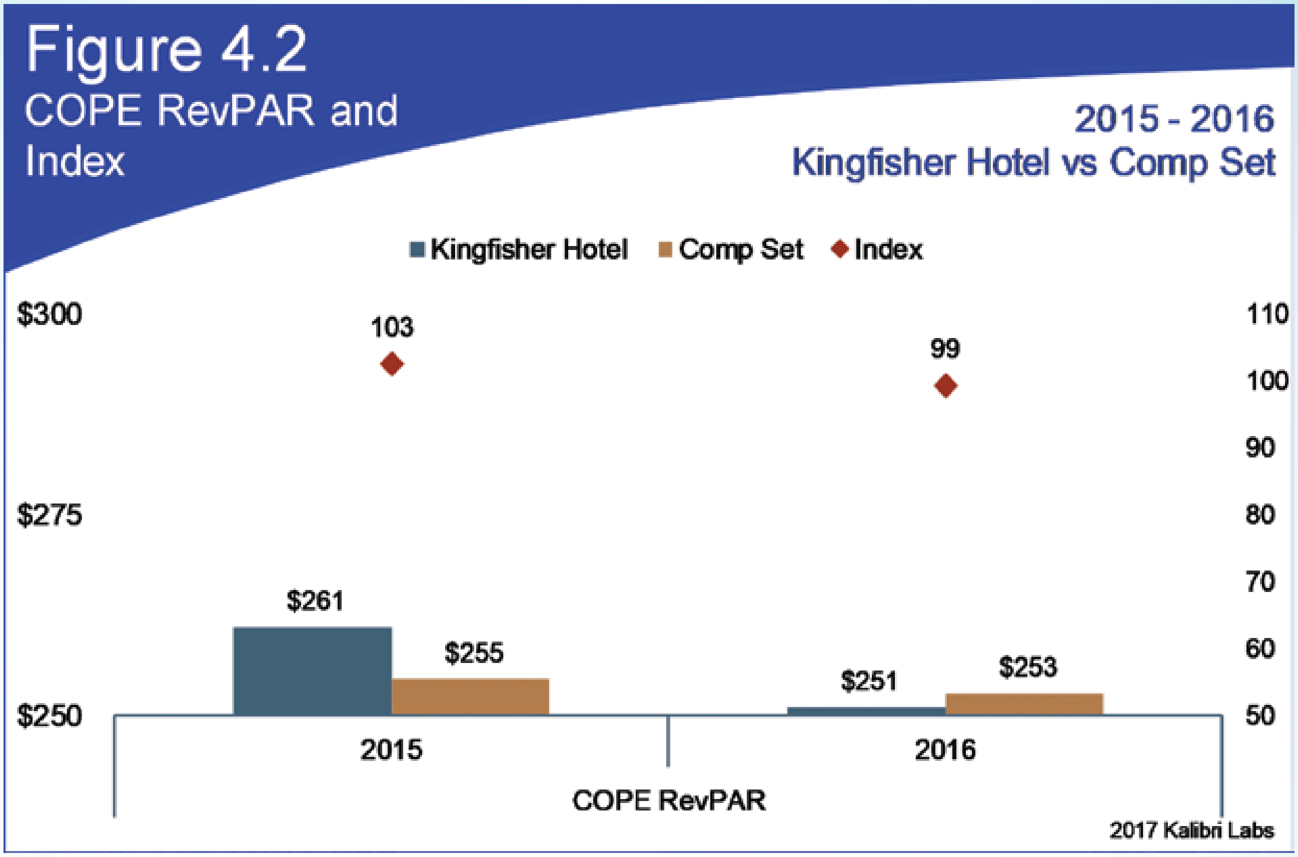
Case Study 4 – Actual Performance Different Than Traditional Metrics Suggest

The Kingfisher Hotel improved its Hotel-Collected RevPAR and Hotel-Collected RevPAR Index in 2016 compared to 2015 and as a result, management believed the hotel had experienced positive growth in their revenue performance. They deployed book-direct promotions, changed over to a newly automated pricing tool and even increased occupancy on shoulder nights.

2016 Hotel-Collected RevPAR showed an $8 increase over 2015 which resulted in a 3% increase in Hotel-Collected RevPAR index.



However, when they looked at their performance on a profit contribution basis by examining their COPE RevPAR, the hotel had declined $10 in COPE RevPAR and had a 4-point drop in index as shown below.



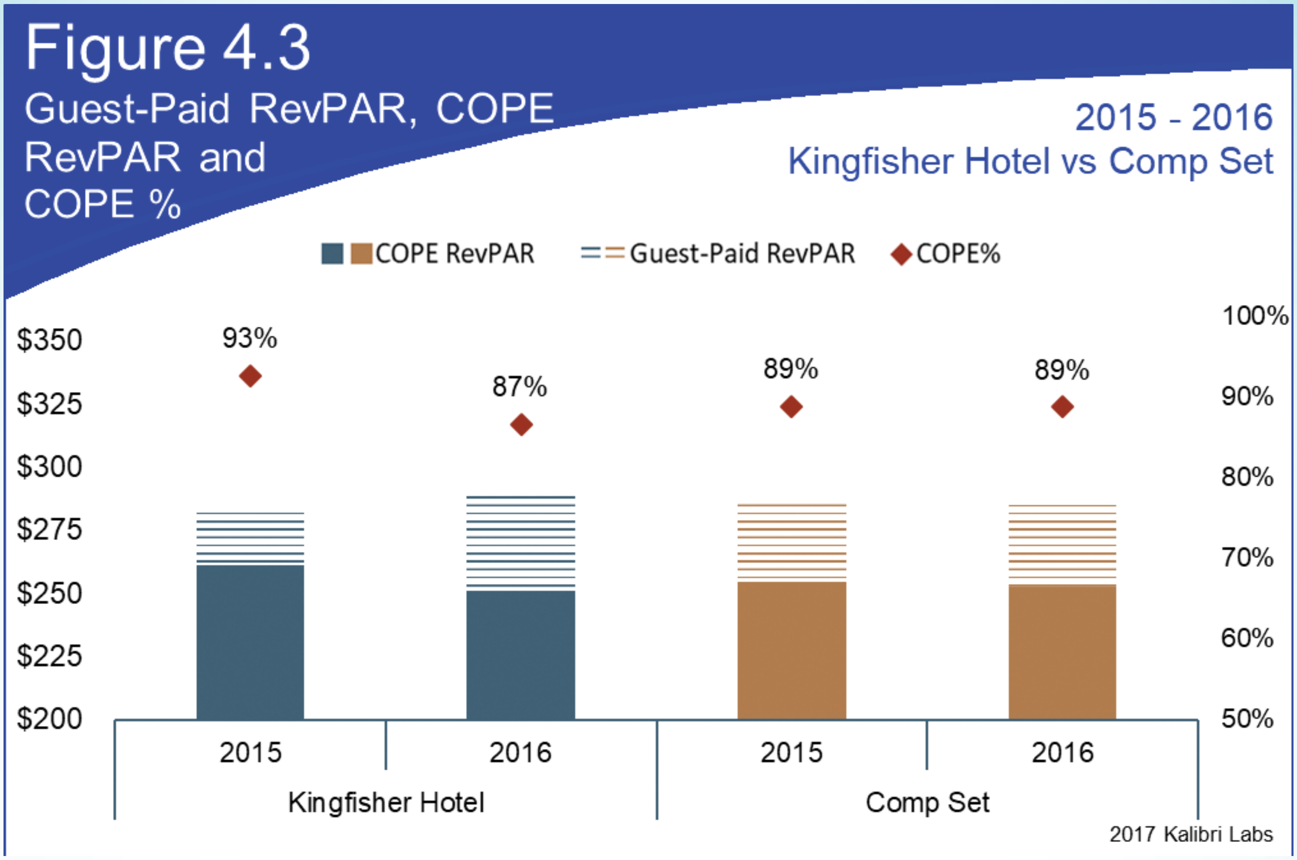
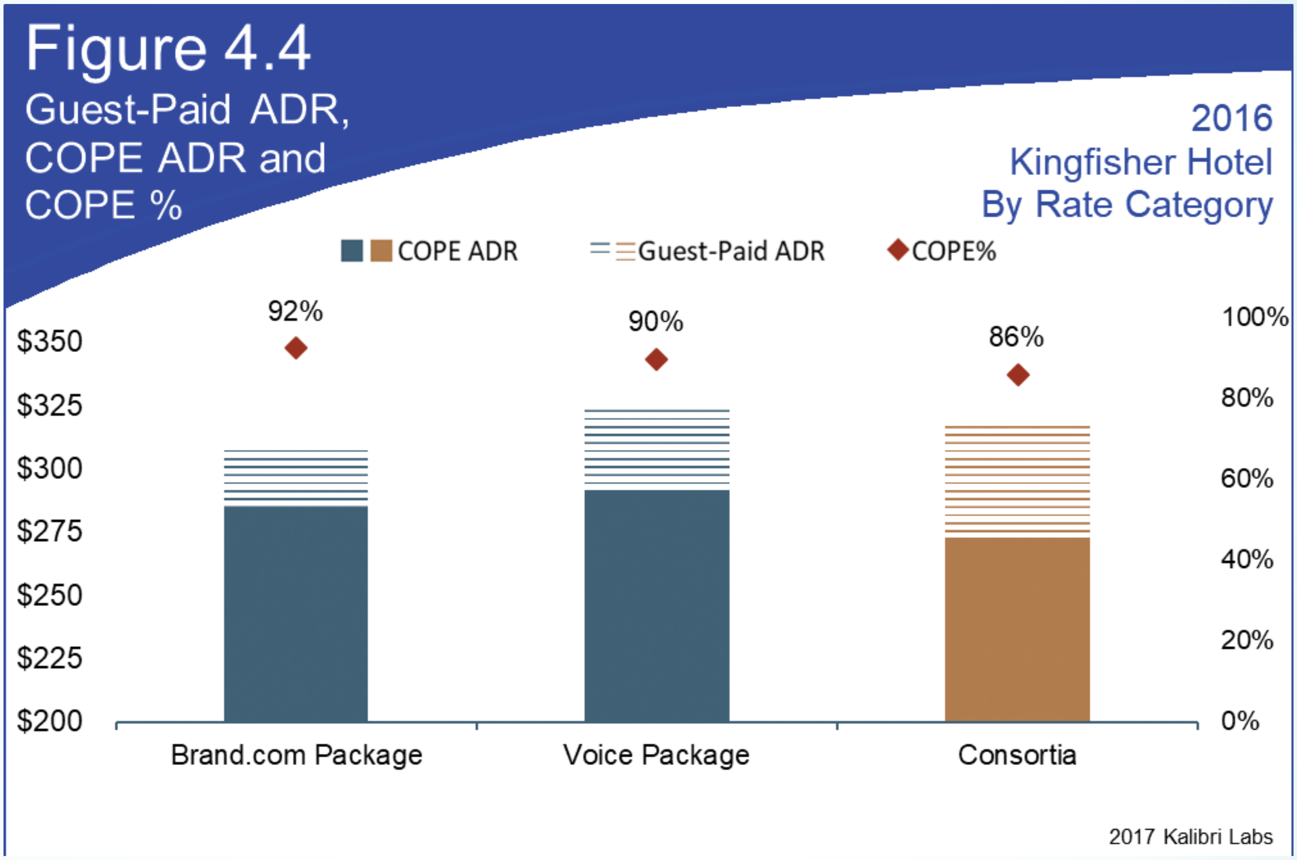


