

CHAOTIC CHANGES IN DISTRIBUTION CHANNELS: Implications for Hospitality Companies

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ABSTRACT: Distribution channels of hospitality products are going through chaotic changes and slowly making the traditional tourism and travel marketing obsolete. These changes are already having significant impact on hospitality companies' operational strategies. As a result, required skills and talents of hospitality employees are evolving from reservation taking and confirming to inventory controlling and forecasting to selling to managing revenue. In addition, the need for synchronization of multiple channels for most efficient operation is further forcing hospitality operations to develop strategies that will minimize the negative impact of those changes on their operations and profitability. This study examines the changes hospitality distribution channels are going through and discusses the strategic implications of those changes for hospitality companies. **Keywords:** distribution channels, electronic distribution, cost of distribution, change, strategy.

RESUMEN: Los canales de distribución de productos de acogida están pasando por cambios caóticos y poco a poco haciendo que el turismo tradicional y la comercialización de viajes se vuelvan obsoletos. Estos cambios ya están teniendo un impacto significativo en las estrategias operacionales de las empresas hoteleras. Como resultado, las competencias requeridas y el talento de los empleados de la hostelería están evolucionando desde la reserva y la confirmación, hasta la tomada de control del inventario y la previsión de ventas a la gestión de los ingresos. Además, la necesidad de sincronizar múltiples canales para la operación más eficiente es obligar a las operaciones de la hostelería a desarrollar estrategias que minimicen el impacto negativo de esos cambios en sus operaciones y rentabilidad. Este estudio examina los cambios de los canales de distribución hoteleros y discute las implicaciones estratégicas de esos cambios para las empresas de la hostelería. **Palabras clave:** canales de distribución, distribución electrónica, costo de la distribución, cambio, estrategia.

INTRODUCTION

Determining the best approaches to delivering products to the marketplace has been one of the most difficult challenges merchants have been facing since the early days of farmers' markets (Connolly, 1999). Traditionally, hospitality products have been distributed through both direct selling and intermediaries such as travel agencies, global distribution systems (GDS), chain reservation systems, hotels' 800 numbers, hotels' marketing sales departments, etc. However, developments in

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the marketplace such as continuing consolidation, brand proliferation, globalization and hospitality companies' attempts for disintermediation accompanied with development in information and communications technologies have presented powerful new possibilities for hotel distribution (O'Connor & Frew, 2004). As a result, traditional hospitality distribution channels are going through chaotic changes that are likely to have significant impact on profitability of hospitality operations. This change is further fueled by the ever-increasing cost of using traditional distribution channels. According to Starkov (2002), a typical GDS hotel booking, at the average GDS ADR of \$117.07 and a weighted average stay of 1.945 nights, would cost the hotel \$24. A booking via a call center/reservation office would cost between \$8 and \$12 (direct and indirect costs).

In the hospitality industry, change is an accepted and necessary part of doing business. Whether it be to stay ahead of the curve in everything from distribution to recently enacted legislation, hospitality operators must be able to position their businesses to be agile enough to remain competitive in today's world. However, the change in hospitality distribution channels seems to be happening faster than the hospitality operators can adopt. As suggested by O'Connor and Frew (2004), the variety and complexity of electronic distribution channels available to hotels has increased dramatically in recent years. It has become very difficult to identify and differentiate between such channels. Literature suggests that the complexity of the distribution channels is likely to further increase in the future. This is likely to create new challenges for hospitality operators since they are having a hard time handling the current chaotic changes in distribution channels. Using the complex network of distribution channels, operators are struggling to increase occupancy and yield while trying to retain and/or improve brand identity and their control on prices. However, one of the biggest challenges for them is managing this very complex network of distribution channels. They are also having a hard time deciding which channel to use due to the varying levels of cost associated with each channel and the complexity of technological requirements, both hardware and skills, to utilize some of the channels. These changes are also forcing operators to develop new strategies to better manage the distribution channels in order to keep distribution costs down and to have a better handle on their inventory control and pricing strategies. These changes are also forcing operators to hire technology savvy employees who can handle the complexity of distribution channels, which increases the labor cost significantly.

