

Digital Comparison Tools Market Study

ANONYMISED RESPONSE FROM LARGE HOTEL CHAIN A

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Questions

Theme 1: Consumers' perceptions, use and experience of DCTs

1. When and why do consumers use DCTs? To what extent do they trust them?

Insofar as the provision of hotel accommodations is concerned, research by Google indicates that consumers use DCTs to book hotel rooms online primarily because they believe they can get the lowest price by doing so. This is shown in Figure 1 below.

Reasons for booking on OTAs

Source: Google 2014 Traveler's road to decision

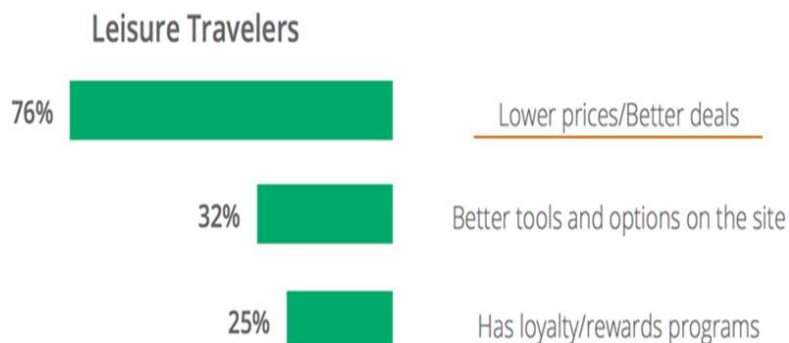


Fig 1. Google research – customers' reasons for booking through Online Travel Agents.

The importance of these findings is underlined by other research showing that price is extremely important to consumers when they book hotel accommodations, however they choose to book. For example, research by the American Hotel and Lodging Association (AH&LA), while focused on American travellers, indicates that consumers generally view the cost of a hotel room as more important than the hotel's location (with 75% rating cost and only 62% rating location – a 13-point spread).

That consumers who book hotel accommodations through OTAs do so in order to find the cheapest price is further supported by AH&LA research showing that roughly two-thirds of consumers booking through OTAs do so because they believe they can get "better deals", or because they believe they have a greater ability to compare prices, than is possible through hotels' direct channels. This is shown in Fig. 2 below.

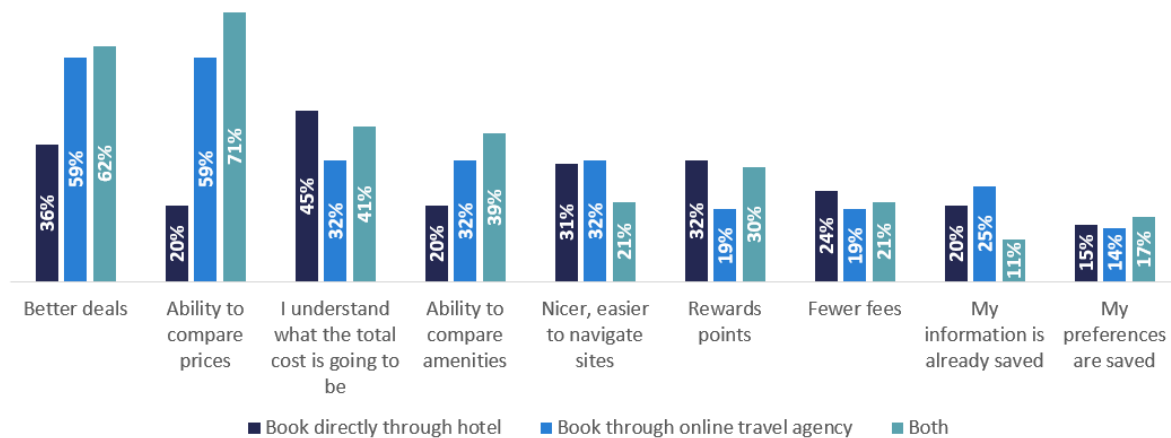


Fig 2: AH&LA consumer preference research showing the reasons given by consumers for choosing to book directly on a hotel website, through an OTA, or both.