Figure 4.3
Guest-Paid RevPAR, COPE RevPAR and COPE %

Upon further exploration, management found that the percentage of Guest-Paid Revenue they retained after direct acquisition costs were paid, or COPE %, had decreased from 93% in 2015 to 87% in 2016 while the competitive set remained flat, as shown in the chart above. The chart above shows Guest-Paid RevPAR, which measures what guests actually paid to stay at the hotel and includes mark-ups for net rated business along with COPE RevPAR, which measures RevPAR after direct customer acquisition costs are removed, and COPE %, defined above, indicating what the hotel keeps after direct acquisition costs are removed.

They wanted to examine what accounted for this change. After examining the performance by rate category, they found that they had taken significantly more luxury consortia business booked through the GDS as part of their strategy to drive business on what had previously been shoulder nights. The relatively long lead-time on this consortia business resulted in some of the hotel's highly-rated and profitable direct Voice and Brand.com package business to be displaced due to the tendency of those guests to book closer in to their stay.

While the rate for the Consortia business was only 10% discounted to BAR, this segment comes with commissions as well as amenity costs in many cases. So, while management assumed they were filling shoulder nights through this strategy, and expected a rise in COPE RevPAR, they were displacing higher profit margin business in the process.



This strategy resulted in a decreased COPE RevPAR Index in 2016. Upon using the data to illustrate this point, management was able to increase their rate strategy during earlier booking lead times to ensure they were able to leave enough rooms available for guests booking directly closer to dates of arrival with them or cover the increased booking costs of the Luxury Consortia business.

Sales and Marketing Efficiency Analysis

Sales and Marketing Efficiency is a metric that is used to evaluate the efficacy of sales and marketing spend in a hotel. Most sales and marketing funds invested are diffused across multiple channels and this money is often not spent in direct connection with a specific transaction. There is funding necessary to gain or maintain local awareness, build relationships or generate leads, however it is still critical to assess its effectiveness and "right size" the spending level. The sales and marketing funds are often used to maintain a basic foundation of business that comes because of a hotel's brand affiliation, location or local reputation. Sales and Marketing Efficiency measures the ***net* revenue generated for every unit of currency ($1/€1/£1) spent on general sales and marketing** such as payroll, training, social media or other expenses applied across multiple channels. Rather than examining the revenue generated by a hotel at the top line, it is more valuable to remove commissions, transaction fees and other direct transaction costs and analyze the remaining Net Revenue relative to the total sales and marketing spend. This metric helps evaluate how well a management team deploys its sales and marketing investment based on the return they get for each unit of currency invested.

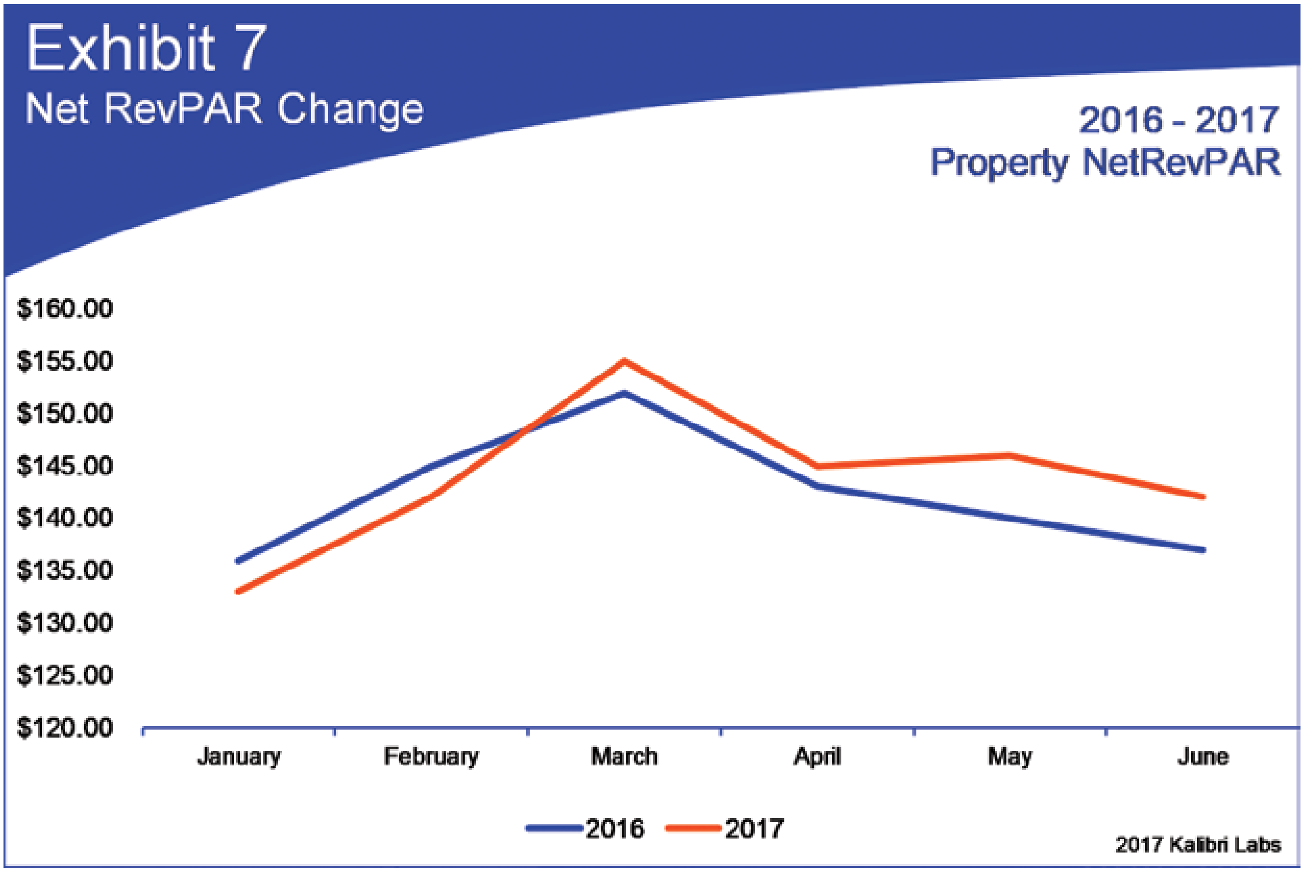
For example, if a hotel invests in a new website and has a drop in Sales and Marketing Efficiency from $12.50 generated for every $1 spent to $8 generated for 3-4 months, one would expect that at some point, the efficiency metric would start to climb back up to the original $12.50 or higher as the return on the website investment is realized. If the hotel never returns to the $12.50 level, one might examine the mix of spending to see if some funds are not being utilized as effectively as possible.

The example analysis below demonstrates how sales and marketing spend and Net Revenue are interrelated over time. The hotel in this example is based on data from the Kalibri Labs database and illustrates how sales and marketing investment can pay off in Net Revenue over time.

The example property in is a full-service hotel with a significant sales and marketing budget. Towards the end of 2016 they conducted an analysis focused on their penetration of corporate negotiated business in their market. What they found was that they were under-indexed compared to their competition and so saw an opportunity to target the negotiated business to generate incremental room nights. The property struggles with occupancy in the spring and summer months and so was willing to take some potentially low-rated business.

To do so they needed to increase their sales and marketing budget to equip the sales team to go after these corporate negotiated accounts. In this case, they decided to add a sales coordinator position to support the larger sales team. With the additional personnel and bandwidth to utilize market data and insights, the team identified 5 key local corporate accounts. These were accounts they were not previously producing but based on their need for incremental room nights they decided to negotiate aggressively on rate given what they knew about the COPE ADR being generated by other competitive hotels in their market.

After implementing this shift the property evaluated the results in a few different ways. The first was to put the changes in the context of the overall performance of the property. How did the Net RevPAR change? How did the property do when all the various customer acquisition costs are considered? Exhibit 7 illustrates the property's Net RevPAR for 2016 versus 2017. At the highest strategic level, the property was able to grow Net RevPAR for most of the year to date in 2017 compared to the prior year. The high-level results of their effort were positive.



