



Multi-Channel Management: The Hidden Costs of Do-It-Yourself Distribution

There is a DIY (“do it yourself”) trend that has swept across the U.S. over the past decade or two. Large home improvement stores such as Home Depot and Lowe’s enable millions of people to undertake projects that they previously could not do on their own. This DIY phenomenon is strong and in many cases, very appropriate, helping people save money by doing the labor themselves.

There are limits, however. Some things are best left to experts. You might paint a room by yourself. You may or may not undertake a bigger job such as wallpapering a room. But would you install a new 200 Amp circuit breaker? Maybe not. Why? Well, you might save money by doing it on your own, but given the relative complexity of the task, the likelihood of error is probably high, unless you are an expert. If you were not successful you would, at a minimum, have to hire some professional help anyway. But the potential costs of making an error could be much higher. Electrocuting yourself or starting a house fire are risks that are too high to justify undertaking the job. So what do you do? Call an expert – an electrician.

In this example of installing a new circuit breaker, most people would call a professional. The decision is an easy one because, for most, there is a clear awareness of the potential risks and costs if you go down the DIY path and make a mistake. But there are plenty of situations where the potential costs of DIY are not so obvious. There is a very common one in the vacation lodging industry: distribution. Most managers of vacation lodging properties are savvy enough to know that they need to market and distribute their product aggressively, and they are faced with the question of how best to do this. Do they do it themselves or seek out a trusted expert (an “electrician” per our previous example) to do the work for them?

This can be a challenging decision – and one frequently made on erroneous assumptions because the “costs” are not nearly as obvious as in our electrical example. Many lodging distribution managers fall into the trap of assuming they can lower their costs by doing it themselves, only to have to call in the “electrician” when they flip the switch and find that they have no electricity. [Hopefully they call before they get professionally “electrocuted.”] Let’s look at why this is.

Three Key Management Tasks of Multi-Channel Distribution

Any vacation lodging supplier determined to grow its business aggressively knows that they must have a multi-channel distribution strategy. The supplier needs to have its products available for booking wherever consumers are shopping. Specifically, this means getting properties in front of travel agents, listed on the leading online travel agencies (e.g. Travelocity, Orbitz, Expedia, etc.), included in product lines of major tour operators, and available for booking via online dynamic packagers and the multitude of smaller, independent websites. In addition, lodging companies should be able to accept

bookings via their own website, call center and front desk (for walk-ins). This represents a minimum of seven types of channels, but potentially dozens of more specific channels depending on how the supplier organizes them.

Managing these channels is not easy. There are three major management tasks regarding distribution channels:

1. Rate and availability maintenance
2. Reservation processing
3. Yield management

Let’s look at these one at a time.

1. Rates and Availability

Each distribution channel partner needs to have a consistent and accurate snapshot of current rates and availability. Usually, this means loading rate and inventory data via Web-based extranets for each channel. In fact, it is not uncommon for larger suppliers to manage upwards of a dozen different extranets. Typically, it is a front desk or reservations manager who handles the extranets. This is a largely manual process ripe with potential for human error. Extranets must be managed 365 days per year, so it is often the case that two or three different people are authorized to manage the extranets. There are substantial hidden costs to this approach: the hard cost of staff salaries to manage the extranets, and also the soft costs of missed bookings when the property data on the extranet is out of date or a double booking or data entry error occurs.

2. Reservation Processing

Each time a distribution channel produces a booking, the channel partner’s system notifies the supplier. In some cases, this notification comes electronically, automatically updating the supplier’s system with reservation information and allocation of inventory. However, more often than not, a booking comes in through a manual process such as email or even fax. This means a reservationist must re-key guest folio information. This process requires a labor expense and is also prone to errors. Also, if using an extranet, the reservationist needs to update all extranets when a reservation has been logged so that the inventory can be decremented to avoid double bookings. The other option is to maintain separate inventory blocks for each channel. Either way, extranets must be carefully and continually monitored and updated. This takes time and costs money.

3. Optimizing Yield

Airlines and larger hotel chains have been actively managing yield for decades. The vacation lodging industry is just starting to take advantage of this powerful tactic. In short, yield management means tailoring availability, pricing and promotions to maximize the value of the inventory being managed, and thus the revenue that can be generated per unit per night. Conditions such as advance

purchase discounts, “fifth night free” promotions, last minute specials and other programs are common marketing tactics that can help lodging companies increase their yield per booking.

Yield management puts a strong emphasis on getting heads in beds. If a room goes empty, then a revenue opportunity is forever lost. Conversely, when demand is high, active yield managers raise prices dramatically to maximize the value of their inventory. This is the same approach airlines use. A seat on a cross-country flight could cost a few hundred dollars if purchased well in advance, but if purchased at walk-up right before departure, it might cost a few thousand dollars. The “cost” of not getting this critical function right is extremely high, and many vacation lodging companies do not have the resources to manage yield effectively. The net result: they are losing money and don’t even know it.

DIY Distribution: Running the Numbers

Let’s look at some likely costs for a hypothetical property. Suppose vacation lodging company ABC is a 500 unit property looking to decide between managing distribution itself or hiring a third-party expert. How should it proceed? What inputs go into the spreadsheet?