Consumers' perception that they can obtain the lowest prices by booking hotel accommodations through DCTs is related to the marketing activity of OTAs [✂] and metasearch engines [✂] that claim (either directly or by implication) that they offer the best prices that are available anywhere. However, this effectively misrepresents the benefits that these DCTs afford. An OTA or metasearch engine may make it easier for a consumer to ascertain what hotels operate in a given location and the nature of their commercial propositions (though as we will go on to show, increasingly hotels are unable to afford to appear on these sites so an incomplete picture is offered to consumers). However due to rate parity clauses in place a hotel has no economically rational incentive to offer lower rates through an OTA or metasearch engine than the hotel offers directly, through its own channels, because doing so would simply lead to growth in higher-cost distribution (given the fact that OTAs often charge hotels commissions amounting to as much 15-30% of revenues booked).

Indeed, the leading OTAs' terms of service have exactly the reverse effect on consumer prices, ensuring that hotels do not offer lower prices to the general public than are available through the OTAs as well.

A factor which reinforces the misconception that DCTs (i.e. OTAs and metasearch engines) enable consumers to obtain the lowest rates available is the systematic and widespread use of misleading advertising in the sector. It is extremely common for OTAs and metasearch sites to show 'discounts' based on spurious comparisons which pressure the consumer to book on their sites or create a false impression that consumers are getting a better deal by doing so.

[✂]

While consumers appear to have a high level of trust in OTA and metasearch sites, they tend to lose that trust and disagree with various operating practices when they are told how such sites in fact operate. For example, AH&LA research shows that when consumers are informed that OTAs/metasearch sites use commercial factors - such as rate of commission paid and rate of customer conversion - to determine the sort order of hotels shown on their search results, over half of all consumers surveyed (57%) believe that that practice is wrong. Rather, nearly all customers surveyed (91%) believe that rank ordering in search results should reflect objective factors (e.g. room rates, reviewer ratings, or distance from a chosen

location) that are important to the consumers using the DCT. This is shown in Figures 7 and 8 below.

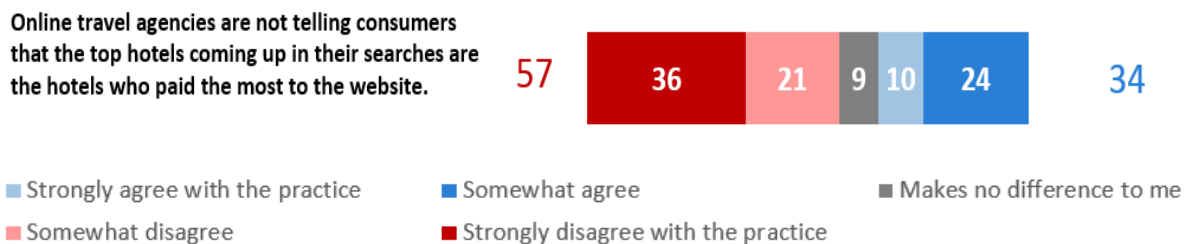


Fig 7 – AH&LA research shows that 57% of consumers disagree with OTAs’ failure to inform customers that commercial factors influence the sort order in which search results are presented.

In your opinion, how should hotels be listed in search results?