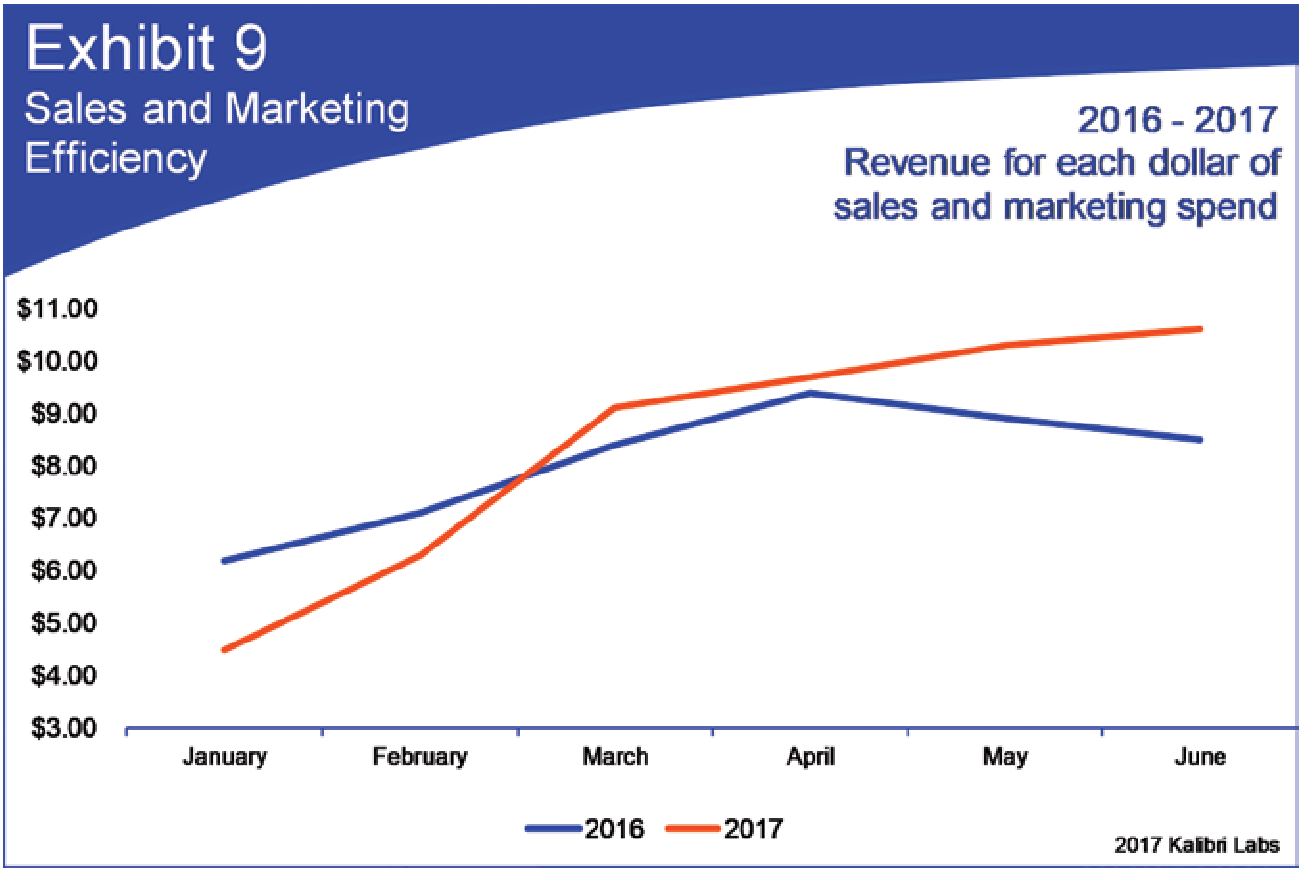
The second method was to look at how they were indexing, in terms of Cope RevPAR, for the agencies they targeted. How had their efforts paid off? Exhibit 8 shows how the COPE RevPAR indices for the 5 target agencies changed from year to year over the same six-month period. The property was able to increase their share of business from those agencies by aggressively targeting room nights and negotiating on rate.

COPE RevPAR Index by Year (January through June)

	Account A	Account B	Account C	Account D	Account E
2016	87	54	65	82	37
2017	95	79	110	105	85

The final method is illustrated in Exhibit 9 where the property looked at their sales and marketing efficiency. Now that they were spending more in sales and marketing expense, were they effectively using those additional dollars? What becomes clear in this analysis is that it takes time for sales and marketing efforts to pay off. When compared to the prior year, the property started off generating less net revenue for each dollar of sales and marketing spend but as the tactics put into place bore fruit this metric grew over time.

Each hotel must perform its own analysis with these figures and make note of the marketing campaigns and other periodic investments it makes beyond the routine spending. With historical views, future performance can be layered and measured against what was achieved in the past to measure progress.



Optimal Business Mix: Planning and Executing

Every hotel has an Optimal Business Mix. Establishing a target for the revenue streams and costs needed to achieve the Optimal Business Mix is the key to a hotel's success in the digital market. This is the ideal mix of business that results in the optimal net revenue for a hotel or the optimal amount of revenue net of customer acquisition costs (which can be similar to a hotel's Gross Margin). From the Optimal Business Mix targets comes a realistic revenue roadmap for a hotel. A management team that has a good handle on its Optimal Business Mix is one that will also manage effectively both (1) the revenue and (2) deployment of the funds to achieve that revenue.

In order to determine what is optimal, one has to take into account several factors.

- the demand available in a market
- a hotel's ability to tap that demand relative to its competitors,
- the property's physical configuration such as meeting space/guest room ratios, amenities and condition of the physical plant
- brand strength/loyalty contribution
- consumer perception of a subject hotel and its competitors

Realistically, a hotel with a brand flag (and this varies quite a bit by brand and location), will receive 30% to 70% of its business from the "mother ship" through group leads, central reservations, corporate promotions, national account production, loyalty programs and other brand-sponsored programs. Most hotels still have to fill the rest by closing on the leads in their local/regional markets or through local initiatives. Loyalty contribution in a chain hotel may be as much as 60% of its room nights but that raises the question as to what the individual hotel can do for retention of the rest of its customers. For independent properties, they may get some lift from affiliation to reservation or sales consortiums, but most of the time, they source 50% or more locally.

DEMAND GENERATORS—PIECING TOGETHER THE PUZZLE OF DAILY BUSINESS

Given that 30% to 70% percent of the business (let's call it 50% for the purpose of discussion) is the local hotel's responsibility, even with the help of a strong brand, getting half of the business requires some promotional and sales savvy.

- A full-service hotel with diverse demand streams may have enough meeting space to fill a big part of its share of the occupancy pie with local groups, meetings, and citywides, then it may only have another 25% to fill with the amorphous unmanaged corporate or transient segments. Select service hotels may still tap the meetings market at a smaller scale or through the social categories such as sports, military, educational, religious and fraternal types (SMERF). These efforts have to be as targeted as possible.
- Sales calls to local corporate accounts can fill part of it, provided this type of business exists in a market, and that a hotel has suitable facilities for it. In an attempt to provide as much of a hotel's business as possible, brands and reservation representation firms are building their infrastructure to step up qualified corporate traffic. Concurrently, online travel agencies (OTAs), Airbnb and travel management companies (TMCs) are all working hard to persuade small-to-mid-sized corporate accounts to use their inventory. This may add risk of diverting those accounts through these channels that may either reduce demand for hotels or raise the cost of acquisition. Getting local accounts to book directly is almost always the preferred path.

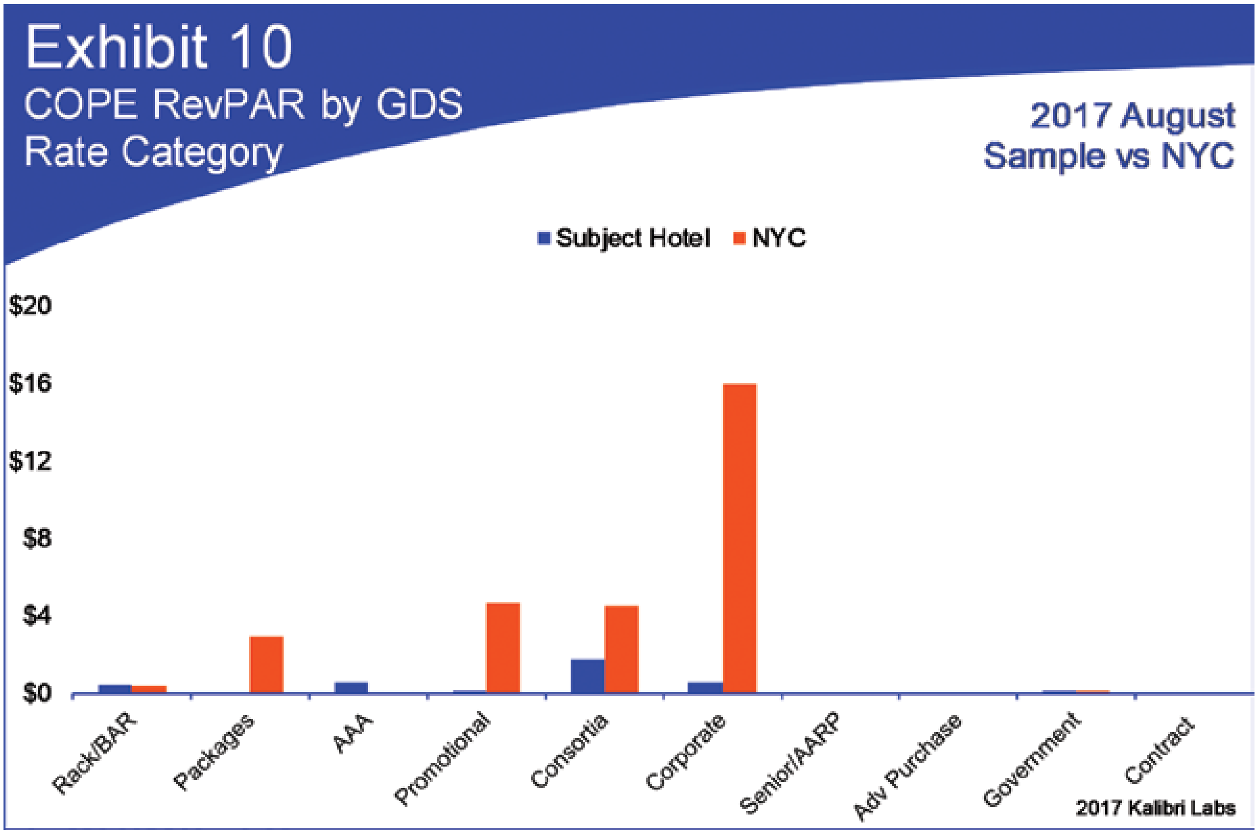
What about hotels without meetings or corporate potential? Where do they turn for more high-value business?

- There are dozens of gateways to local demand such as destination marketing organizations (DMOs)/convention and visitors bureaus (CVBs), local attractions, cultural/music and arts venues, parking facilities, universities, sports teams, regional festivals and travel industry employees coming to the hotel's destination. A hotel can tap into social media about local activities including nearby sports, recreation, cultural arts and travel inspiration sites with destination coverage and potential visibility to a local or regional audience.
- There may be government business, auto club/senior programs (e.g. AAA/AARP), promotional and advanced purchase business or local corporate business for which a hotel has not actively participated. Knowing what is available in the market is critical to sourcing the right mix.

