



Global Payments in a Pre-paid Environment

Today

To quote the new American President, Barack Obama, these difficult economic times offer a chance to "discover great opportunity in the midst of great crisis." As the case always seems to be, the travel industry seems to be at the forefront of both the economic challenges and the innovative solutions to survive and eventually thrive.

Different aspects of the travel industry face unique and often inter-related complexities. We all remember last summer when the price of oil peaked around \$150 per barrel. For the airline industry, the huge leap in jet fuel threatened the very existence of the industry as we knew it. Having been through many crises before, the airlines realized quickly that dramatic action was not just necessary but that it was critical to survival. With consumers becoming increasingly price sensitive, and the cost structure spiraling out of control due to jet fuel, the airlines quickly implemented across the industry a series of survival measures – many of which have become permanent changes:

- Price increases across the board were initiated
- Fuel surcharges were added to ticket prices to mask the total price increase
- Layoffs across the industry helped reduce costs (and service levels)
- Capacity reductions were enabled to eliminate unprofitable routes, limit over-competition and maintain price thresholds
- Innovative fee structures for ancillary services were added:
 - Checked in baggage fees
 - Credit card surcharges
 - Food and beverage charges
 - Pillows, blankets, headphones no longer free

The results of these emergency measures were overall revenue and income positive for most carriers. Obviously, the free fall in the price of oil has helped partially offset the precipitous drop in revenue resulting from the global recession.

Unfortunately, for the hotel industry, one cannot park a hotel in the desert until demand returns. In addition, the airline industry's move toward a la carte pricing for ancillary services is something the hotel industry has long perfected – with revenue from in-room dining, €4 for a

Coca-Cola Light in a mini-bar refrigerator; \$8 for a laundered shirt; \$29.95 for an hour of internet access; etc. Thus, one may ask if there are any ways forward that the hotel industry could learn from its equally troubled brethren in the airline business.

We would argue that there are two significant opportunities for transformation to the hotel industry with the potential to fundamentally improve the economic stability of hotels. Consider the following scenario – you board a plane flying from Los Angeles to Mumbai. You are upgraded into a luxurious business class seat. Upon arriving in Mumbai, you walk through the airport, collect your luggage and then walk up to an airline desk where you are asked how you enjoyed your trip and a form of payment is requested. Of course, this scenario would never happen with a plane trip – yet it exactly the process flow for most hotel transactions.

Taking this scenario one step further, imagine that the plane ticket was reserved from LAX for \$2,000. To pay for this ticket with a major global credit card, the processing fee for this purchase will range from \$40 - \$60. If I had been offered the option to pre-pay for this transaction in advance using a funds transfer from my bank – perhaps for some additional frequent flier miles, the processing cost to the airline may very well be less than \$1 – with \$39 – \$59 flowing directly to the airline's bottom line. While not all consumers would opt for this payment method, some will – and an appropriate portfolio of payment methods will make consumers happier and reduce transaction processing costs.

In this analysis, we realize that tremendous structural challenges exist in transforming hoteliers to a pre-paid business model. The information to be provided herein is designed to stimulate discussion and provide some additional tools for individual hotel chains to consider in developing a payment strategy.

What's going on today?

Online reservations in the hotel industry vary dramatically for the consumer – with very disparate experiences on hotelier sites when compared to online travel agency (OTA) sites.

For the hotel specific sites, the normal process flow tends to include a reservation with potentially a credit card guarantee. More often than not, the credit card is not even authorized and is sent along to the local property and will only be authorized/settled in case of a no-show situation (assuming the card exists and has an available credit balance).

A few hotel sites are now offering a pre-paid option. The pre-paid option is often at a slight discount and is non-refundable. For most hoteliers, the payment processing is still done at the hotel property level within the Property Management System (PMS). The information is collected centrally on the chain's website and then the information is sent along to the property for manual processing.