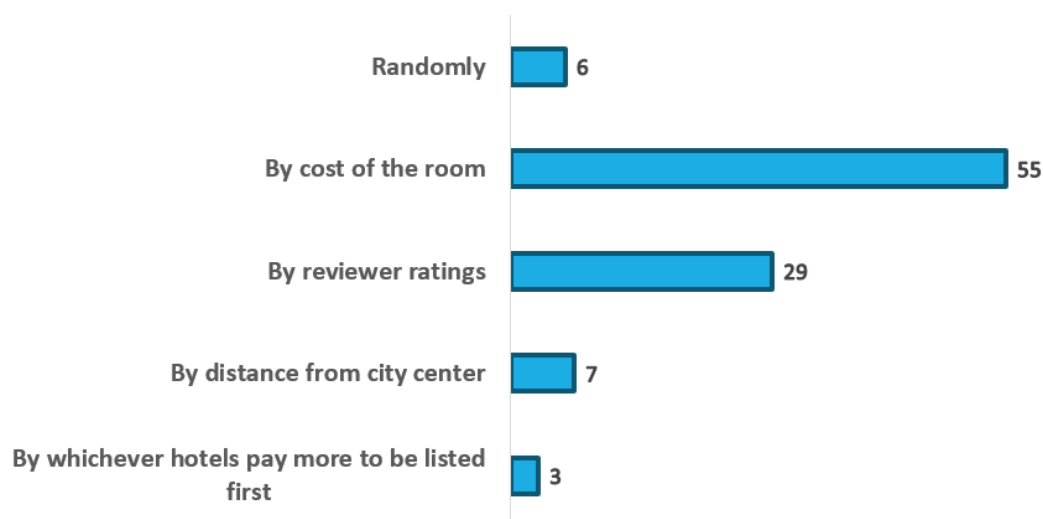


Fig 8: AH&LA research shows that consumers overwhelmingly feel that search result rankings should be determined by an objective factor (primarily price). This is understandable given the fact that consumers say they use these sites in order to get the lowest price.

2. How do consumers choose which and how many DCTs to use?

Consumers actually have very little practical or meaningful choice about what DCT they use when booking travel. There are several reasons for this.

Firstly, while there are many OTAs, [Expedia] are so dominant in their sector consumers rarely find the smaller OTAs listed on Google when they search. Furthermore, few new entrants have any realistic opportunity to emerge, because they can attract only limited numbers of customers and suppliers. Given their limited commercial potential, smaller OTAs are typically content to operate under the commercial/pricing ‘umbrella’ of the leading OTAs, rather than trying to compete aggressively with them.

Secondly, consumers typically face an ‘illusion of choice’ when they consult different OTA and metasearch websites. Experience has shown that DCTs that are able to establish themselves in this sector are often quickly acquired by one of their larger rivals. Indeed, many of the ‘high street’ OTA and metasearch sites that consumers use to compare and book hotel rooms are actually owned by [Expedia]

3. What are consumers' expectations of DCTs - for instance in terms of market coverage and the relationships between DCTs and the suppliers they list?

As set out above, consumers are led to believe that DCTs in the online hotel booking sector are providing search results that consist of relatively comprehensive lists of hotels, ranked objectively according to criteria that are valued by consumers (e.g. price) and that show consumers the 'whole market' (i.e. all available hotels in a particular destination). In practice, we know this is not the case. Customers typically are presented with offers only from hotels or websites that can afford to advertise on a DCT's site. The search results that consumers see often are determined and ranked in light of commercial factors (i.e. factors relating to dealings between the DCT and the listed suppliers) rather than objective factors of interest to the consumer¹.

Consumers also believe that the services offered by DCTs in our sector are 'free'. They typically are not aware of the high rates of commission that OTAs (and, increasingly, metasearch operators) impose on hotels (which can ultimately lead to higher room prices for all guests as hotels must recover these costs). Nor are consumers typically aware that the leading OTAs' terms of service prohibit hotels from offering on their own websites (and sometimes metasearch engines) general public rates that are lower than those that are made available through the OTAs.

Thus, while consumers use these sites in the belief that DCTs are helping to keep hotel rates down, the reality is far more complex. At a minimum, OTAs and metasearch operators should do more to make consumers aware of these factors in accordance with the Unfair Commercial Practices Directive and as clarified in the recent Guidance accompanying the directive².

4. What are consumers' experiences of using DCTs? Do they benefit from using them and, if so, how? What works well and what could be improved?

¹ The default sort order is often determined by commercial factors as set by the OTA, rather than objective factors such as price or distance from a location. This is not made clear to consumers using the site.

² Recent Guidance issued by the European Commission states:

'The UCPD does not ban business practices whereby inclusion or ranking in whole or in part is based on payment from another trader, but requires the search engine provider, to the extent that it qualifies as a "trader under the UCPD", to clearly distinguish such search results from natural search results. The purpose of such disclosures is to inform consumers when they are being solicited as opposed to being impartially informed. Article 6(1)(c) prevents traders from misleading consumers on the motives for commercial practices, the nature of the sales process and direct or indirect sponsorship or approval of traders or products. In addition, Article 7(2) prevents traders from hiding the commercial intent of a commercial practice.'

In light of the foregoing, any search results showing the websites or URLs of traders who have paid to be included or ranked higher than they would be ranked by relevancy or other objective criteria should be clearly and prominently labelled to show that the ranking or inclusion is paid for. [T]he UCPD requires all traders to clearly distinguish a natural search result from advertising. This also applies to operators of comparison tools.