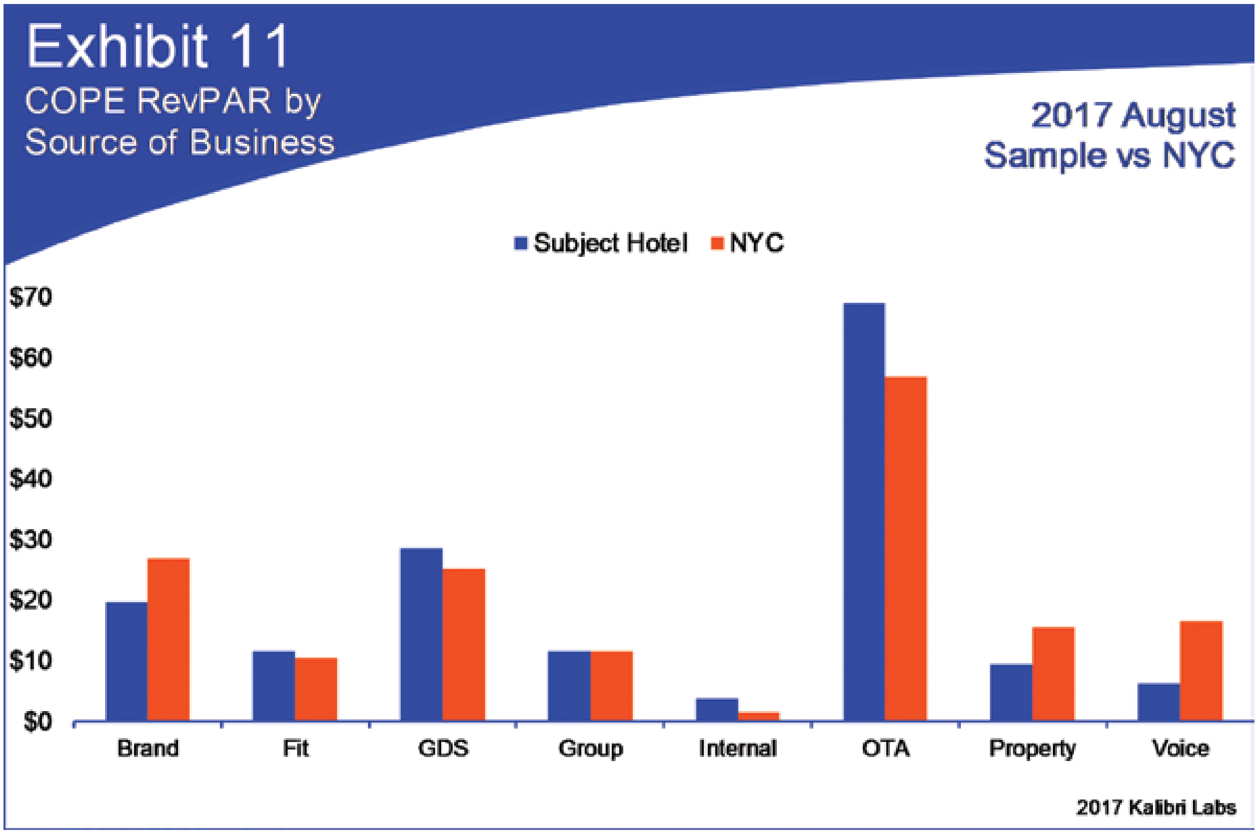
  Brainstorming a list like this may reveal a few demand streams that could fill some need periods at good net ADRs which means reasonable rates with acceptable distribution and promotional costs. While the dominant channels in a market certainly provide the easiest levers to pull, seeking and testing all appropriate sources in a marketplace can yield a healthy mixture of sources of business. It is the responsibility of the hotel team to find all the options in the marketplace, assess whether they are under- or over-indexing on the available demand drivers and after determining that they yield a desirable net revenue, build a tactical plan to pursue a short list of targeted opportunities.

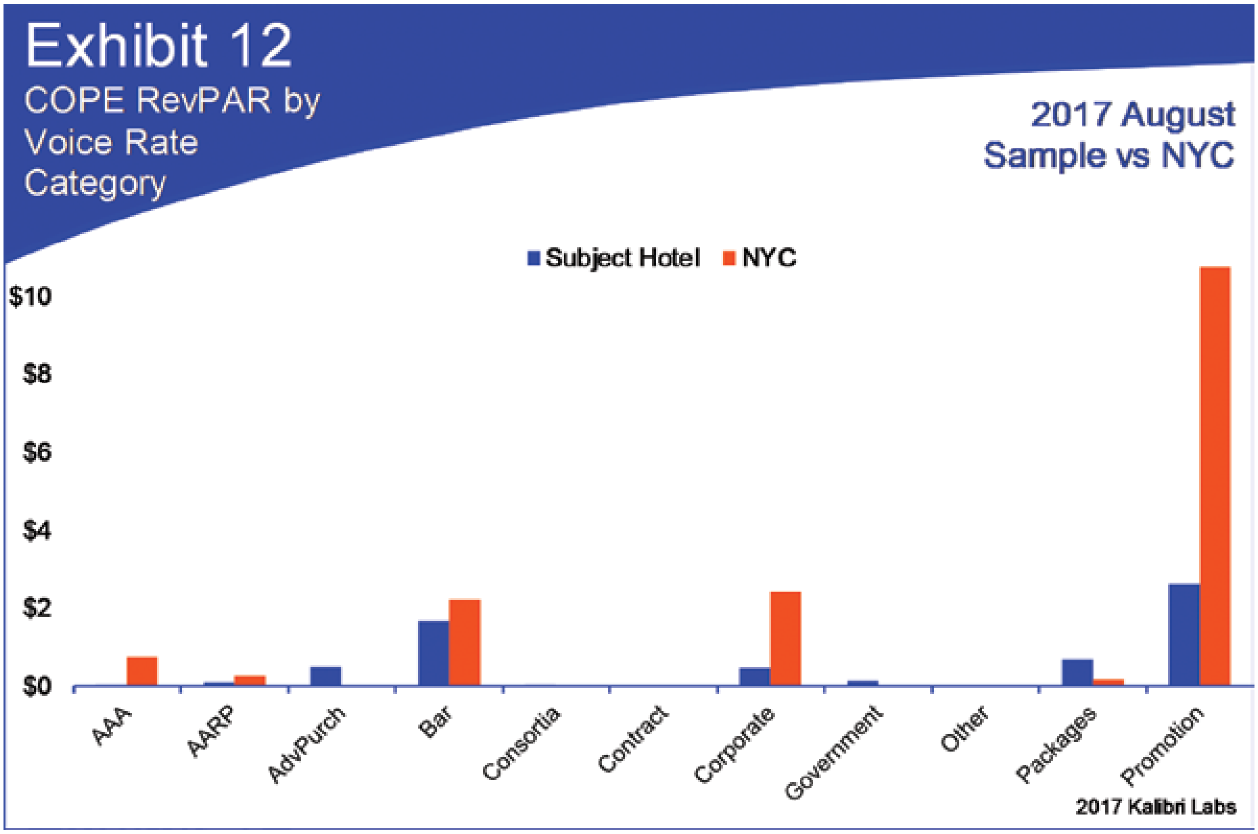
In the example below a property is significantly under-indexed in Corporate and Consortia business coming through the GDS compared to its competitive market. Using this market intelligence, it appears there is untapped demand for this property in those segments. The hotel team can evaluate the available net ADR through each customer segment to determine if it's an opportunity worth pursuing in terms of its contribution to profit.

The blue bars represent the sample hotel based in New York City and the orange bars represent the whole New York market for that chain scale. COPE RevPAR and COPE ADR in the chart below represent those metrics net of direct customer acquisition costs.



In addition to identifying opportunities for third-party business, it's important for a hotel to take a critical eye to its direct channels. The example below shows a property that is over-indexing through the OTA source but underperforming in direct sources. It's clear that this property has opportunity to grow its direct sources based on its benchmark group. The second chart goes into detail of how to obtain that business, there's a clear opportunity to build promotional rates and alter the Voice sell strategy to capture some of the additional business in the market. Additionally, there's opportunity to drive Corporate business as well as special rates such as AAA through the Voice source.





Comparing a Subject Hotel Against its Competitors in the Market

These are some questions that a hotel team can address to ensure they have examined every opportunity in the quest for profitable bookings.

- Is the hotel getting a reasonable share of the brand.com business coming into its marketplace? i.e., is it getting at least the average of what other hotels are receiving?
- How does one hotel's online content compare to each of its competitor's? Is it more compelling?
- Do consumers find one hotel's website meets their needs better than its competitor's?
- Does it know which digital venues or communication vehicles are triggering the bookings?
- How about its "voice" or call center business — how is it performing relative to others in its market?
- What is the consumer perception of one hotel over another?
- Are the channels a hotel chooses to sell through ones that are frequented by guests that are a good fit for its product?
- Beyond revenue and cost, what is the impact on the hotel's brand (whether it's an international brand, regional or an independent) to be present in a particular channel? This can cut both ways.

  Selling a line of clothes in Saks Fifth Avenue gives it prestige and panache, while having that line in Walmart says it is acceptable for the "regular Joe."

CONVERSION AND RETENTION

Although most hotel marketing tends to focus on building traffic and acquiring new business, the companion disciplines of conversion and retention also play a role in a hotel's results. Since there is limited incremental demand in the U.S. lodging industry, and the demand is not highly "elastic" (i.e., consumers are not likely to purchase more rooms when the rate is lower) a hotel performing optimally will recognize that any traffic that comes its way, through any channel, is limited and is a hot target for its competitors, and, therefore is highly valuable.

Conversion

- Is the hotel doing the best job possible to convert the traffic that flows through existing channels?
- Are call center and website conversion rates being tracked?
- Has content in each channel been systematically reviewed for its success in aiding conversion, such as the website, scripts in the call center and text in the GDS systems
- Are the funds being spent on cost-per-click or cost-per-acquisition campaigns worthwhile given the conversion rates?

- Are adequate resources being used toward improving conversion?

Retention

- Are retention programs growing and productive, whether it is a brand loyalty program or a local version used for non-loyalty members, recognition-based or in an independent setting?
- Are social media channels being tapped to heighten engagement?
- Are marketing resources being used for improving repeat business or referrals?
- Are there strong incentives for guests to return to a hotel or to the brand beyond discounts or other pricing offers?