In short, distribution channels of hospitality products are going through chaotic changes and slowly making traditional tourism and travel marketing obsolete. These changes are already having signifi-

cant impact on hospitality companies' operational strategies. As a result, required skills and talents of hospitality employees are evolving from reservation taking and confirming to inventory controlling and forecasting to selling to managing revenue. In addition, the need for synchronization of multiple channels for most efficient operation is further forcing hospitality operations to develop strategies that will minimize the negative impact of those changes on their operations and profitability. Therefore, the purpose of this study is to examine changes hospitality distribution channels are going through and discuss the strategic implications of those changes for hospitality companies.

TRADITIONAL DISTRIBUTION CHANNELS

One of the most important factors that affects the competitiveness of any business and one of the primary activities of a company is the way in which they bring their products to the marketplace (Porter, 1985; WTO, 1997). Previous studies provided several definitions of channels of distribution (Buhalis, 2000, 2003; Lewis, Chambers et al., 1995; Middleton, 1994). Simply defined, distribution is the act of getting a company's products and/or services to the customer. For manufactured products, distribution means making the necessary arrangements to get a physical product to a place where a customer can buy it. However, for most hospitality products, it means providing necessary information about availability, prices, qualities and convenience for customers so that they can make their decision whether to purchase the promised services to use at a later date by going to the hospitality organization that offers the product (Poon, 1993). Basically, hospitality product distributors communicate the necessary information and transfer the right of usage of the service to the end user without taking an ownership of the product offered. They act like a broker, which assists hospitality organizations to distribute their products for a fee or a commission. Traditionally, hospitality organizations use their services as a cost saving option due to the fact that developing their own distribution channels can be cost prohibitive and the distributor can get closer to the customer (Dube & Renaghan, 2000).

Figure 1 presents the distribution channels that have been traditionally used by hospitality organizations to distribute (to disseminate information about) their products. As presented in Figure 1, traditionally most hospitality products have been distributed through travel agents. For their services, agents charge a fee or a commission. In the past, agents used to call the hotel to make the booking. With the introduction of electronic distribution systems, which started as an internal system for the airlines for inventory control in the early 1960s, agents

started making bookings through electronic distribution systems. The first inventory-control system, the SABRE, was used as a computerized reservation system for airlines and was developed by American Airlines in 1964. The introduction of the SABRE system revolutionized the distribution of hospitality products by giving direct access of the systems to travel agents, allowing them to see real-time availability and pricing information, and to make instant bookings. In the beginning, hotels heavily relied on airline systems to provide information about their products by loading their various room types, descriptions, and price categories into spare capacity on the airline systems. However, this limited the amount of information hotels could provide to travel agents because of storage limitations. In order to provide more detailed information necessary to sell hotels effectively, companies started developing their own systems with a more appropriate database structure, and subsequently electronically linked them to the Global Distribution Systems, as the airline systems became known. To connect hotels Central Reservation Systems (CRS) to GDS's a "universal switch" – a bi-directional translator connecting any hotel reservation system to the numerous GDS platforms was created (O'Connor & Frew, 2004).

TRADITIONAL DISTRIBUTION CHANNELS

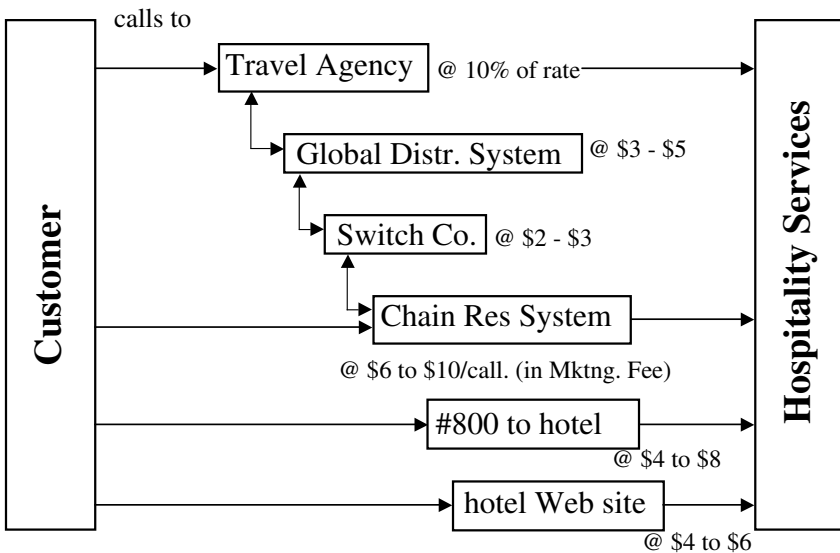


Figure 1. Traditional distribution channel

Another traditional distribution method has been the chain's CRS. In this method, the customer calls the chain's call center to make their bookings. Distributing products through chains' CRS traditionally has been more cost effective than distributing products through travel agents. However, the capital cost of developing and maintaining a central reservations system is substantial. For this reason, many hospitality organizations currently outsource their CRS.