As noted above, an OTA or metasearch engine may make it easier for consumers to ascertain what hotels operate in a given location and the nature of their commercial propositions. To the extent it exists, this utility is undermined by numerous factors, including:

- Misleading rankings and discriminatory levels of detail in DCT search results (discussed further below), which may give consumers an incomplete and very inaccurate view of their options when they are seeking hotel accommodations;
- Widespread use of abusive DCT advertising/marketing practices that mislead consumers about the existence of illusory ‘discounts’ or ‘deals’ and may result in some consumers paying more for hotel accommodations than the lowest rates that are actually available on the market;
- Leading DCTs’ imposition of commission rates and other terms of service that, rather than bearing any rational relationship to the value of services rendered, reflect exploitation of the network effects that have developed with their platforms and ultimately drive up consumer costs; and
- The fact that small hotels and B&Bs find it increasingly difficult to be listed on DCTs because of their high commission rates and other restrictive terms of service, so that an increasingly limited picture of the market is presented to consumers.

Theme 2: Impact of DCTs on competition between suppliers of the services they compare

5. What factors influence suppliers’ use and choice of DCTs and why?

Ideally we (and, we believe, most hotel operators) would like to work with many OTAs, in order to promote greater competition between them (i.e. regarding their rates of commission and other terms of service) and to facilitate bookings by as many customers as possible. However, two considerations increasingly bias our use of DCTs – firstly, very substantial and growing network effects make the leading OTAs [redacted] ‘gatekeepers’ to such large volumes of business they are essentially unavoidable business partners; and secondly (but related to the first consideration), the growth of these [redacted] makes it less attractive to do business with smaller OTAs or metasearch engines on terms that may antagonise the leaders.

[redacted] are becoming ‘gatekeepers’ to large volumes of business from consumers who depend largely or exclusively on them and labour under the misperception that their search results present comprehensive views of the accommodations that are on offer in a given location at the best price. We face increasing risks that we may lose some business if we do not appear well placed in the search results of [redacted] – while we normally would not require additional ‘positive’ advertising, we must pay them for listings in order to avoid ‘negative’ advertising (i.e. consumer assumptions that we have no accommodations on offer if we do not appear in their search results).

Consistent with the outsized shares that [redacted] now command in the OTA sector, most of our hotels receive the great majority (almost 90%) of their OTA bookings in the UK and continental Europe through [redacted]. Our hotels therefore have strong disincentives to deal with any smaller OTAs in any way that might undermine their relationships with [redacted]. These disincentives are heightened because the leading OTAs have essentially unfettered discretion to determine where a hotel appears in their rankings of consumer search results,

and with how much of the detail that consumers may consider important in selecting accommodations.

The lack of transparency about their business models and their sort-and-display criteria (i.e. the criteria that determine the order in which, and levels of detail with which, hotels meeting a consumer's search criteria are listed) strongly influence how hotels deal with [X]. Moving a hotel down in a consumer's search results (de-ranking) can have a significant impact on bookings through the site; [X].³ Likewise, the leading OTAs may respond to commercial disputes by reducing the display of pictures or other material about a hotel (dimming), which can readily mislead consumers about the hotel's desirability or create a false impression that it has little/no availability. Hotels therefore are mindful of the leading OTAs' interests, and do not want to jeopardize their ranking or display with the leaders (e.g. by reducing the inventories made available to them or by offering other OTAs more favourable terms) given the risk of retaliation.

Various considerations compound the problems presented by the sheer scale of leading [X] OTAs. For example, while regulators in the EU have adopted a variety of measures to try to enhance competition in the sector, these relate only to hotels located in certain countries in Europe, and we contract with [X] on a global basis. The global scope of our relationships create possibilities for bias or retaliation outside of Europe where we take measures within Europe that an OTA considers undesirable, even though the law in a particular country allows for such practice.

Furthermore, smaller OTAs [X] do not attract sufficient commercial traffic to make them particularly attractive – particularly as the bigger players always demand or expect that they also will receive the best commercial terms. Accordingly, the increasing clout of the leading OTAs necessarily reduces the commercial attractiveness of dealing with their smaller rivals.

6. To what extent do DCTs make it easier for suppliers to enter the market, attract more consumers and engage more effectively with them?