For the OTAs, the process flow for the consumer follows the transaction flow for just about every retail transaction. The payment is made before the product is consumed. For the OTA consumer, the overall transaction may include airfare, hotel and other travel products. To the hoteliers, the critical aspect of the consumer OTA experience is that the OTA is training the consumer to pre-pay for all aspects of the travel package, including the hotel stay.

For their business model, the OTAs must commit to their travel partners at the time of purchase (in most relationships). The impact of this nuance to payment processing is very restrictive. An OTA may only offer a consumer a payment product with a real-time confirmation unless it is willing to accept supplemental business risk. As such, during the course of this discussion, we will try to emphasize areas where hotel-specific sites can enact competitive advantages vis-à-vis the OTA option.

What challenges exist?

Quite a few structural challenges exist with a transition to pre-paid transaction processing. The ownership structure of the hotels with a strong desire to have the hotel property control the revenue is a difficult barrier. The contractual agreements with management companies which manage costs and revenue across the transactions are also impediments. Legacy systems also add a barrier to process transformation. In order to enable this payment transformation, these impediments will need to be mitigated. Fortunately, the legacy system issue is beginning to change with some of the hotel booking systems allowing for the pre-payment of transactions.

With a commitment to move forward, the challenges can still be daunting. Hoteliers may have properties in one country but sell in dozens. For instance, a small hotel chain in Tahiti would likely have a limited local customer base – but may need to sell in many countries. In order to create an effective payment strategy, a hotelier will need to:

- Offer multi-currency options to customers
- Understand the local payment cultures in the countries in which sales are occurring, including a thorough understanding of the payment methods that are popular, cost-effective and in line with the business model
- Potentially implement to a variety of payment types around the world, although a number of companies exist that can provide this service with one implementation to many payment products in many countries.

While the challenges are many, the increase in sales conversions and reductions in transaction processing costs should easily exceed the time and energy to overcome the challenges.

What do we anticipate?

The global economic recession seems to be the ideal time for transformational change in the way hotels process payments. With the movements already underway, we see more and more hotel booking engines enabling pre-payment for its hotel customers. In fact, we see an environment where by 2015, the hotel payment cycle will mirror the remainder of online retail.

Based on our conversations with various industry leaders and experts, on more specific levels, we anticipate:

- Consumers will become increasingly comfortable with pre-payment as they continue to be trained by the OTAs and first mover chains that focus on their preferred customers
- Pricing for pre-payment will no longer need to be discounted as long as the terms for pre-payment allow for cancellations similar to the post-pay model.
- In some markets, mirroring the experience of the airline industry, over half of all online sales will be paid for with a payment method other than a credit card – resulting in tremendous cost savings for the hoteliers who develop payment strategies which give consumers choices they want – which just happen to be lower-cost payment methods.

Payment Methods Around the World

Not everyone around the world prefers to pay with a credit card. Visa, MasterCard and American Express would like to think of their products as the ‘normal’ payment method while other payment mechanisms are ‘alternate payment methods.’ Certainly, credit cards will always be a crucial component to any merchant’s online payment portfolio; however, in many markets, the major international credit cards do not have significant market share and are, in fact, the ‘alternate’ payment method.

Credit and Debit Cards

Every merchant is familiar with credit card processing of online and call-center transactions. In many geographies, the major international credit card companies, Visa, MasterCard, American Express and JCB, hold enviable market share positions. The payment products are well-established and offer many consumers with a high comfort level for the purchase. Working through local acquiring banks, hoteliers and OTAs are able to offer payment options in local currencies to these cardholders.

Credit and debit cards provide an immediate authorization as to the availability of funds on a specific cardholder’s account. From the hotelier perspective, this authorization should, in the great majority of instances, provide enough comfort to allow the booking to be reserved. With

credit and debit cards, merchants do maintain some risk that the transactions are fraudulent and could be subject to 'chargeback' by the consumer.