A discussion on how marketing resources are deployed would be useful in the context of setting goals for Optimal Business Mix. There are many channels and limited time and money to address them all. Priorities have to be set and a timeframe placed on each element of a revenue strategy to achieve the Optimal Business Mix. Each hotel's decision about its allocation of resources toward acquisition, conversion and retention may depend on the support it gets for each of these from a brand for chain hotels and sales or marketing affiliations for independents.

Determining an Optimal Business Mix is about the relative net benefit of each channel given its corresponding cost. Since most channels serve some combination of booking, informational and promotional role, deciding which yield the best results may depend on the hotel's need for it to support its goals for acquisition, conversion or retention.

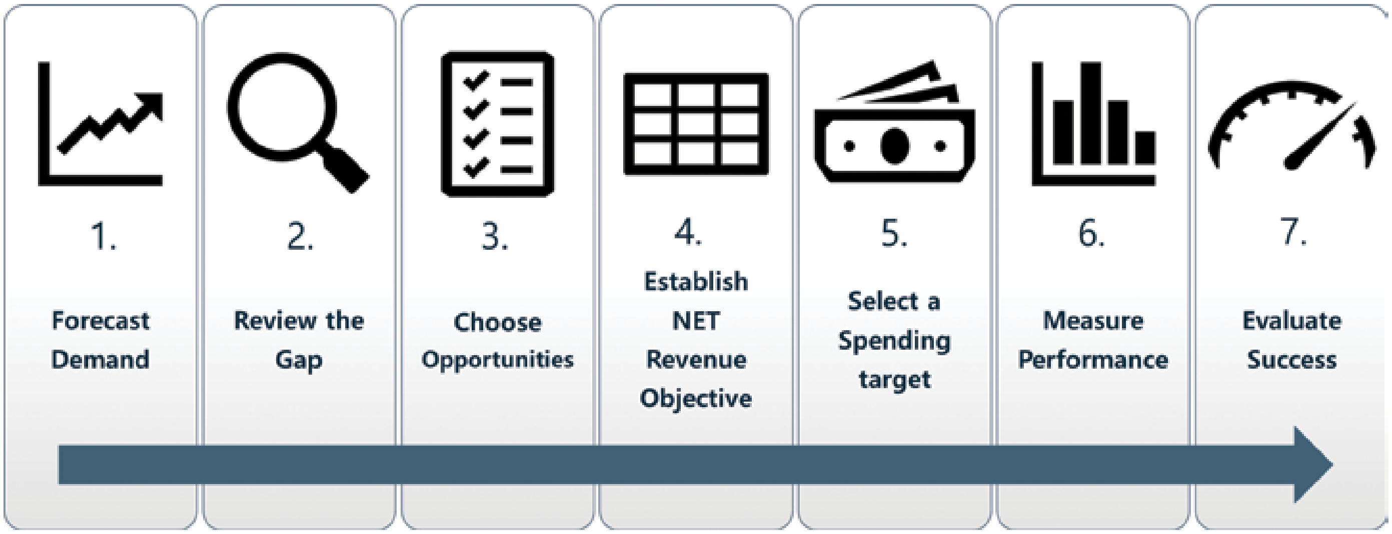
DETERMINING THE OPTIMAL BUSINESS MIX

Based purely on a cost-per-channel assessment, a hotelier might want to fill up on Brand.com and Voice (through call centers) but, realistically, most hotels will fill with a mixture of demand from all channels. When hotels choose a Net Revenue target built on room night and rate objectives by channel and customer segment, the costs associated with generating that business is baked into that plan since the costs for each channel are generally known.

For many hotels, the old adage that "you can't control the channel a customer uses" lead management to be passive about how to approach their market. Some decisions were made by random influences like which third party vendor pushed hardest and argued their channel is best for the hotel. Targeting top line revenue targets sometimes leads to high revenue but limited flow through.

Net Revenue targets calculated from the Optimal Business Mix would be an ideal basis for management's bonuses or incentives and would mean a hotel owner is paying for what they want, which is optimal profit contribution. For a hotel to improve its profit levels, it has to establish clear goals by channel and rate category. A hotel team needs to quantify the Net Revenue from a hotel's existing business mix by examining costs and revenue from each channel and rate category. Once it has, then make some decisions about setting targets for its Optimal Business Mix.

OPTIMAL BUSINESS MIX SCHEMATIC



(1) Forecast demand for each source of business available to a hotel
(2) Review the gap between the subject hotel and a reasonable market share for each demand driver
(3) Choose the most promising opportunities and quantify them so the results can be tracked
(4) Establish a Net Revenue objective for the desired Optimal Business Mix
(5) Based on the targeted mix, establish a spending target for both booking costs and sales and marketing costs to achieve the mix
(6) Measure performance against the Optimal Business Mix by channel, rate category and specific opportunity to grow market share.
(7) Evaluate where the hotel was successful and where there is room for improvement to enable a gradual improvement in Net Revenue and Revenue Capture.

Wishing for a higher percentage of high profit margin business is not productive if the demand for it in its market is not there. However, if demand exists in profitable channels and the hotel is not poised to take advantage of it, there could be a lot of money left "on the table." A proactive approach to revenue strategy will ensure that a hotel is aware of the business available net of acquisition costs and has a plan to pursue the mix that is both realistic for it to acquire and yields the highest net revenue possible.

However, if demand is meager from high-profit channels, and the lower rated business spigot is running, a hotel should tap into this stream as long as it can justify that it makes some profit on every booking. Taking it on the top line with limited or no flow-through to the bottom line is not a sustainable method, even if it covers operating cash flow requirements in the short term.

It's All About the Costs, Or Is It Really about the Profit?

Determining an Optimal Business Mix is not about cutting out third party business and taking it all direct; it is about getting a mix of business that is most profitable given the constraints in the market. Some third-party volume may prove more attractive than direct depending on the costs to acquire it and on what is available. Naturally, channels vary in profitability, but it is not advisable to accept business through a channel that contributes no profit. If a channel brings consumers that may return or spend more money in high profit ancillary revenue centers, it may be worth paying more to bring them the first time. This concept is sound as long as a hotel can prove that customers come back and that they spend enough money in revenue centers beyond the room rate to make it worthwhile to incur the high acquisition costs. "Hoping it will work out" is not a viable strategy nor is saying these are the "costs of doing business." Labor costs are a cost of doing business, but everyone agrees they need to be systematically managed and, at 15-25% of guest-paid revenue, so do customer acquisition costs.

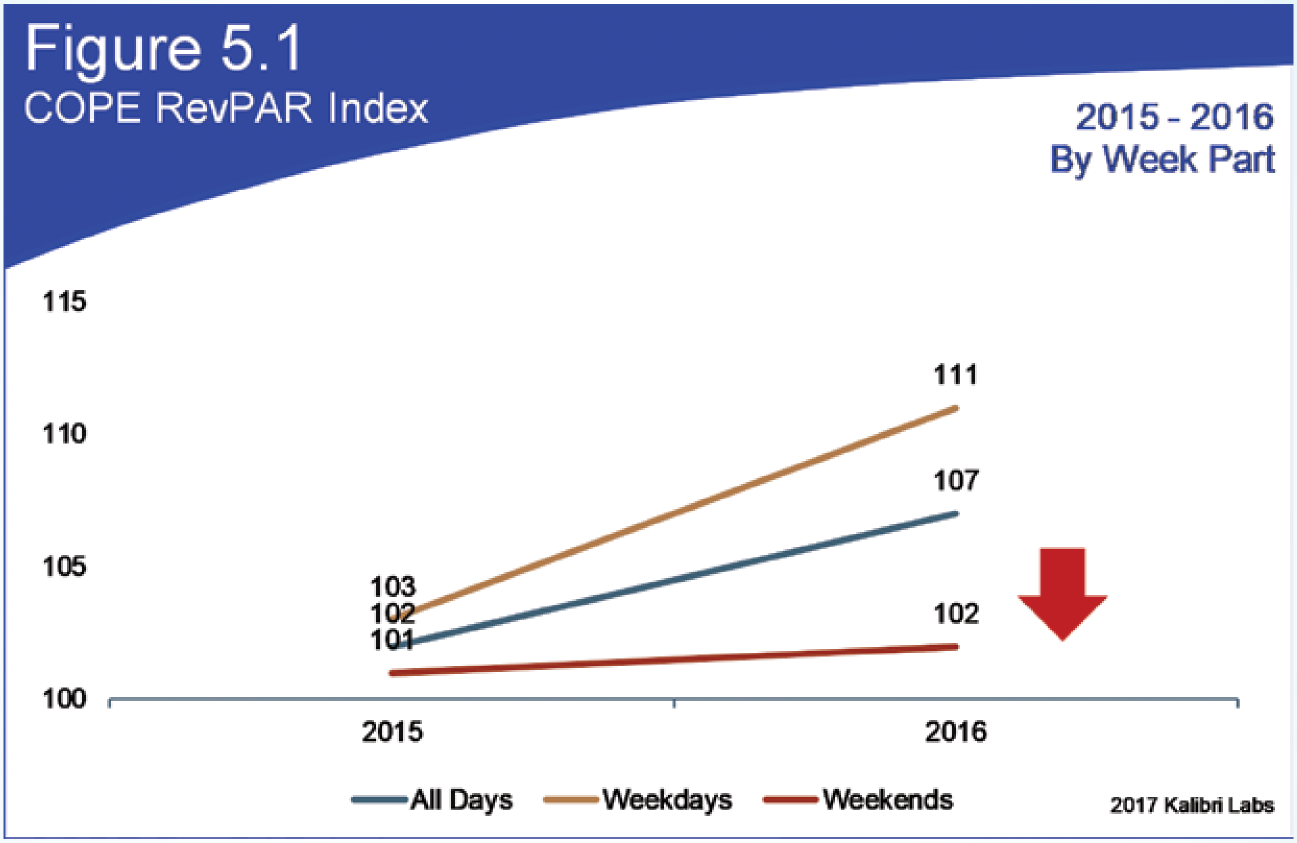
IMPROVING PROFIT MARGINS

SOMETIMES YOU CAN'T INCREASE DEMAND BUT YOU STILL WANT TO IMPROVE YOUR PROFIT MARGINS. WHAT ARE YOUR OPTIONS?