For small businesses in particular in our sector, OTAs and metasearch engines provide a useful service that enables them to reach a broader – even global – audience to whom they can market their rooms. However, given these large DCTs' terms of service, this benefit comes at a very high – and increasing – price.

Firstly, many hotel operators are charged an increasingly high rate of commission over time for bookings made through DCTs. OTAs/metasearch engines often charge between 15% and 30% of the cost of the *total* booking for a reservation made. This is extremely costly given the hotel's role of actually looking after guests for their entire stay, maintaining their properties, affording a range of amenities, employing people, paying due taxes and ensuring that their accommodation is compliant with consumer protection/health and safety standards etc. Accordingly, while a large OTA may expose a relatively unknown hotel to potential business, the new entrant or other small hotel will find it more challenging to operate profitably given such high distribution costs.

To compound this problem, due to the marketing power of the large OTAs, even when customers enter a particular hotel (or hotel brand) as an Internet search, they are often diverted through Google advertising and paid search to the OTA website, rather than to the direct site (which appears lower down in the search).

³ [X]

Given their marketing power and the network effects of their platforms, the leading OTAs – DCTs in our sector – have become ‘gatekeepers’ on the internet and, as such, an inevitable business partner for many hotel operators. Thus, while OTAs may facilitate entry to some extent by small hotels (i.e. properties that are not affiliated with a well-known brand), they also make it more difficult for such hotels to succeed because of the much higher distribution costs (e.g. commissions and charges for preferential display) they impose.

Secondly, the leading OTAs’ terms of service do not allow hotels to offer customers in their direct online channels a lower general public price (i.e. price for non-closed user group members) than the price displayed on those OTAs’ websites. This means that the high cost of sale associated with an OTA booking must be spread across *all* consumers (regardless of how they book), infringing upon the hotel’s commercial freedom and ability to reward loyal customers and others who book directly at lower cost to the hotel. Such rate parity terms have been banned in countries such as France and Germany for their negative effect on competition. This inability to offer lower prices through their own direct channels, again, makes it more difficult for new hotels to enter, may dampen downstream competition in the industry, and makes it more difficult for all hotels to sustain their profitability.

Thirdly, given the terms of the leading OTAs’ contracts, an accommodation provider/hotel is unable to withhold rooms from an OTA when it is near to selling all its rooms and is aware that customers are likely to book those rooms directly. This might occur in periods of high demand – when, for example, a conference is in town or a wedding is being held, or perhaps simply whenever the hotel can fill its rooms due to word of mouth, repeat business etc. Although the hotel doesn’t want the OTA to handle bookings (and impose its commission costs) at that point, the hotel cannot reserve its inventories for direct sale. This ultimately makes bookings less profitable for the business and – combined with the leading OTAs’ other terms of service regarding rate parity and the like – can ultimately lead to higher prices for the consumer.

7. How have DCTs affected competition between suppliers? What impact has this had on the price, quality and range of products offered by suppliers?

Hotels operate in extremely competitive markets, given the wide range of accommodation options available to consumers – particularly with the emerging sharing economy – in any particular location. Given the inherently competitive and dynamic nature of the industry, the emergence of DCTs in our sector over the last ten years has not appreciably boosted the already-robust price and other competition amongst hotels. They have however really boosted costs to the sector.

To the extent that the OTAs and metasearch engines may affect competition amongst hotel operators, this is likely to occur because travellers can see more of the accommodations that are on offer in a location, and may more readily compare rates (though, as noted above, such “comparisons” are often highly misleading). We believe this is likely to enable smaller operators to compete more widely for customers. However, such competitive benefits are more limited for large hotel groups/chains, which already operate websites that consumers can readily access through a variety of searches/domain names, and that typically offer accommodations under different brands across a range of amenities and rate points. Accordingly, OTAs and metasearch engines offer less value to large chains in terms of visibility to potential guests than they do to relatively small operators.

Notwithstanding this point, it is interesting to observe that in Europe, where small businesses make up the vast majority of accommodation providers, growth in our sector in terms of rooms in the development pipeline is almost entirely in the ‘branded’ hotel sector, i.e. with the larger chains. Small businesses find it more difficult to compete effectively,

notwithstanding the visibility offered to them on OTA websites, given the fact that the leading OTAs now operate effectively as ‘gatekeepers’ and inevitable business partners, enabling them to impose high distribution costs that reduce smaller hotels’ ability to operate profitably and keep rates low.