Labor

First, we need to make some assumptions about ABC’s labor costs. Let’s assume they will need at least three part-time people to manage five to 10 extranets. These people will work shifts and cover for each other on weekends and vacations. We will say that the fully loaded cost for these people is \$3,333 per month (or \$40K per year). In some markets this will be low, in other markets this will be high.

Connectivity

We will keep some of our other assumptions pretty simple as well. ABC will need to connect to the GDS systems. There are several vendors who can provide this service and each will charge a nominal setup fee of approximately \$5,000 and a per transaction fee of about \$10. They will also charge a hosting fee per property and various fees to run special promotions.

Credit Card Processing

ABC will also need to process credit cards. It probably already has a rate of about 2 percent with its current vendor. However, when it fully allocates charge backs (which are more frequent with online booking) and associated customer service costs, it is closer to 3.5 percent.

Distribution Deals

Lastly, ABC will need to cut deals with the major distribution partners (such as online travel agencies) and others in their network. These deals are relatively easy to do because the online travel agencies are looking for high quality content. However, they are hard to do at attractive rates. Several major travel sites charge what can amount to 30 percent (or higher) of the gross sale for distribution. Online agencies will usually want a net rate, which means that ABC will have little to no control over their pricing and limited ability to manage rate parity across channels.

Collections

Now comes the fun part: collecting payment after someone has actually made a booking. Online travel agencies typically pay 30 to 45 days after the stay has occurred. In some cases, you may have to invoice them for payment. GDS payments occur on a similar time horizon, but you will be responsible for paying the travel agent commission directly to each agency. This all translates into a fairly substantial flow of paperwork to keep track of the financials.

Comparing the Costs

How does all of this stack up against the likely costs of working with an outside expert in distribution? Well, first, ABC lodging company will have to bear the costs of connectivity, credit card processing and distribution partner deals whether it does it on its own or work with a third-party. An outside firm may facilitate or even provide many of those services, but at the end of the day, these are the costs of doing business in a multi-channel distribution world.

The key point of comparison here is labor. Let’s say the outside expert adds an additional 5 percent of cost on each room night. Of ABC’s 500 units, if we assume that 50 percent of all available room nights are consumed by owners each year, that leaves a total of 91,250 room nights to rent out (250 rooms x 365 days in the year). If we then assume a 60 percent occupancy rate on an annualized basis with an average daily rate (ADR) of \$150, then total revenue would come to a little more than \$8.2 million (60% x 91,250 potential room nights x \$150 ADR). The 5 percent cut of the outside expert is a little over \$410,000. That’s a huge difference over the \$40,000 we allocated for fixed labor costs!

But our comparison should not end there. We must also consider harder-to-quantify costs, such as how effective ABC’s part-time staff would be relative to the third-party expert? How well will it merchandise the product? How effective will it be in optimizing pricing while keeping tabs on the competition in your market? Will these part-time staff benefit from best practices established from years of experience managing distribution for a large portfolio of properties?

The answer to these questions is probably that, overall, they will not do as well. Part of this has to do with experience, resources, technology and know-how. The other part has to do with taking a dispassionate approach. Many property managers are emotionally attached to their product and resist reducing prices or changing strategy even in the face of clear evidence that the marketplace wants something different. Sound familiar?

So it is probably fair to assume that an outside distribution expert can achieve a higher ADR and occupancy rate than the DIY team. Let’s adjust the numbers a little based upon these new factors. We’ll assume the DIY team achieves an occupancy rate of 55 percent, rather than 60, with an ADR of \$135. Then let’s increase the occupancy and ADR for the outside expert to 65 percent and \$160, respectively. This changes the gross revenue picture significantly: \$6.8 million for the DIY team versus \$9.5 million for the expert.

The High Cost of Lost Revenue

Now, it is true that the hard cost for the expert is still much higher – \$474,500 vs. the \$40,000 in fixed labor cost. But that \$434,500 in additional cost is also bringing in another \$2.7 million in revenue that ABC would never have otherwise realized! And there are other less tangible costs to consider as well. A DIY team managing multiple extranets manually will inevitably result in lost bookings (and revenue) due to human error (over bookings, data entry errors, etc.). So let's assume a 1 percent loss in revenue for the DIY team.

Another hidden cost is the lost opportunity to generate supplemental revenue from all of those additional bookings that the expert would have brought it. That could amount to thousands of guests not buying food and drinks at your restaurants and bars, or taking advantage of other amenities and services you may offer. According to our comparative numbers above, ABC's outside expert would deliver 9,125 more room nights than the DIY team. If we assume

the average booking has 2.3 guests, and each guest generates just \$25 per day in incremental revenue, that amounts to an additional \$525,000! So it looks like ABC's outside expert would have already more than paid for itself!

The numbers tell a pretty compelling story. On the surface, it certainly looks like ABC lodging company could save a lot of money by pursuing the DIY approach. But the hidden cost of lost revenue opportunity is potentially significant. Of course, the situation with each vacation lodging company is different, and you will need to create your spreadsheet and run the numbers as they apply to you. But just make sure you factor in those hidden costs of a DIY strategy for distribution. Just like when it comes to replacing that circuit breaker, the potential costs of DIY distribution can be high indeed. And it is definitely not worth getting electrocuted – literally, or professionally!

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