



## Hotels Revisit Their Internet Strategy

When large hotel companies first checked into cyberspace they let others -- online travel agencies -- dictate the terms. But the hoteliers have been fighting hard to take back control, and they don't expect to relinquish it.

Large hotel chains have beefed up their own Web sites and added incentives to get travelers to book rooms via them. They have also become more selective about how many rooms they sell wholesale to the online agencies, the biggest of which are **IAC/InterActive Corp.'s** (IACI:Nasdaq) Expedia, **Sabre's** (TSG:NYSE) Travelocity and **Cendant's** (CD:NYSE) Orbitz. And in one high-profile instance, a major chain, **InterContinental Hotels Group** (IHG:NYSE) essentially slammed the door on IAC's online agencies when it stopped providing them with rooms to sell.

In the coming year, those trends are likely to continue.

"I expect the hotels will reduce the amount of merchant or prepaid inventory that they make available to the third-party intermediaries," said Henry Harteveltdt, an analyst at Forrester Research, a Cambridge, Mass., technology consulting company.

It hasn't taken long for things to change. During the economic downturn that followed the Sept. 11, 2001 terror attacks, travel suffered. Eager to fill rooms, hoteliers were willing to offer up blocks of inventory to online travel agencies at significant discounts. The agencies would turn around and list the rooms at a markup. Although major hotels allowed travelers to book at their own Web sites, their technology in some cases wasn't as sophisticated as that of the online agencies.

But hotels began to rethink their dependence on the online agencies. They realized the agencies were controlling the relationship with their customers. "To serve the needs of our best customers, we need to have them booking directly through us, either through our call centers or through our Web sites," said Bala Subramanian, senior vice president of distribution and brand integration at **Hilton Hotels** (HLT:NYSE). With a direct relationship, Hilton can learn about the preferences of its guests and use that knowledge to serve them better.

To lure customers to their own sites, the hotel chains began guaranteeing that travelers wouldn't be able to find better rates anywhere else on the Internet. InterContinental Hotels claims it was the first to do so. Hilton, **Starwood Hotels and Resorts** (HOT:NYSE) and **Marriott International** (MAR:NYSE) followed suit. Starwood offers loyalty points for online bookings made at its Web site, but not at other sites.

Hotels also began to develop grievances about the way some online agencies were doing business. InterContinental took its complaints public last April, when it announced a set of standards it required online partners to meet.

Leslie McGibbon, the company's communications director, said some agencies were telling travelers that rooms were sold out when the agencies' own supply was gone, but rooms were still available elsewhere. Lack of automation in the booking process was causing some problems as well.

"A lot of the online chaps were faxing bookings to a hotel, but the fax had fallen behind the fax machine, and the hotel wasn't expecting the guest," McGibbon said. "There was no room, and that can have an impact on guest loyalty and satisfaction, but the hotel had done nothing wrong."

Another grievance was that some agencies weren't detailing what the various fees and taxes were on a room above the wholesale price InterContinental was charging the online agencies.



A failure to meet InterContinental's standards caused the company to terminate its relationship with Expedia and Hotels.com last fall, though McGibbon won't say what specific standards were at issue.

But David Dennis, a spokesperson for Expedia and Hotels.com, said the key problems were over disclosure of rates and fees and how the two companies were telling travelers no rooms were available at its site.

He said Expedia and Hotels.com will give customers one figure that sums up taxes and fees but won't break out line items because it doesn't want to reveal what its merchant margin is. "Other hotel partners don't want us to expose our net rate," Dennis said.

When Expedia or Hotels.com runs out of rooms at a particular hotel, it instructs travelers that the sites were unable to find rooms for the dates specified, Dennis said. "Customers understand that means the rooms are not necessarily sold out at the hotel," he said. "When you walk into Target and see that there's no Tide detergent left on the shelf, you don't say there's no Tide left anywhere in the world."

Despite the dispute, Expedia and Hotels.com would welcome InterContinental back as a partner, Dennis said.

Hilton has also terminated relationships with third-party sites over the way they were treating customers, but Subramanian declined to specify which ones.

Another factor behind the big chains' revolt was that they realized they could lower their costs of distribution. Bookings at their own sites didn't have incremental costs, while the margins on the merchant business with online agencies could be significant.

"Third parties cost more," Hilton's Subramanian said. "We don't necessarily have anything against them. There are times when we really need the business, like two years ago, and even today in some markets that are still recovering."

As the economy has strengthened, so has Hilton's bargaining power with the online agencies. Subramanian said Hilton has been able to whittle down the margins on merchant business through online agencies, though he wouldn't offer specific numbers. He also said Hilton had become efficient at using agencies when it needed to. "You never turn anything off," he said. "You just calibrate carefully what you need to drink from each fountain."

The big chains are reporting significant shifts in the mix of their business between their own sites and third parties.

Dan Gibson, senior vice president of corporate affairs at Starwood, said 75% to 80% of the company's Internet bookings are now made on its own branded sites, up from about 60% during the downturn that followed the 9/11 terrorist attacks. About 10% of the company's total bookings are now made via the Internet.

"We've won the battle of capturing them on our proprietary Web sites," Gibson said.

Hilton is seeing a similar shift. For all of last year, bookings at its own site jumped by 35% from 2006, while bookings from online third parties fell about 5%, Subramanian said.

Still, even chains like Starwood view the online agencies as partners that can help them gain customers they might not get any other way.

And the efforts by the big chains are far from putting the online travel agencies out of business. Expedia's Dennis noted that about 80% of the rooms Expedia and Hotels.com sells are from small to medium chains and independent hotels, which don't have the brand recognition or necessarily the marketing resources of the big chains.

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