In addition to the above-referenced global brands, quite a few local or regional cards maintain popularity. Cards like Carte Bleue in France or Tarjeta Naranja in Argentina are very well known in their local markets. These regional cards offer a local alternative and may have a higher market share in a target sales market. In some cases, regional cards are co-branded with one of the major global brands. Regardless, the incorporation of regional cards does allow for a fairly simple localization to a web interface.

With a move toward a pre-paid environment, hoteliers are able to incorporate payment via pre-paid cards, including amenity and gift cards, which often process in conjunction with credit card processing systems. These mechanisms allow for the simpler processing of third party transactions. Finally, Virtual Credit Cards (or single-use cards) may enable smoother hotel check-in and accommodate legacy system processing with some hoteliers.

Credit and Debit Cards: Some ways to maximize effectiveness

- Fraud Screening – with credit and debit cards, merchants are at risk for fraudulent transactions. Many companies create internal rule sets to attempt to mitigate fraud. More often than not, these rules turn away more good customers than bad. A number of companies offer expertise in ways to minimize fraud while maximizing accepted good transactions.
- 3D Secure – the global card schemes have ushered in a 'solution' to consumer concern about card security and identity theft. Verified by Visa, MasterCard Secure Code and J Secure are all cardholder registration-required confirmation tools designed to better assure your customer is who he or she says he is. From a merchant perspective, the 3D Secure transaction results in a liability shift from the merchant to the card scheme should a fraud be perpetrated. A hotelier must understand its local sales market to determine the effectiveness of implementing 3D Secure. Some regions have embraced and adopted 3D Secure. Others lag in acceptance. Incorporation of 3D Secure in markets without acceptance could result in increased drop-off rates and, thus, lower conversion rates. 3D Secure is not available for call-center sales.
- Installments – in much of Latin America, consumers prefer to (and often demand to) pay over time. Since credit card credit limits tend to be lower in these markets, a 7-night stay at a hotel in London might exceed a normal credit limit. As such, in many Latin American countries, credit card issuing banks allow a consumer to choose to pay over time. The consumer might pay in 2, 3, 4, 6 or 12 installments (up to 36 in Colombia). The merchant is guaranteed its payment but may receive payments over the course of the installment period.

- Descriptors – depending upon the acquiring bank for credit cards, hoteliers may be able to incorporate stay details into the descriptor as a mechanism for chargeback reduction.
- Local Acquiring - to avoid foreign currency exchange or foreign transaction fees, hoteliers can offer multi-currency solution through a local acquiring channel. Without the local acquirer, in some countries, a consumer will be charged an additional fee ranging from 1 – 4% of the purchase prices.

Credit and Debit Cards: Cost Structure

Credit Cards tend to be one of the most expensive methods of payment for the hotel industry since most providers will charge a percentage of the overall transaction value – along with a gateway or transaction processing fee. Debit cards tend to be charged on a flat fee basis so for hotels, the cost of debit cards tends to be less.

In both cases, merchants may experience supplemental costs for chargebacks or reversals of transactions.

Credit and Debit Cards: Advance Booking

Credit and debit cards both offer real-time confirmations as to the availability of funds. This payment mechanism can be used for any bookings, including last minute reservations.

Direct Debits

Direct debits automatically draw money from consumer bank accounts via an electronic fund transfer. The payment is a merchant controlled (pulled) mechanism wherein a consumer provides banking account details and authorizes a merchant to pull the funds from the consumer's account. Available on an ongoing/recurring basis, it is popular for collecting subscription payments or recurring billing. However, it is also gaining popularity for one-off online payments, such as airline tickets.

This payment method option is available in a number of countries around the world – including Germany, where it is called ELV, and the USA, where it is known as ACH. The benefit to offering potential hotel guests the option of paying with direct debit is two-fold. First, the payment method is a flat-fee payment mechanism. Second, the direct debit opens the potential for anyone with a bank account to purchase a hotel stay – rather than limiting to the universe of credit card holders with adequate available balances.