- INCREASE CONVERSION ON THE DEMAND YOU GET
- STEAL FROM COMPETITION
- MOVE FLEXIBLE DEMAND FROM ONE TIMEFRAME TO ANOTHER
- SHIFT YOUR BUSINESS MIX TO GET A LARGER PROPORTION OF HIGHER PROFIT MARGIN SOURCES OF BUSINESS

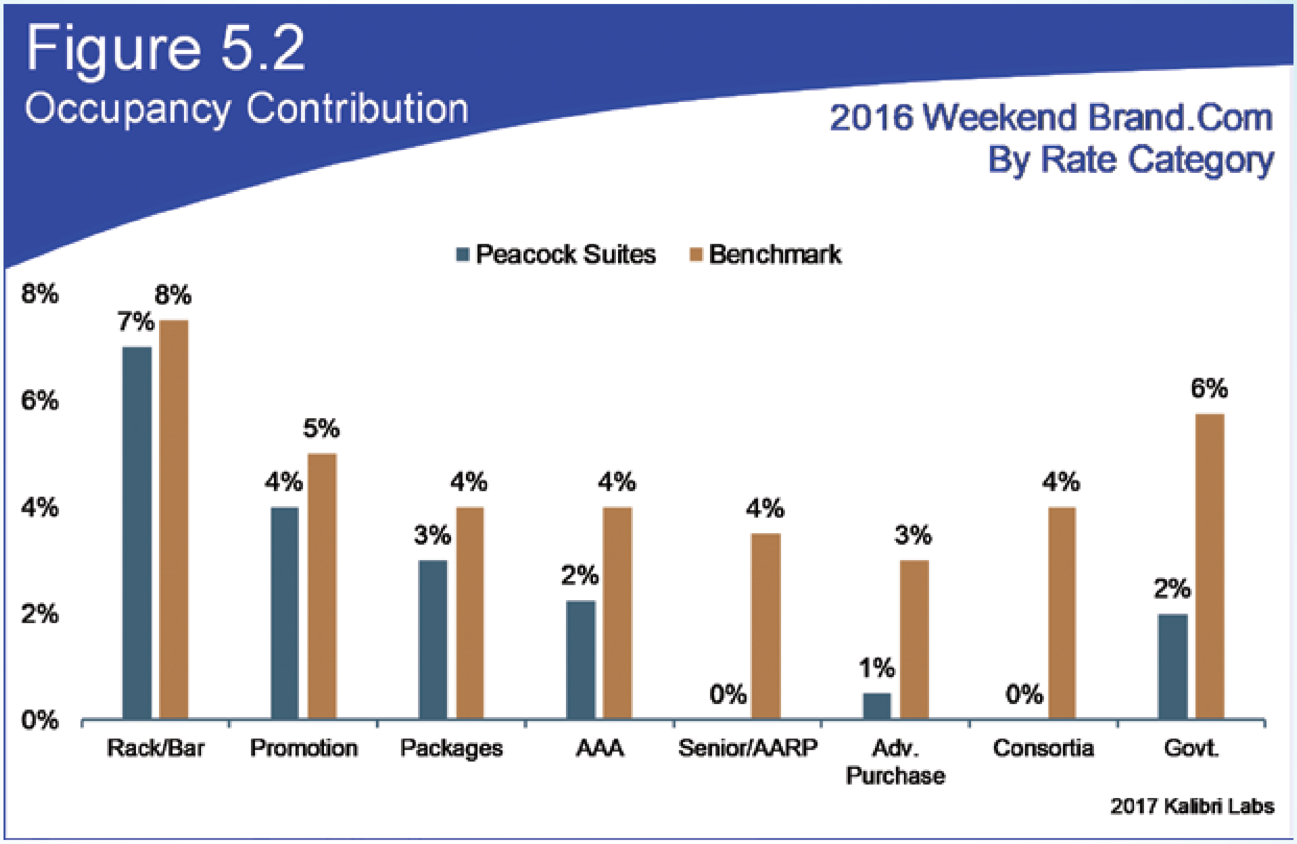
Case Study 5 – Incremental Weekend Opportunity Based on Profit Contribution

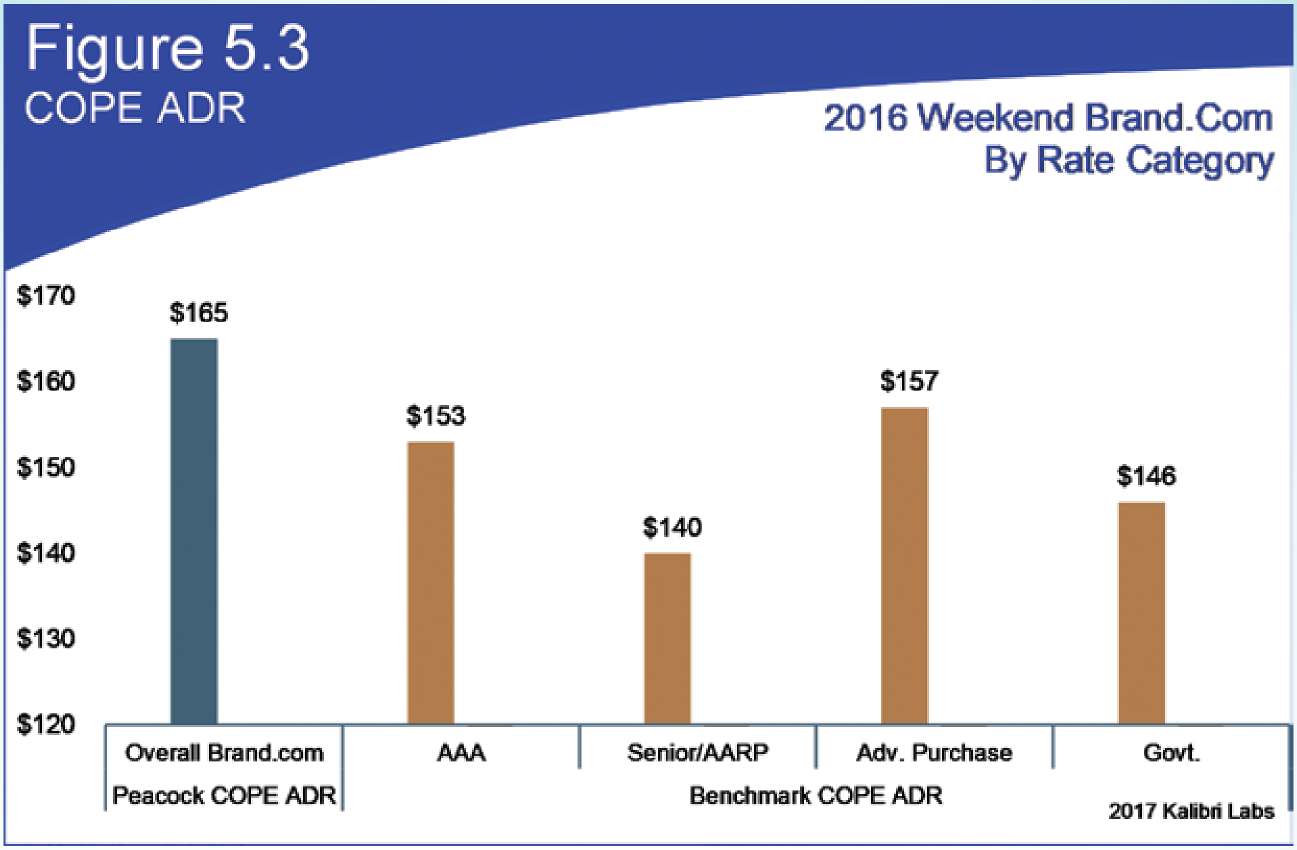
The Peacock Downtown Suites hotel team planned and executed a strategy to continue performing above fair share in a changing market throughout 2016. This strategy focused on improving weekday production and resulted in a COPE RevPAR Index increase from 102 to 107 in 2016, as shown below. This strategy was effective at driving their COPE RevPAR index even higher than before, but when broken out by week part, it appears weekend business remained relatively unchanged.



The difference in the hotel's performance by week part, exhibited in Figure 5.1, prompted management to investigate how they could maintain their strong weekday performance but also drive incremental weekend business to improve their total COPE RevPAR further.

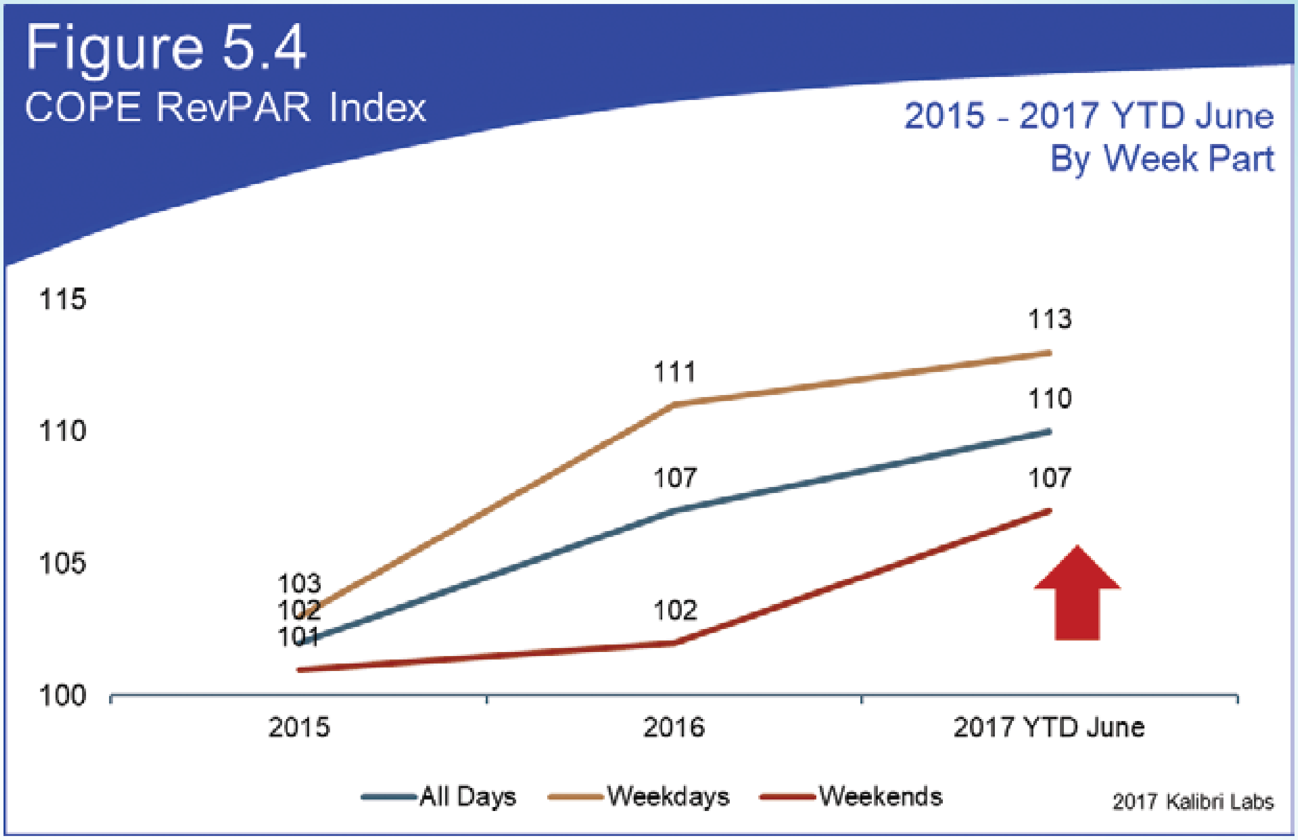
Hotel decided to evaluate their Brand.com performance, compared against their competitive benchmark group, to see if there were any direct business opportunities in the market that they were missing.





