



PAYMENTS TRENDS AND FUTURE BEST PRACTICES IN THE HOTEL SECTOR

Global Hospitality Payment Working Group

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1 EXECUTIVE SUMMARY

Hotel Electronic Distribution Network Association (HEDNA) set up a Global Hospitality Payment Working Group in early 2016 to provide clarity as to options, design and best practices for the entire stream of payment processing in the hotel industry. Mike Carlo (Onyx CenterSource) and Pascal Burg (Edgar, Dunn & Company) co-chaired the HEDNA Global Hospitality Payments Working Group that included representatives from a wide range of hotel industry stakeholders.

This white paper is primarily based on the findings from that payment working group. The objective is to gain a better understanding of the current situation about payments in the hospitality sector, assess available solutions that would address the key pain points and recommend future best practices for three key areas: Guest-centric payments, B2B payments and Commissions.

Payment processing for the hotel industry has become increasingly complex with the advance of technology and rising demand from customers in today's digital world. The growth of mobile, new entrants and need to accept international payment brands have pressured hotels to assess and revamp their payment systems. However, the entire stream of payment processing is too difficult to be handled as one big process. The HEDNA Global Hospitality Payment Working Group (hereinafter referred to as the "Working Group") decided to develop three smaller issue focused groups to identify the key payment pain points, potential solutions and future best practices. The three focused groups include:

- ***Guest-centric payments***, which looks at how hotel guests pay for their services and the major hurdles that hotels face in optimizing their payment solutions
- ***B2B payments***, which focuses on how hotels receive payments from their trading partners (e.g. travel agencies)
- ***Commissions***, which concentrates on the commission model. Priority has been given to smoothing the commission process for business travel bookings made through the Global Distribution System (GDS)

A key characteristic of the hotel industry is property-centric payments. Hotel payment strategies are currently designed around where the property is located – not where the guest (purchaser) is located. The legacy payment processes, given ownership structure of certain hotel brands, have created major hurdles for hotels, including the ability to accept any payment methods from any channel that customers wish to use, handling prices in different currencies, having corporate control or overview of their numerous overlapping acquiring relationships and ensuring PCI compliance. To

optimize their payment solutions, hoteliers are considering moving towards centralizing payment systems that are guest-centric. Many believe a hospitality focused solution should be reliant on the best experience for the guest. Meanwhile, the hotels can still get their funds locally in the expected currency.

In terms of B2B payments, the relationships between hotels and their trading partners generally fall into two broad categories: (1) Merchant Model and (2) Agent Model. Under the merchant model, customer pays upfront to the travel company for the reservations made and, later, the travel company pays the hotelier the amount agreed. Over 90% of the payments are made using either money transfer or credit cards, although both payment methods have their shortcomings and advantages. The Working Group has identified technical challenges that needed to be addressed and envisioned that the concept of Value Added Network (VAN) could be leveraged as potential solutions.

Under the agent model, a customer makes a hotel reservation through the travel agent and pays the hotel directly upon check out. The hotel, in turn, pays the agent a commission for that booking. The Working Group believes intermediaries will continue to exert significant influence over which hotels they refer business. Hence, even though the existing commission model has demonstrated success, the group has worked together to identify where improvements need to be made and how to achieve those improvements.

Overall, the findings from the Working Group suggest that payments have been an extremely important topic for hoteliers because it can impact both sides of their P&L (e.g. not only cost of acceptance but also revenue). The table below highlights some of the potential impacts in each of the three key areas given the appropriate payments strategies and initiatives.

	(+) Revenue	(-) Costs
Guest-centric payments	<ul style="list-style-type: none"> Promote additional services and generate new revenue sources Accept local payment methods and AFOPs to boost sales conversion 	<ul style="list-style-type: none"> Reduce operating complexity Reduce service fee
B2B payments	<ul style="list-style-type: none"> Optimize payments received from travel agencies 	<ul style="list-style-type: none"> Eliminate manual processing Improve efficiency
Commissions	<ul style="list-style-type: none"> Receive more business from intermediaries 	<ul style="list-style-type: none"> Reduce manual work Improve collecting and reconciling process

2 THE RATIONALE FOR CHANGE, INCLUDING ECONOMIC JUSTIFICATION

The primary intent for this Working Group and this Future Best Practices document has been to review the payment process and infrastructure existing today, to compare and learn from other industries and to identify a vision of where hotels can and should be in the near term.

The rationale for change depends on the perspective of many parts of the hotel payment ecosystem.

- For **marketing and sales**, the rationale is simply to make guests feel comfortable and welcome throughout their experience
- For **distribution**, the rationale is more about keeping guests on a hotel's preferred journey
- For **eCommerce**, the rationale is conversion and upselling non-room revenues
- For **finance and investors**, the most critical rationale will be adding 1 – 4% to the bottom line for all cross-border guests

As hotels increasingly focus on driving direct sales to their own apps and portals, guests have expected and are starting to demand a seamless, fully integrated relationship between themselves and the hotels. Guests view their mobile device as an appendage which will accompany them throughout their journey – from taking pictures, posting reviews, checking in, interacting with on-property services to checking out. With this journey, a guest will need to pay and a hotel will need to receive payment – ideally in the way the guest prefers to and is able to pay the hotel.