Direct Debit: Cost Structure and Advance Booking

As mentioned, the cost structure for direct debits involves a flat fee – usually much less than €1. While there is less fraud risk than credit card processing, there is some risk that the transaction will find insufficient funds when the consumer's bank is contacted for payment. Additionally, some risk of consumer reversal, like a chargeback, does exist but it tends to be limited to a very short window of time after the transaction is completed.

Given the risks of insufficient funds and reversal, direct debits are best suited to 7+ day advance bookings and are not the best choice for last minute purchases.

Bank Transfers (Local Wire Transfers)

Local wire transfer involves a consumer paying into a merchant's bank account around the world. The consumer can pay in person, via phone or via electronic banking. From a logistical standpoint, the hotelier offers a reservation to be held for a certain period of time. The consumer then must initiate (or 'push') the payment to the hotelier. With a customer pushed payment, the potential for funds never to be sent does exist and from an inventory-management system must be addressed in the initial payment rule set.

Bank transfers will work well with hoteliers as they are non-reversible and some consumers prefer bank transfers as no sensitive financial details are shared. Bank transfers are charged as a set per-transaction fee rather than a percentage, which makes them inexpensive for higher-value hotel transactions.

Bank Transfers: Cost Structure and Advance Booking

Again, bank transfers are charged at a flat-fee – also likely to be less than €1 or €2 for transfers which are not cross-border. The great thing to the hotelier is that once funds have been received from a bank transfer, because they are customer 'pushed,' there is absolutely no risk for fraud nor chargeback.

Because of the inventory management challenges associated with the potential non-transfer of funds if the consumer does not complete his or her part of the transaction, the bank transfer product is NOT recommended for last minute purchases but is highly recommended for longer advance purchase transactions.

Real-time Bank Transfers

In several markets, banks or groups of banks have teamed up to provide a payment option which is often known as real-time banking. Real-time bank transfers give an immediate online authorization/confirmation of funds availability. It offers quick settlement (usually next-day), security for the merchant as payments are guaranteed (no chargeback because it is a customer

pushed payment), and security for the consumer (consumer interacts with their own online bank application). This payment method is solely available for internet-based purchases and involves a consumer being redirected to his bank login page for security check and then confirmation.

Real-time banking is also more cost-effective for higher value transactions, combining the benefits of a card-based transaction with the benefits of a bank-based payment.

Real-Time Bank Transfers: Cost Structure and Advance Booking

In many countries, real-time bank transfers are charged at a flat-fee – again less than €1 or €2 per payment. In other countries, pricing is based as a percentage of the transaction amounts. As with bank transfers, once funds have been received from a bank transfer, because they are customer ‘pushed,’ there is absolutely no risk for fraud nor chargeback.

Because of the immediate authorization and confirmation of funds, the real-time bank transfer product is recommended for last minute purchases.

E-Wallets

As the payment landscape continues to innovate, quite a few upstate payment methods have gained traction in online and call center distribution. Some, like PayPal, have made tremendous inroads in the airline industry but, to date; little effort has been targeted toward the hotel industry given the prevalence of post-paid transactions.

With an electronic virtual wallet, consumers can upload money to an account and pay funds online. This secure method of payment was a key factor in the early success of online auctions and has quickly become an acceptable eCommerce payment method across multiple industries. Among the more successful e-Wallets are PayPal, WebMoney, and Moneybookers

PayPal is the largest worldwide e-wallet with over 160 million account holders. WebMoney is an electronic money and online payment system founded in 1998. Originally targeted mainly at Russian clients, it is now used world-wide. The company has more than 4.5 million users. Based in the UK and founded in 2001, Moneybookers has over 5 million members and is available worldwide. Unlike many competing online fund transfer services, Moneybookers requires identity verification before using their service to minimize fraud and prevent money laundering.

E-Wallets: Cost Structure and Advance Booking

E-Wallets generally charge a percentage of transaction as the processing fee to merchants. In most cases, this charged amount is less than a comparable credit card rate; however, the true

value of e-Wallets is the ability to sell to demographic groups that generally have lower credit card penetration rates.