Calling the hotel's 800 (toll free) number has been another traditional distribution method. Basically customers directly call the hotel using the toll-free numbers to make their booking. Contract customers mostly use toll-free numbers. It is not an effective distribution method for all segments due to the fact that this method does not provide much information about the product. Therefore, the potential customer's motivation and ability to book are severely limited through this method. Usually customers who have already decided where to stay use this distribution method.

In recent years, distributing products through the Internet has become one of the fastest growing methods of distribution. Since the introduction of online booking with payment in 1996, the year when the first online air flight booking with online payment was completed, the Internet has revolutionized hospitality distribution systems. As suggested by O'Connor and Frew (2004), until the introduction of web-based bookings, "hospitality channels of distribution systems cooperated, rather than competed, with each other. Relationships were effectively linear, participants had a mutually beneficial role to play while data was distributed over proprietary networks and was not available to non-members. Use of electronic distribution was lucrative, but also expensive and lacked flexibility. Between 1993 and 1997, commissions and other reservation costs by approximately 117% (Waller, 1999). This cost increase, coupled with advances in information technology, convinced many companies of the need to find alternative ways to distribute their product." However, introduction of web-based bookings changed everything.

CHAOTIC CHANGES IN DISTRIBUTION SYSTEMS

Since 1996, most hospitality companies have begun experimenting with web distributing, which has had a profound impact on the way hospitality products are marketed, distributed, sold, and fulfilled. Web-based distribution provided an opportunity for hospitality companies to eliminate middlemen from the distribution process. They basically realized that the web is not merely an online brochure, but is a powerful and inexpensive distribution channel to cut cost and thereby improve their competitive advantage, a way to disintermediation to sell their products online directly to travelers (Tse, 2003).

Introduction of online distribution has shaken up the hospitality distribution channels. It enabled hospitality companies to set up very sophisticated web sites to provide detailed information about their products and prices. It gave them direct control of their inventory and prices while providing direct distribution of their products to their customers. This enabled them to lower their distribution costs by bypassing switch corporations, GDS, and travel agents. However, introduction of online booking with payment also created an opportunity for third-party websites and online travel agents to distribute multiple products from multiple providers by enabling travelers to search and purchase an entire trip online. Availability of online booking increased the competition among hospitality distributors, which resulted in an increased consolidation of distribution channels. While the Internet enabled both hospitality companies and their distributors to distribute products globally, it also forced them to go through chaotic transformation.

Hospitality companies' attempts to disintermediate and recent developments suggest that retail travel agencies have already reached their inflection points. Continuing increases in online bookings and elimination of commissions by airlines continue to squeeze their revenues. Most business travel agencies have been consolidating, rebating commissions, and charging clients transaction fees. All surviving agencies are adopting a fee-for-service strategy. Online travel agencies are also reaching their inflection point due to elimination of commissions and increasing disintermediation efforts of hospitality companies.

As reported by O'Connor and Frew (2004), many of the hotel chains have taken advantage of the opportunities presented by the web. A 2002 survey of the top fifty hotel companies revealed that over 95% of chains had a company web site, with nearly 90% of these providing reservation facilities to allow the customer to book directly (O'Connor, 2003). Chain sites are becoming more and more effective. In order to increase look-to-book ratios, hospitality companies recently started to offer a lowest fare guarantee, which significantly increased the number of Internet bookings flowing through their own sites rather than through the web intermediaries. Direct distribution through their own websites with their own booking engines enabled hospitality organizations to avoid GDS fees, switch fees, and travel agent commissions, which are estimated to be substantial, with cumulative gross savings for the 2000 to 2003 period forecast to reach US\$1.3 billion, representing an annual saving equivalent to 1.7% of total industry profits in 2000 (Ader, Lafleur et al. 2000).

