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I Told You So: How The Flash Sale Bubble Popped

I By Max Starkov

Back in early 2011, in an interview article "Another look at flash sales sites," for HOTELS Magazine's successful eMarketing Blog, I argued social buying and flash sales sites such as Groupon Getaways with Expedia, Living Social, SniqueAway.com, BloomSpot, etc. were a recessionary phenomenon, and not a new, emerging distribution channel that was here to stay. There is no doubt that as the economy improves, some of these flash sales sites will go away, and the remaining players will have severely diminished roles in hospitality.

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Since 2001 we have witnessed a similar "countercyclical" increase and decrease in OTA market share: the better the economy, the smaller the OTA market share. As an example, the OTAs' share of CRS reservations for the top 46 hotel brands increased from 11.8 percent in 2008 to a height of 17.1 percent in 2010 and shrank to less than 16.5 percent in 2011 (eTRAK, HeBS Digital Research). All trends point out that the OTA share will decrease to well below 15 percent in 2012.

I also cautioned hoteliers of the existence of "The Law of Unintended Channel Share Loss," which stipulates the following: Any booking via the most discounted channel (i.e. Flash Sales Sites such as Groupon, LivingLocal.com or SniqueAway.com or an OTA) is one less booking for the same hotel via the hotel website, call center and GDS (in that order).

Last year, in several articles and industry presentations I predicted that as recessionary phenomena, the social buying/flash sales sites would suffer from an improving economy and rising travel demand. Why? Social buying and flash sales sites such as Groupon, LivingSocial.com, and SniqueAway.com are an integral part of the economy and the supply-demand market equilibrium. For social buying and flash sales sites to exist, there **must be market equilibrium** (price-quantity) between the demand side (quantity of members/engaged social buyers) and the supply side (quantity of fresh, intriguing deals). Since travel consumers and customers in general (the demand side) are always open to discounts and deals of any sort, an increasingly important part of any social buying/flash sales site is its ability to convince the supply side, i.e. hoteliers, to run deals and accept the large discounts that are integral to the offers.

Similar to 2011, in 2012, all signs are indicating that the hospitality industry continues to be in recovery mode. STR projects all three of the key performance measurements (occupancy rate, ADR and RevPAR) will enjoy steady increases for the year as a whole: a 0.2-percent increase in occupancy to 60.0 percent; a 3.7-percent jump in average daily rate to $105.29; and a 3.9-percent rise in revenue per available room to $63.18.

As travel demand improves, hoteliers have already become reluctant to participate in social buying/flash sales sites because of their "open discount" business model, and provide the supply side of the equation with fresh, intriguing deals. As a result, both sides of the equation suffer and shrink. Online travel consumers, disappointed by the lack of fresh and intriguing hotel deals, have started reverting back to the traditional booking channels: hotel direct, OTAs, GDS and voice.

Here are only some of the indisputable signs of this weakening and shrinkage in the supply side we witnessed in 2011, which have already weakened the demand side as well:

- Visits to social buying/flash sales sites declined in 2011 by 25 percent since June 2011 (Hitwise), due to:
    - Too many competitors
    - Deal fatigue
    - Not enough good deals
- Groupon was forced to partner with Expedia
- Groupon: Customer acquisition costs are out of control:
    - Advertising costs: $263M in 2010 vs. $4.5M in 2009. $180M in Q1 2011!
    - Revenue per subscriber has fallen by 64.2 percent (06/09-03/11)
    - Number of deals sold per customer have decreased by 34 percent
- Off & Away, an aggressive hotel discounter, was forced to shut down at the end of 2011

The most recent developments in early 2012 further support my predictions for "shrinkage" of the social buying space. Groupon, Inc. shares fell more than 7 percent so far in January , 2012 – below the

company's initial public offering price of $20 – on "concern the company may not have as many daily deals to offer as some merchants pull back (as reported by Alistair Barr (Reuters)."

Susquehanna Financial Group and Yipit (a daily deal industry tracking firm) surveyed almost 400 merchants recently about their experiences running daily deals with Groupon, LivingSocial and other providers. According to the survey, "52 percent of the surveyed merchants are currently not planning to feature deals in the next six months. Nearly 24 percent of the merchants intend to feature only one deal in the next six months, the poll also found."

I told you so!

Why should hoteliers be wary of using the social buying/flash sales sites? Here are only a few of the reasons that the economics do not work for the hospitality industry:

- Flawed "Open Discount" business model:
    - Discounted rate is out in the open, which is against rate parity/BRG principles
    - Destroys rate integrity: against existing contracts (OTAs, corporate travel)
- Lack of opaqueness establishes new lower market price: Hotel cannot charge rack rate since customer has accepted the discount rate as the new market value
- Cannibalization of existing customer base: 65 percent of daily deal buyers are already frequent (38 percent) or infrequent (27 percent) customers (ForeSee 06/11)
- Deal face value is artificially ballooned to show value: This puts off potential customers by positioning the hotel as "too expensive"
- Steep discounts of 50 percent to 67.5 percent are simply unacceptable

Here is a case study clearly showing the true cost of distribution via the flash sales sites:

	A Full-Service Hotel in Washington DC			
	Flash Sales [Groupon]	**OTA**	**GDS**	**Hotel Website**
BAR (Best Available Rate) - Two nights	$400	$400	$400	$400
Deal Face Value	$200	$400	$400	$400
Third-Party Commission	35%	25%	12.5%	0%
Net to Hotel	$130	$300	$350	$390
Cost of Reservation	**$270**	**$100**	**$50**	**$10**
Cost as Percentage from BAR:	**67.5%**	**25%**	**12.5%**	**3%**

As we see from the example, the cost of distribution via the social buying/flash sales site is 27 times higher than the cost of a booking via the hotel own website.

Why are some hoteliers still finding the social buying/flash sales sites attractive? There are two types of hoteliers in the industry:

o Smart, sophisticated hoteliers who understand that using social buying/flash sales sites leads to price and brand erosion, and ultimately damages the hotel's price integrity and overall online revenues in the long run

o Hoteliers who employ a "lazy man's approach" to hotel distribution and who are more interested in the immediate results, while ignoring or not caring about long-term repercussions

Some hoteliers participate in social buying and flash sales sites merely because their competition is doing so. My advice? Don't succumb to the devil. A smart hotelier would never repeat the mistakes or dumb moves of a dumb competitor, so why do it now with the flash sales sites? Stick to the fundamentals in hotel distribution and make sure you are covering all your bases in the Direct Online Channel, including website re-designs, SEO, SEM, email marketing, social media, mobile web, online media, the voice channel, and GDS Travel Agent channel.

So, should hoteliers "flash or not flash" in 2012?

The answer is a categorical NO! As mentioned above, the economic model of social buying/flash sales sites does not work for the hospitality industry. The flawed open business model destroys rate parity and establishes a lower market price. The deals cannibalize hotels' existing customer base while putting off potential new customers with artificially ballooned deal face values.

What should hoteliers do in 2012 as far as the online channel is concerned?

The main focus and priority for any hotelier should be to sell as much inventory via the most cost-effective distribution channels that can potentially generate the most bookings while preserving rate parity and price erosion. This is the direct online channel – the hotel's own website.

Click here to read the entire blog article on HOTELSMag.com, as well as a full selection of Max Starkov's blog articles on hot industry topics and latest trends in the online channel in hospitality.

About the Author:

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