E-Wallets provide an immediate authorization and can be used for last minute bookings.

Cash-Based Options

For many consumers, cash is the only option available, especially in emerging markets, such as Eastern Europe, Latin America, Africa, and Asia where credit card penetration is low and where bank infrastructure is still developing.

For some hoteliers, the ability to sell into some of these markets will necessitate the inclusion of cash payment options, like Chinese Postal Payments, konbini (convenience store payments) in Japan and/or Western Union. With these payment options, a consumer will make a reservation and then go to the post office, convenience store or Western Union location with cash to finalize the booking.

Cash-Based Options: Cost Structure and Advance Booking

The cost structure tends to be a flat fee – which, again, is advantageous to hoteliers. While many of these cash-based systems will provide an immediate notification upon receipt of funds, the consumer must go to one of these locations to pay with cash. Since an action must occur and there is no guarantee the consumer will complete the transaction, these payment methods are not recommended for last-minute purchases.

Why?

The benefits to the hotel industry by offering pre-paid transactions have the potential to be transformational for the hoteliers. As stated before, the consumer has been trained by the OTAs to expect to pay for hotel rooms before travel commences. Moreover, hotel bookings, along with car rental, remain two of the only internet-based transactions where payment occurs after commitment to purchase. With a transition to a pre-paid model for hotel bookings, the hoteliers can expect to see the following benefits:

Cash Flow

A luxury hotelier currently allows for bookings to be made on its website and through its voice channel. The reservations on average are made 30 days in advance. Currently, the reservation is passed along to the local property and the consumer will pay with his or her credit card at the end of the stay. With a pre-paid solution, the hoteliers would have their funds well in advance of the visit – and, because of this average time lag, there will be a far greater likelihood of identifying a fraudulent transaction.

An increase to cash reserves as a result of pre-payment is just one aspect of the cash flow benefit. A second positive cash flow benefit to pre-payment is the end to the ongoing challenges to collecting upon ‘no-show’ reservations. With a fully pre-paid solution, this longstanding complication to the hotel booking business will be rendered moot.

Increased Conversions

For hoteliers, the most cost effective distribution channel will likely be their own website and call centers. With a commitment to pre-paid transactions, the hoteliers will be able to offer its consumers an appropriate portfolio of payment products. Done correctly, this portfolio should be designed to maximize revenue by increasing conversions to the hotelier’s website. From a competitive standpoint, the inclusion of locally-preferred ‘alternate’ payments can provide hoteliers with a competitive advantage when compared to the payment options allowable under the OTAs business model.

To understand the magnitude of the potential benefit, one may look at customer preferences. The following chart demonstrates that even in key European economies with high internet penetration, payment preferences vary – and do not solely rely upon credit cards for online payment:

"How do you normally pay for each of the following?"

Online shopping:	EU-7	UK	SE	NL	DE	FR	IT	ES
Credit card	38%	51%	20%	31%	24%	55%	23%	43%
Debit card	25%	49%	50%	7%	5%	28%	12%	24%
Online banking transfer	18%	2%	30%	55%	30%	9%	2%	10%
<i>Per Rechnung</i> (with invoice)	N/A	N/A	N/A	N/A	45%	N/A	N/A	N/A
Standing order/direct debit	6%	1%	0%	8%	14%	2%	4%	3%
Cash	3%	1%	7%	2%	1%	1%	13%	8%
Check	N/A	1%	N/A	N/A	N/A	9%	N/A	N/A
Giro	N/A	N/A	10%	22%	N/A	N/A	N/A	N/A
Other way	3%	2%	2%	5%	5%	2%	3%	8%
I don't do this	9%	8%	7%	4%	6%	6%	44%	12%
Not answered	2%	1%	5%	1%	3%	2%	0%	3%
Sample size	4,052	1,080	210	350	1,237	703	217	255

Base: 4,052 European online shoppers
(multiple responses accepted)