On the other hand, the continuing trend in consolidation is strengthening the power of a few major players in hospitality distribution systems. For example, Pegasus provides several key services that are cru-

cial for distributing hospitality products such as property reservation systems, both voice and electronic, property management systems, central reservation system, etc. It is also the switch for Orbitz, Sabre, Apollo, WorldSpan, and for on-lines like Expedia, Priceline, and central commission processor for thousands of hotels. Sabre continues to provide services for surviving agencies while pioneering disintermediation through Travelocity, GetThere, etc. It seems like these companies are trying to develop a strategy through controlling a major part of the distribution system that will enable them to “own the customer.”

In order to have a better control of distribution of their products, to decrease the cost of distribution, and to have a better control over pricing, hospitality companies have also been integrating distribution channels into their systems through consolidation. For example, Carlson Wagonlit Travel is owned by hospitality supplier Carlson Co. Accor owns travel agencies and tour operators. Galileo, a GDS, is now owned by Cendant and is being integrated into a comprehensive franchise agency and travel supplier company. Others are developing their own online booking systems and providing “lowest price guarantee.”

Availability of online bookings also increased the number of distributors and the complexity of the distribution system. In addition to online travel agencies and companies’ websites, in recent years, wholesalers, consolidator sites, auction sites, and opaque sites started playing a significant role in hospitality product distribution - especially, opaque and wholesale merchant sites have started playing a key role in distribution. As suggested by Brewer and Kang (2005), opaque sites are online channels that hide product information until the purchase is finalized. There are two kinds of opaque used in websites, brand opaque and price opaque. The brand opaque products protect rates by omitting the name or location of the product until the customers have made a purchase (e.g., Hotwire). The price opaque sites display the names of the supplier but the price is hidden in the bundled offerings (e.g., Travelworm). Opaque models can also occur in an auction or ‘name-your-own-price’ situation (e.g. Priceline). A merchant model refers to third party sites that purchase room nights in bulk, mark up the net rate by a predetermined percentage, and resell them through their distribution systems. While these third party sites are additional ways to sell inventory because of their advantage of selling rooms with short lead times offering hotels immediate nonrefundable payments for the rooms sold, they are also hospitality companies direct competitors to their own websites and central reservation offices (Brewer & Kang, 2005).

Increasing complexity of distribution channels also made it harder for hospitality operators to have full control of their inventory and

prices. Experts suggest that because of online distribution hospitality operators are slowly losing control on their own prices, inventory, and price integrity. Sometimes, the rates customers obtain from third party websites such as opaque and wholesale merchant sites are lower than the lowest rate offered at company websites. In addition, Internet booking sites have created customers that are savvy in their ability to search out the best rates making the hotels' pricing strategy transparent. While hotels employ discounting strategies on various websites with the belief that they can increase their market share, recent studies suggest that price cuts do not increase demand as much as they reduce revenue (Enz, 2003). One reason for this is that competitors constantly monitor the rates in their market. One study suggests that it takes only 10-30 minutes for competitors to find out about rate changes in the market (Emeksiz, Gursoy & Icoz, 2005). Basically, companies are losing control of distribution and pricing. In addition, the cost of distribution keeps going up. Electronic distribution is having a significant impact on operators' bottom lines. Even though customers are paying higher prices for hospitality products, the hospitality operator's share from what customers pay keeps getting smaller and smaller. Therefore, it is crucial for companies to develop strategies to regain control of distribution and pricing.

SUGGESTED STRATEGIES

Developments in the marketplace such as continuing consolidation, brand proliferation, globalization, and hospitality companies attempts for disintermediation accompanied with development in information and communications technologies have presented powerful new possibilities for hotel distribution (O'Connor & Frew, 2004). As a result, traditional hospitality distribution channels are going through chaotic changes and slowly making the traditional tourism and travel marketing obsolete. These changes are further fueled by the ever-increasing cost of using traditional distribution channels. These changes are already having a significant impact on hospitality companies' operational strategies. As a result, required skills and talents of hospitality employees are evolving from reservation taking and confirming to inventory controlling and forecasting to selling to managing revenue. In addition, the need for synchronization of multiple channels for most efficient operation is further forcing hospitality operations to develop strategies that will minimize the negative impact of those changes on their operations and profitability.