8. What are the barriers, if any, to DCTs increasing competition between suppliers, and how can these be overcome?

There are a variety of barriers to DCTs’ increasing effective competition between hotel operators. As noted above, the leading OTAs’ imposition of high rates of commission inflate hotel operators’ costs, making it more difficult to offer low rates and undermining smaller operators’ ability to compete profitably. The leading OTAs’ other terms of service (including, in particular, their insistence that hotels not offer rates directly to consumers online that are lower than those on offer through the OTA websites) likewise establish a significant impediment to rate-based competition.

Rate parity clauses (buttressed by required parity in the availability of room inventories) actually reduce the amount of choice and competition for consumers as illustrated in Figure 9.

9. In what ways, if any, have DCTs changed suppliers’ approach to consumers – for instance in terms of whether they treat consumers who use DCTs differently to those who do not?

DCTs in our sector have attempted to isolate their relationship with consumers who book accommodations through their sites, so as to minimise any competition that might be afforded by other service providers. Amongst other things, this has led OTAs to undermine the direct relationship that hotels try to build with their customers as valued guests (for example, OTAs often refuse to provide hotels with the contact details of guests for pre-arrival or post-stay hospitality). This has meant that it is more difficult for hotels to satisfy their customers’ needs and to provide the highest quality services possible.

On the other hand, OTAs want hotels to provide to guests that book through an OTA website the same level of service/amenities as the hotels provide to guests that have booked with them directly (or who are part of the hotel’s guest loyalty scheme). Such OTA demands (including terms of service that require parity in conditions) may prevent hotels from offering particular benefits and amenities (like free WiFi or room upgrades) to guests who have booked through the hotel’s lowest-cost channels or developed a loyal customer relationship over time.

Theme 3: Competition between DCTs

10. In what ways do DCTs compete with each other – for instance in terms of coverage, the savings consumers can make, the services they provide, their ease of use, transparency and how they protect consumers’ data?

Aside from the network effects (i.e. mutually reinforcing growth in numbers of users on each side of the platform) that the leading OTAs exploit, the services offered by OTAs are largely commodities from the hotels’ standpoint. Metasearch engines are expanding into booking capabilities that, in a very few years, will make them largely indistinguishable from OTAs. Input from hotel operators, and consumer reviews, provide most of the content that is available on any of these sites. Accordingly, once a site is up and running, each DCT offers essentially the same, largely automated service. These operators’ lack of transparency

about their business models and search-and-display criteria mean that any differences in this regard are unlikely to be noticed by large numbers of consumers.

We are not aware that any OTA has offered to us or any of our hotels lower rates of commission if lower room rates or greater availability are made available to them; rather, smaller OTAs generally appear to be content to keep their commissions as high as can reasonably be maintained under the pricing 'umbrella' established by the leading OTAs.

11. What factors influence how effectively DCTs can compete – for example, whether they can secure the necessary consumer data, supplier information or other data?

OTAs' ability to compete is largely determined by the numbers of users on each side of the platform (consumers and hotels, respectively). Growing numbers of users create a virtuous cycle, with increasing content for the website (in consumer reviews and room inventories/information provided by hotels to the most used websites).

[✂]

12. If there are barriers to competition between DCTs, how significant are these and how can they be overcome?

Several measures could contribute significantly to the emergence of more effective competition amongst DCTs. These include the following:

- DCTs should be prohibited from imposing any kind of parity requirements (regarding, e.g. prices and inventory availability), or retaliating against hotels for exercising non-parity, not only with respect to other DCTs but also with respect to the suppliers whose products/services appear on their websites.
- DCTs should be required to fully disclose to consumers their business models, search-and-display criteria, and commission rates. This would help to ensure that leading OTAs cannot leverage their position through various actions (e.g. dimming and de-ranking) that enable them to impose non-competitive terms of service and dissuade hotels from challenging their unfair/misleading practices or seeking to negotiate better terms with other OTAs. Likewise, consumer awareness of the extent to which their payment for hotel accommodations actually goes to the booking platform (which consumers typically perceive as "free") would expose these charges to market forces, as consumers increasingly realise that exorbitant commission rates are likely to lead to increases in the costs of hotel accommodations and, therefore, seek out platforms that charge more competitive rates.
- The laws regulating potentially misleading advertising and marketing practices should be actively applied in this sector, given the numerous abuses that occur regularly in it. This would not require the adoption of any new legislative instruments, but simply more vigorous enforcement of rules that already exist.
- DCTs should be prohibited from deceiving consumers into thinking that they are booking direct with suppliers when they are not. Their online ads, and call center representatives, should clearly identify who they are (i.e., not the hotel).
- All of the foregoing should be backed up with active enforcement and penalties that are actually dissuasive – so that violations of law are not just considered a cost of doing business.

- The laws governing industry mergers and acquisitions should be enforced more vigorously, with genuine regard for the importance of network effects in the DCT (and, particularly, OTA) sector. [X] Further consolidation by leading DCTs should be prohibited.
- Recognising that the leading DCTs are now firmly entrenched in some industries, with virtually insurmountable network advantages, some measure of price/commission rate control may be appropriate. This need not be a burdensome or unduly complicated regulatory endeavour, as actual prices would not need to be monitored or determined – rather, the regulator would need to have regard only to commission *rates* (i.e. percentages) that the DCTs impose on prices which are set in competitive markets by suppliers of the goods/services appearing on their websites (here, hotels). A constructive approach might be to establish a ceiling on such rates, leaving individual DCTs free to determine in light of competitive conditions what rate (below that ceiling) they will actually charge.

Theme 4: The regulatory environment

13. Are there any areas of regulation or self-regulation applying to DCTs that lack clarity, certainty, consistency, or enforcement?

We are not aware of any self-regulatory schemes in the hospitality sector for OTAs or metasearch sites. [X]⁴[X]. The principles⁵ set out a commitment to boost transparency and adhere to the provisions of the Unfair Commercial Practices Directive and the like, but in practice these are not respected.

14. Do there appear to be any areas where DCTs may not be meeting competition or consumer protection requirements?

Regular breaches of the EU Unfair Commercial Practices Directive and competition laws, as set out briefly above.

15. Do any aspects of regulatory approaches to DCTs need to change and, if so, why?

Given the concentration of power by various intermediaries and the practices that ensue as a result, regulators and legislators need to consider whether the current regulatory framework is adequate to deal with these models. Some or all of these steps noted in response to Question 12 might well be needed and appropriate.

16. Finally and in relation to all of the issues above, what likely developments over the next three years should we take into account and why?

Development regarding OTAs/metasearch:

⁴ [X].

⁵ http://ec.europa.eu/consumers/consumer_rights/unfairtrade/docs/key_principles_for_comparison_tools_en.pdf.

We expect to see continued insistence on OTA terms of service (like those discussed above) that limit hotels' commercial freedom and may lead to higher prices for consumers in hotels' direct channels and metasearch engines.

We believe OTAs will continue to pursue aggressive industry consolidation through the acquisition of competing OTAs and metasearch engines. This has been seen in particular, in the last several years, [§]. These sites will maintain various brands as 'distinct' entities to continue the presentation of illusory choice to consumers, despite insisting on standard operating terms and conditions with hotels for all brands.

We expect more 'hybridisation', with metasearch sites increasingly bringing on booking capability and a continued interdependence of OTAs and metasearch through advertising spend etc.

Unchallenged, we predict continued use of misleading advertising, including claims of fictitious discounts, lack of transparency about the sort orders and display criteria used on DCT sites, inaccurate 'best price guarantees' and the like, that shore up consumer misperceptions about the costs and benefits of using such sites and cause wide scale consumer harm.

Developments in the hotel sector:

Given the challenges facing hotels, we anticipate more consolidation of hotel companies over the years to come and a decrease in the number of independent operators. Industry data already shows that the pipeline of growth in the independent hotel sector is almost non-existent. The graph below indicates that room growth will all be among chains (i.e. larger brands such as Accor, IHG etc). One of the reasons presented for this trend is the power of the OTA players and the pressures they place on the sector.

Given the current make-up of the European hotel sector, where the vast majority of hotel rooms are un-branded, this will present a major change in the sector moving forward.

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