In this new guest-centric, mobile world, the industry's legacy is its worst enemy. Hotels, for millennia, have accepted payments at property in forms of payment determined by the hotel property. While OTAs and other travel companies have disrupted this mindset over the past twenty years, every major hotel brand continues to operate with a property-centric mindset with regard to payments. To put this into perspective, for example, Apple would never try to sell an iPhone in the US for 3,400 RMB simply because the phone was made in China. Yet, the hotel industry continues to offer guests pricing for its products based on where the hotel is located. Historically, the complex ownership structure of the hotel business led to this phenomenon. Hoteliers wanted control over their funds, often leveraging personal relationships at local banks to get their funds as quickly and cost-effectively as possible. However, the industry has changed. Economies of scale for payment processing will make a difference across a global or even regional hotel brand. For a cross-border guests, hotel brands are easily spending 1 – 4% more to process transactions in this legacy manner. Offering optimal routing in credit card transactions, multi-currency pricing and locally preferred payment methods (which are often charged on a flat fee) can dramatically reduce the cost of payment processing, which will make a difference in a low-margin hotel business.

In a Hudson Crossing report on cross-border payments in the travel industry, the report's author, Henry Harteveldt, demonstrated how a well formulated, guest-centric payment strategy could move payment processing from a cost center to a profit center for cross-border guests.

Multicurrency Pricing and Locally Preferred Payments Offer Cost Effective Options

US company selling in Germany		Multicurrency Pricing (MCP)		
Form of payment	Credit card	Credit card	Credit card	Bank transfer
Selling currency	USD	EUR	EUR	EUR
Acquiring bank location	US	US	Optimal	N/A
Transaction amount	\$1,000	€768	€768	€768
Direct cost (2.7% US processing; 1.6% optimal processing, 1 Euro flat fee bank transfer)	\$27	€21	€10	€1
Minus: Indirect costs: fraud/chargeback/labor (2%)	\$20	€15	€15	N/A
Net	\$953	€732	€742	€767
Multicurrency FX conversion gain (3%)	N/A	€23	€23	€23
Net	\$953	€754	€765	€790
Cost/gain	\$47	€13	€3	€22
EUR value in USD	N/A	\$18	\$4	\$29

Source: Hudson Crossing, Harteveldt

This analysis does not contemplate the economic benefit of channel shift – effectively keeping a guest, such as an outbound Chinese customer, on a direct booking channel because a brand can accommodate locally preferred payment types. In assessing these future best practices for the industry, one of the first ‘pain points’ raised was a requirement for many major hotel brands to redirect Chinese guests from their brand.com apps to a Chinese based OTA that could accommodate payment in Alipay, UnionPay, WeChat, etc.

Moreover, the analysis above does not incorporate significant ancillary sales for services and goods on property. Payment and currency are both very important criteria for a successful retail transaction.

For this transformation to occur, assumed conventional wisdoms will need to be shaken by the industry:

- Hoteliers may very well receive funds more quickly and pay less to process transactions in a central processing environment



- The notion of pre-paid transactions becomes more prevalent with locally preferred and less expensive payment options
- Pre-paid does not need to be discounted nor non-cancellable. Airlines have fully-prepaid fares for refundable first-class tickets. The OTAs have done a lot to educate the consumers
- A one-night no-show penalty is not sufficient for a hotelier taking a week or more out of inventory. The one-night penalty was industry designed decades ago and is not in any way required

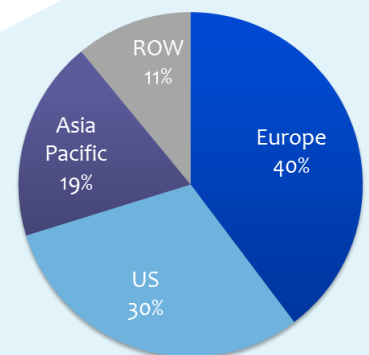
The Working Group firmly believes that as an industry we can do a lot to make our guests happier through localizing payment strategies around them – and, as a result, work to reduce payment processing costs for hoteliers.

3 GUEST-CENTRIC PAYMENTS

The global hotel industry revenue in 2016 was about \$600bn USD, of which 80% was room spend and the other 20% was ancillary spend (e.g. food, beverage, entertainment, retail, gym/spa, etc.) Ancillary services are becoming an increasingly important part of the hotel business as hoteliers recognize their potential to drive revenue growth. With the support of mobile technology, hoteliers can now better promote their additional services while delivering personalized and seamless experiences to their guests. Increasingly, payment is a critical piece of the puzzle that hoteliers need to solve to accommodate the different guests from around the world.