Based on the above weekend segment breakdown, which examined the occupancy contribution by each segment within Brand.com, there were a few clear opportunity areas for this property. The management team looked at the COPE ADRs of the segments that presented the most opportunity, specifically leisure-oriented AAA, Senior/AARP, Advance Purchase as well as Government.

Using the chart above, they narrowed Advance Purchase as their most profitable opportunity area. They would continue their weekday strategy, but bolster overall performance by aggressively building out Advance Purchase rates for weekend business, to drive incremental nights and shift share.



Using that strategy, the property was able to continue strengthening weekday COPE RevPAR index as well as drive significant gains on the weekends. They recognized the different tactics that they would need to implement to drive profitable business during different week parts. As of mid-year 2017, the property was able to achieve a 110 COPE RevPAR index by adjusting their tactics to target weekday and weekend business separately.

NEXT-GENERATION COMP SETS AND CHANNEL OPTIMIZATION

Hotels compete with different properties for each segment of the market: corporate, government, retail, AAA, AARP, retail groups, corporate groups, etc. The concept that a hotel competes with the same set of properties for all the market segments is rarely accurate. The reality is much more complex and requires a deep understanding of the demand drivers in each market. Additionally, not all hotels compete equally for a given market. A "group" hotel may compete for some group demand with hotel A but more with hotel B. Therefore, considering competitors A and B equally for performance indexing would be far from reality and potentially misleading.

Traditionally, hotel properties have selected their competitors, and adjusted their pricing strategy based on the factors below which reflect their own perception of the market dynamic, even when the nearby properties have substantially different mixes of business or may vary in other salient ways such as brand strength or guest room to meeting room ratios.

- Proximity to my property
- Proximity to demand generators
- Chain scale / overall quality of the competitor vs. my property
- Price proximity

Data-driven outcomes such as correlation of demand patterns, consumer reviews, and overall business mix are more reliable factors to truly find out the level of competitiveness between two properties than most factors perceived by properties. These data-driven factors also may vary based on market segment. For example, room-quality and convenience tend to be more relevant for corporate and government segments, whereas facilities and proximity to certain locations or attractions are usually more important for group/meetings segments. Additionally, rate tends to be more important for the more price-elastic market segments, such as retail segments.

We can establish and achieve our optimal business when we know:

1. with which properties a hotel is competing by segment and by weekpart
2. which demand drivers exist in the market and what is a hotel's current share of it

The ability for a hotel to reach its Optimal Business Mix is also dependent on its position in the market place. A hotel with less experienced staff, poor service, or inferior facilities will have a harder time reaching its objectives compared to a hotel that is viewed more favorably by consumers. This varies by segment, naturally, and it is why consumer review data is critical to understand the ability for a hotel to reach optimal performance.

Business Mix Optimization

This case study seeks to outline the value of setting a benchmark based on a hotel's own Optimal Business Mix as opposed to measuring itself against a simple average of its competitors' collective performance.

Instead of benchmarking against the average of five or six hotels—who may or may not be good operators or even fully comparable—a hotel may find a more accurate target when it benchmarks against its own optimal—the best that the subject hotel can achieve. Performance from 12 or 20 hotels may be considered—but instead of looking at the competition in total, hotels would only look at the segments of that business they compete on—leisure, group, corporate by weekpart—to come up with a more accurate benchmark to evaluate performance.

- What are the rates and room nights available?
- What is your ability and your competitor's ability to tap that demand.
- What do consumers say about you and what do they say about your competitors?
- How well suited is your product to the demand that exists in the market?
- What is the base of your demand that comes through loyalty or recognition programs?

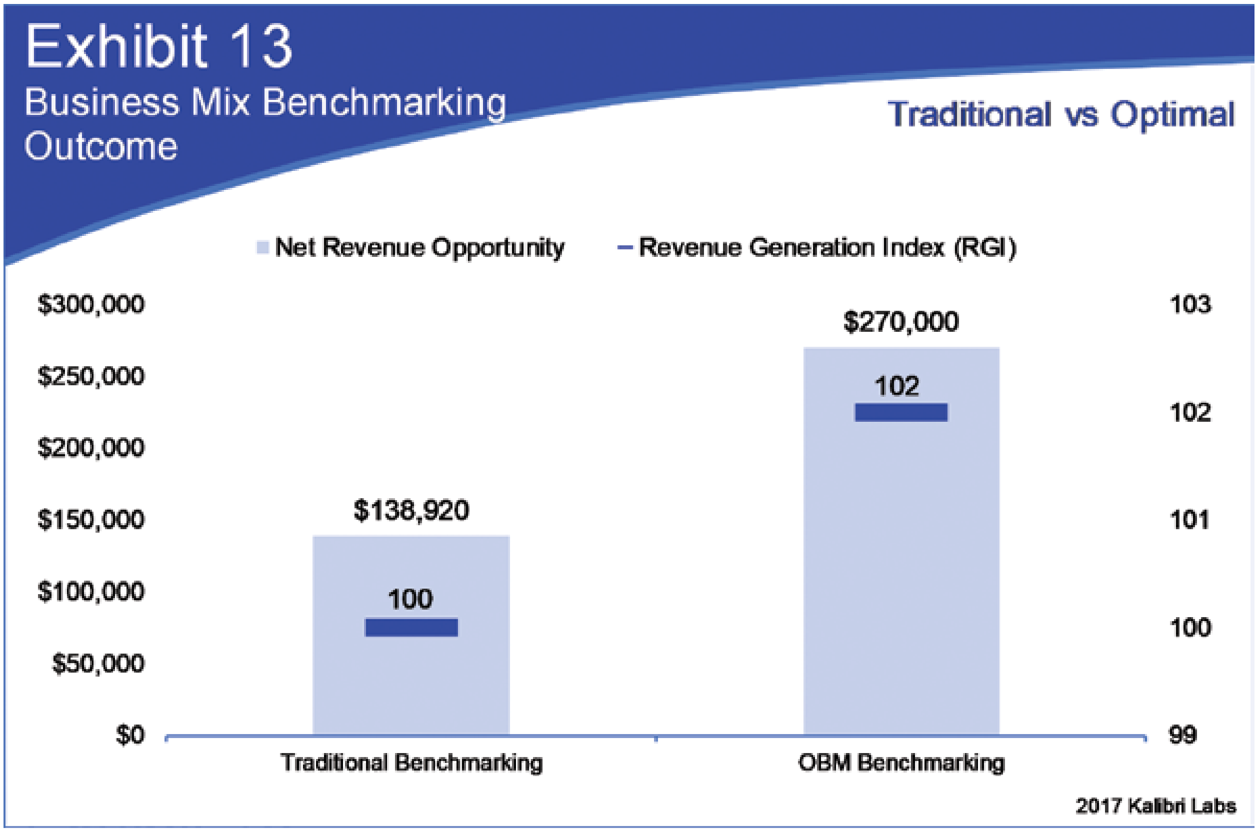
BENCHMARKING ON OPTIMAL BUSINESS MIX

Hotels traditionally benchmark their performance against the average RevPAR of their comp set. Using this method, they are incentivized to strive for average rather than "optimal" performance. That is, once a hotel's RevPAR index hits 100 or above, most management teams often feel they have achieved their objectives, regardless of whether it can actually do better than 100 (and if its index is already above 100, whether it can do even better than it is currently). Further, by focusing on top-line revenue, hotels are not maximizing net revenue, or the revenue they keep after deducting direct costs for guest acquisition and sales and marketing (sometimes called gross margin). One way to remedy both issues is to develop an optimal business mix focused on maximizing net revenue and considering competitive performance as only one of several inputs to setting this target, rather than to come up with a top-line revenue target based on an arithmetic average of a group of hotels with an objective aimed at the middle of the pack.

As an example, consider a 120-room, Upscale hotel (the "Subject Hotel") that achieved a RevPAR of $126 over a period of one year. Its comp set consists of four nearby properties that achieved a weighted average RevPAR of $130 over the same period, resulting in an RevPAR index of 96.9. If, like many hotels in the industry, the Subject Hotel's idea of "success" was a RevPAR index of 100, it would target to earn an additional $175,000 in top-line revenue. Assuming 15 percent of top-line revenue is spent on guest-acquisition and the hotel had to spend $10,000 on sales and marketing initiatives to acquire the additional business, this would result in an increase of $139,000 in net revenue. How exactly it would earn the additional revenue is not clear.

Now consider the same hotel, but instead of benchmarking against the average performance of its competitors, it benchmarks against a net revenue target based on the best, or optimal, business mix it can achieve. The optimal business mix ("OBM") is the total market demand available to the Subject Hotel based on its comp set by segment and weekpart, with added factors for loyalty contribution and consumer review scores. Using this method, the Subject Hotel would target to earn an additional $230,000 in net revenue. After grossing up for the estimated 15 percent guest-acquisition costs and $10,000 in sales and market costs assumed in the traditional benchmarking scenario, that would amount to an additional $270,000 in top-line revenue. Earning $270,000 more in top-line revenue would result in a RevPAR index of 102 for the Subject Hotel, surpassing what it would have achieved had it settled for the average performance of its competitors by $131,000.