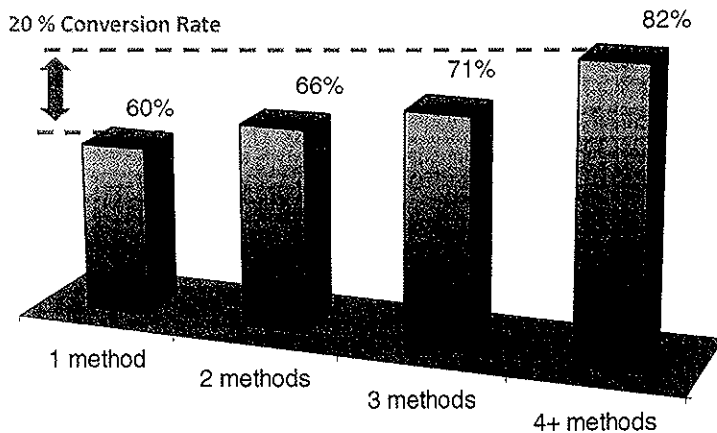
Source: European Technographics® Benchmark Survey, Q2 2008

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Source: Forrester Research, Inc.

Compilation of research across many industries shows that the incorporation of additional payment methods. Of course, many properties have high occupancy rates – the increases in conversions may not lead to significant increases in occupancy rates for these locations; however, the hotelier can expect an increase in conversions on its own web interface.

Effect of Increased Payment Methods



Cost Savings

With the high average transaction value for the hotel industry, an appropriate portfolio of payment methods should result in significant cost savings in many markets. KLM-Air France has been the leading innovator with regard to payments in the airline industry. According to Maarten Rooijers, E-Payments Manager at KLM, "Alternatives to credit card payments have contributed to an increase in KLM's online sales and has lowered KLM's online payments distribution costs."

Creating an efficient payment strategy for a pre-paid hotel industry will include a diversified portfolio of payment options – almost all of which will result in lower processing fees and less risk than credit cards. To see a hypothetical example of the economic power of this transformation, please assume that a hotelier has 500,000 transactions – with an average value of \$500. If the hotelier can shift 50% of its transactions from credit cards to other, customer preferred, methods (depending on the geography), the potential cost saving realized would be dramatic.

Using this example, the cost savings would be roughly 40%:

500,000 \$500.00	Credit Card Gateway	Debit Card Full Service	Direct Debit (E)	Online Banking	Bank Transfer	Cheque	Total
Gateway Fee	\$0.50	\$0.45	\$0.45	\$0.45	\$0.45	\$1.50	
Network Fee	2.00%	\$0.50	\$0.50	\$1.50	\$1.50	\$1.00	
AVG / Payment	\$10.50	\$0.95	\$0.95	\$1.95	\$1.95	\$2.50	
Payment Split 1	100%	0%	0%	0%	0%	0%	
TOTAL	\$5,250,000						\$5,250,000
Payment Split 2	50%	10%	10%	15%	12%	3%	
TOTAL	\$2,625,000	\$47,500	\$47,500	\$146,250	\$117,000	\$37,500	\$3,020,750

Cost Savings **\$2,229,250**

Conclusion

As previously stated, the opportunity for transformational change in the hotel industry exists and the recent global economic tumult may provide the perfect environment to reconsider previously sacrosanct business processes. Transformational change is never easy but with the potential for increased cash flow and cost savings, an industry-wide movement toward pre-paid transactions should make the consumer and the hoteliers happier at the same time.

In summary, the anticipated highlights of this discussion are four very basic points:

- Hotels remain one of the very few industries which allow its customers to book/buy online and still allow for payment to be made after the service is rendered
- OTAs have trained consumers to pre-pay for hotel stays
- Pre-payment will increase cash flow and solve the 'no show' issue for hoteliers
- Pre-payment allows for the introduction of non-card based payment options which will increase customer satisfaction, generate higher conversion rates AND reduce transaction processing costs.

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