One of the most important problems created by online distribution channels is the control of distribution and pricing. Hospitality operators traditionally used optimization methods to allocate inven-

tory and to yield maximum revenues. They forecasted and managed their yield using occupancy, room rate with the combination of length of stay, timing of booking and stay, and room type. However, utilization of several third-party sites and online travel agencies made it harder to manage prices. Before the introduction of the online booking, hospitality operators were able to offer different rates to different segments and they were able to hide those rates from the rest of the market. However, with the introduction of the online booking, it became harder to hide the low rates from the rest of the market because they are published online on some third-party website. They are also unable to manipulate blackout dates, allotments, and availability, in addition to the limited ability to close out inventory.

Nowadays, most operators' inventory and rates are available to all customers through different websites. However, operators have limited control on maintaining rate parity. It is also becoming more difficult to keep prices consistent across channels and they are unable to change rates as needed. Since customers are becoming more and more technology savvy, they keep searching third-party websites, provider's websites, and online travel agency websites to find the best deal, which makes application of traditional yield management approaches almost impossible.

Operators need to revise their yield management system. The revised system should address the positive and negative issues introduced by the Internet. Several experts suggest that the lack of effective use of the Internet by operators and failure to revise the yield management systems are resulting in erosion of revenue. Effective use of the online resources requires knowledge of the guest and their reasons for booking, but now also means managing the room inventory and prices online to maximize yield. Operators are now challenged to distinguish the source of demand and the purpose of the stay. Therefore, operators should form a department with an appointed manager whose responsibility is to manage different distribution channels. Because of recent developments and the ever-increasing complexity of distribution systems, managing distribution channels has become a full-time job.

Consolidation is creating distribution tycoons. As discussed earlier, through consolidation several companies are trying to control the flow of distribution and trying to "own customers" because providing distribution services are very profitable. One way hospitality operators can deal with this development is to develop their own booking sites with their own booking engines. While this may be a feasible option for chains, it may not be very feasible for independent properties. In addition, recent changes in society heighten the value of time and the importance of information. Leisure time has become a scarce commodity, and, thus people are not willing to spend hours and hours

searching for information. They are looking for places where they can access the information they need to make their vacation decisions. Therefore, providers' on-line websites need to offer multiple products (air, hotel, car, etc.) from multiple vendors as their key attraction and thus offer the ability to research and purchase an entire trip on-line. Hospitality operators have started to offer comprehensive websites that offers multiple products from several vendors. Those websites provide detailed content and reservation facilities for multiple products, which they can only get by cooperating with other intermediaries. However, they are having a hard time competing with third party and online travel agency websites. Operators need to do a better job promoting those websites. Also they should keep forming more non-exclusive virtual alliances with different vendors to develop new synergistic relationships that will provide one-stop shopping opportunities to customers. However, simple information provision is not enough. These websites should offer detailed information that will be a value to the prospective customers. Providers should also make sure that these websites are easy to surf, fast, safe, and allow customers to make reservations in a fraction of the time, cost, and inconvenience required of traditional methods.

Another critical factor for operators is the positioning or visual ranking of their websites on the user's search engine. The visual ranking is crucial because studies suggest that about 80% to 85% of overall website visits begin in a search engine or a directory service and a large portion of Internet users rely on search engines to locate relevant information on the web (e.g., Google, Yahoo, MSN) (Starkov & Price, 2004). This makes positioning of the hotel website on major search engines critical because if users have difficulty finding the website, they may book through another source, unnecessarily costing the property. Therefore, it is suggested that operators purchase keywords or pay to be listed as sponsored sites to avoid the risk of not appearing on the first page of the user's search. Several of the third-party websites and online travel agencies are using such strategies (Hotels.com, Expedia, Travelocity, and others). If the operators' web site is not on the first page, third-party websites will appear as primary booking options.

Another important issue is the management of the distribution channels and synchronization of distribution channels. As suggested earlier, operators should establish a new department to manage distribution channels. This department can also be used to synchronize all distribution channels in order to eliminate the problems such as losing bookings, unplanned overbooking, etc. that are likely to be created if they are not synchronized.

In summary, distribution channels are going through chaotic changes and these changes are having profound impact on the way hospital-

ity operators distribute their products. While some of these changes threaten the bottom line, they also provide opportunities that can be used for disintermediation and to lower the cost of distribution. These changes also provide opportunities for companies to have full control over the distribution system, inventory, and prices.

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