The example provided is a case where the Subject Hotel was underperforming relative to its comp set. In cases such as these, it's easy to say that the hotel should aim higher since it has room to grow regardless of what method it uses to set its revenue target. However, the example would still hold if the Subject Hotel was already performing above the average performance of its comp set. For example, if the Subject Hotel's starting RevPAR index was 105, there is no reason to believe that it's performing optimally. Bench-



marking using the OBM method might result in a business mix that brings the Subjects Hotel's RevPAR index to 108, or 110, or higher.

Of course, using the OBM method to set a net revenue target will not always result in a revenue target that is higher than the target that would be determined if a hotel simply benchmarked its performance against the traditional metric, that is, the average RevPAR performance of its comp set. Hotels have to be realistic about their position in a market and some, such as the hotel in our case study with a 96.9 RGI, may only be able to reach an Optimal Business Mix that will bring it to an RGI of 98. Due to physical condition, relative consumer review scores, location and local competitive dynamic, some hotels have more limited potential than others. No matter what the upside is for any given property, allowing it to reach for its own Optimal Business Mix is a more accurate target than making an assumption that it can reach an arbitrary average of those hotels across the street and around the corner. However, even in these cases, the OBM method should be preferred to the traditional method. That is because the OBM method not only provides a revenue target, but also guidance on how to achieve that target by itemizing which channels and which rate categories have potential for the hotel. Under the traditional method, a hotel first calculates a revenue target, and then tries to figure out how to get there. Under the OBM method, the hotel's revenue target is directly tied to its optimal business mix. Therefore, under the OBM method, the hotel is not only determining how much additional revenue it can earn to perform optimally, but also how to achieve that revenue through specific changes in its mix of business tied to realistic opportunity that exists in that hotel's market and specific costs to achieve the optimal result.

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ABOUT HFTP

Hospitality Financial and Technology Professionals (HFTP®) established in 1952, is an international, nonprofit association headquartered in Austin, Texas, USA, with offices in Hong Kong, United Kingdom and the Netherlands. HFTP is recognized as the spokes group for the finance and technology segments of the hospitality industry with members and stakeholders spanning across the globe. HFTP uniquely understands the industry's pressing issues and assists its stakeholders in finding solutions to their challenges more efficiently than any organization. It does this via its expert networks, research, certification programs, information resources and conferences/events such as HITEC®. **The association is the ONLY nonprofit producing hospitality financial and technology conferences on a global level.**

CONNECTIONS

HFTP provides its members and stakeholders a variety of outlets and opportunities to connect with professionals with similar professional interests and concerns.

Conferences — Year-round, HFTP produces a variety of face-to-face events where attendees can network.

Online — The Community@HFTP is a discussion platform where members pass information back and forth.

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PROFESSIONAL DEVELOPMENT

HFTP is the only nonprofit that offers hospitality financial and technology conferences on a global level. Offered year-round, the programs are presented by industry thought leaders in professional development, best practices and skills training.

HFTP also offers a regular schedule of webinars via its ProLinks program. These are available live, allowing participants to interact with the speaker and other attendees. Webinars are also archived for later reference.

Upcoming Events

HITEC Dubai • Dubai, UAE

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ProLinks Webinar Series • Webinars on a variety of hospitality topics of interest, free to HFTP members.

CERTIFICATION

The Certified Hospitality Accountant Executive (CHAE) is the industry designation showcasing members competency in the area of accounting. Unlike other technology designations, the Certified Hospitality Technology Professional (CHTP) shows a dedication to hospitality and technology. Active CHAE and CHTP designees have reported higher salaries and various career advancement opportunities.

RESEARCH AND RESOURCES

HFTP supports a variety of professional resources, research reports and common practice guides on a variety of finance and technology subjects.

The **HFTP Americas, Asia and Middle East Research Centers** not only provide comprehensive research, studies and reports on a variety of topics such as mobile payments, data security and accounts management; but, members can request their own research projects to meet their needs.

The **Hospitality Data Protection Officer Task Force** is an expert group establishing guidelines to help with preparation for the May 2018 compliance date of the EU General Data Protection Regulations (GDPR).

Online Information

PineappleSearch.com is a hospitality-specific search site that narrows results to industry relevant information.

HITEC Bytes aggregates the most current hospitality technology news for members to browse through.

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Demystifying the Digital Marketplace: Spotlight on the Hospitality Industry

continues a long traditional of publishing excellence from the HSMAI Foundation. The Foundation was established in 1983 to serve as the research and educational arm of the Hospitality Sales and Marketing Association International. The Foundation's mission is to develop knowledge and insights for the future to fuel sales, inspire marketing and optimize revenue.

In recent years, the HSMAI Foundation has published reports and research on the most timely and critical topics, including:

- *Second Edition: The Evolving Dynamics of Revenue Management: A Comprehensive Revenue Optimization Road Map for Hotel Owners, Operators and Practitioners*
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The HSMAI Foundation has been focused on insights, research, and scholarship. To deliver relevant resources to leaders in sales, marketing, and revenue management, the HSMAI Foundation has partnered with organizations and companies such as AH&LA, STR, American Express, TravelClick, Pegasus, Vizergy, U.S. Travel Association, and others to create reports, 25 association white papers, scholarship programs, and an online clearinghouse.

The HSMAI Foundation wishes to thank all of the industry leaders from hotels and brands that helped in collecting the data that made this comprehensive analysis possible. In return, in the months and years ahead, the HSMAI Foundation will be offering even more insights into how hotel sales, marketing and revenue management professionals can apply the findings of this important study to their businesses, with the goal of finding the optimal channel mix for their properties.

PLEASE VISIT

www.hsmaifoundation.org to learn more about the HSMAI Foundation and to tap into all of the insights, research, and scholarship we have to offer.

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IHG OWNERS ASSOCIATION

The IHG Owners Association represents the interests of owners and operators of more than 3,500 InterContinental Hotels Group® (IHG) properties in the United States, Africa, Australasia, Canada, Europe, Latin America, Mexico and the Middle East.

Established by Holiday Inn founder Kemmons Wilson in 1955, the Association is committed to representing our members by being their voice with IHG and communicating on their behalf about issues that affect them and the hotel industry as a whole. The Association also provides our owners with opportunities and resources to better educate themselves on topics that will help them and their businesses.

One resource that we truly feel is beneficial to our owners is the Demystifying the Digital Marketplace: Spotlight on the Hospitality Industry. The IHG Owners Association contributed to this report years ago. Our continuous support is a reflection of the Association's belief in the report's findings and how these discoveries can be beneficial to both our members and to all stakeholders in the hospitality industry.

We are confident and hopeful that this report will help spur conversation and enlighten readers. And, more importantly, equip all hotel owners and operators with the necessary tools that they need to better understand distribution trends and other important components that will help to ultimately increase their ROI.

Best Regards,

Don Berg
CEO, IHG Owners Association

Deepesh Kholwadwala
2018 Chair, IHG Owners Association

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CINDY ESTIS GREEN

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Cindy Estis Green's career began in corporate marketing and senior operations roles for Hilton International. After founding the data mining consultancy, Driving Revenue, and selling it to Pegasus Solutions, Ms. Green spent twelve years as managing partner of The Estis Group providing strategic marketing consulting to the hospitality industry. Co-author of the groundbreaking 2012 study *Distribution Channel Analysis: A Guide for Hotels* and the 2017 *Demystifying the Digital Marketplace: Spotlight on the Hospitality Industy*, Estis Green has been honored as one of the 25 Extraordinary Minds in Sales and Marketing by HSMAI, the Hospitality Sales & Marketing Association International; was inducted into the prestigious Hospitality Technology Hall of Fame; and named as one of Cornell University's 90 Influential Hotelies. She currently leads the AH&LA Consumer Innovation Forum, and holds a board seat for The Knowland Group as well as the Hospitality Financial and Technology Professionals association (HFTP). Ms. Estis Green launched Kalibri Labs in 2012, a firm providing a next generation benchmarking platform to evaluate hotel revenue performance. Using innovative big data techniques, Kalibri Labs helps hotels manage the cost of customer acquisition and optimize profit contribution. Estis Green holds a BS degree from Cornell University and an MBA from The American University.

MARK V. LOMANNO

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Mark Lomanno is a Partner and Senior Advisor at Kalibri Labs. In addition to his role at Kalibri Labs he also advises several start-up and venture capital firms in the hospitality and data space as a member of the Board of Directors and Advisors providing strategic direction and building industry relationships. Lomanno is the former President and CEO of Smith Travel Research (STR). Under his fifteen years of leadership, the company grew from a domestic U.S. firm to the most respected name in global hotel benchmarking. While at STR, he co-authored the 2012 study *Distribution Channel Analysis: A Guide for Hotels* with Cindy Estis Green.

Lomanno serves on the advisory board and is a Research Fellow at the Center for Hospitality Research at Cornell University and University of Delaware's school of Hotel, Restaurant and Institutional management, is an active member in the Hotel Development Council of the Urban Land Institute and is a named Conti Professor at Pennsylvania State University. Lomanno also serves on the advisory board of The School of Tourism & Hospitality Management at Temple University, where he teaches a graduate level course "New Media and Distribution." Lomanno holds a MS in Marketing from LaSalle University and an MBA from Temple University.

MATT CARRIER

Matt has spent six years in the hospitality distribution and revenue strategy space. With that experience, Matt is inspired by the rapid evolution in this area of the hotel industry and by the opportunity to drive change and support hotels in improving their performance.

Prior to joining Kalibri Labs, Matt spent several years as a part of Marriott's Channel Strategy and Distribution team working on a variety of initiatives in the online hotel distribution space. These included both industry-wide efforts and product lines within Marriott. Matt had responsibility for reporting, marketing and merchandising for Marriott's vacation packaging vertical, collaborating across internal teams on industry-wide projects and working with the distribution team to vet potential new partners. Matt Carrier is formerly the Director of Revenue Strategy & Account Management at Kalibri Labs and holds a BS from the Cornell University School of Hotel Administration.

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