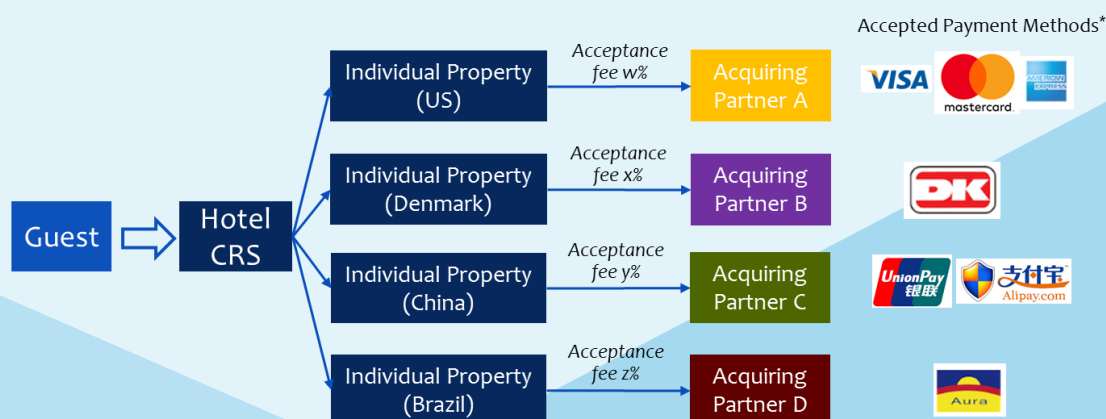
Europe and the US continue to represent the key regions for the industry, accounting for approximately 70% of total global hotel spend. While there are more large chain hotels in the US, smaller independent hotels are more common in Europe and the rest of the world. Nonetheless, the hotel industry is very fragmented due to the business ownership structure. Most hotel properties are either managed, franchised or licensed. Only a small portion of the properties are owned by the brand (or company). Hence, the conventional hotel business models are more property-centric. This also means its payment strategies are designed around where the property is located – not where the guest is coming from.

Global Hotel Spend Volume



While most hotels have a centralized room reservation system, they do not have a centralized payment processing solution. When the guest reserves a room, payment information is captured during the booking process but then gets forwarded to the individual property where the guest will stay. That individual property is the merchant of record, which has its own acquiring relationship to manage and process the payment. The chart below illustrates this process.

Property-centric Payments



*Note: This is for illustrative purpose only. Not all accepted payment methods corresponding to each country are shown in this chart.
Source: EDC



This mechanism has created four major hurdles for hotels to optimize their payment solutions and subsequently profit margin.

1. **Payment acceptance:** the ability to accept any payment method from any channel that customers wish to use. This is particularly important as the industry is moving toward a more omni-channel approach. In addition, international guests are increasingly looking to pay with their accustomed payment methods when they travel
2. **Multi-currency:** Hotels need to accept payments from customers from any country, and hence, they face the challenge of handling prices in different currencies when selling hotel rooms
3. **Operational inefficiency:** Hotel chains typically do not have corporate control or overview of their numerous overlapping acquiring relationships, which are managed at the property level. These multi-vendor arrangements have made hotel payment processing very complicated, and in fact, have limited the chain's ability to negotiate with service providers, which leads to higher cost
4. **PCI compliance and security:** Since hotels are not “islands on their own”, they rely on connectivity with multiple players. So, while the Central Reservation System (CRS) or Property Management System (PMS) used by a hotel might be compliant to the Payment Card Industry Data Security Standard (PCI DSS), the interface between the many systems used in the hotel sector may not be PCI DSS compliant

To triumph these hurdles, hotels are considering moving towards centralizing payment systems that are guest-centric. Many believe that a hospitality focused solution should be reliant on the best experience for the guests.

3.1 PAYMENT ACCEPTANCE

With the advance of technology and explosive growth of global smartphone penetration, customers today are well-informed and technologically adept. Numerous merchants are already focusing on omni-channel retailing to deliver consistent, personalized, and new experiences to customers while providing them with choice and convenience. To compete more effectively, hoteliers are also catching up with this trend. Many are integrating mobile technology to enhance their guest experience. However, it is very difficult to tie the mobile app to a specific property, which may have different a business strategy especially when it comes to payments.

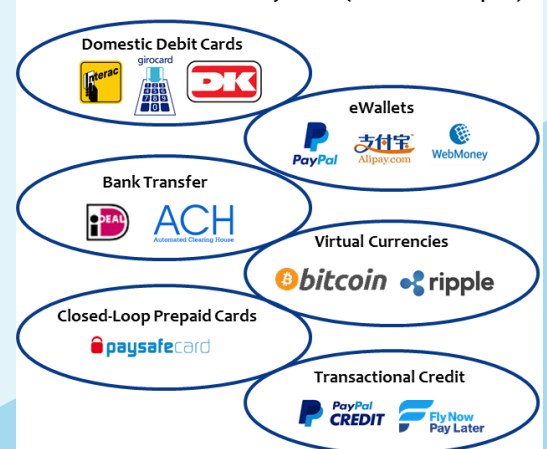
Digitization of Hotel experience

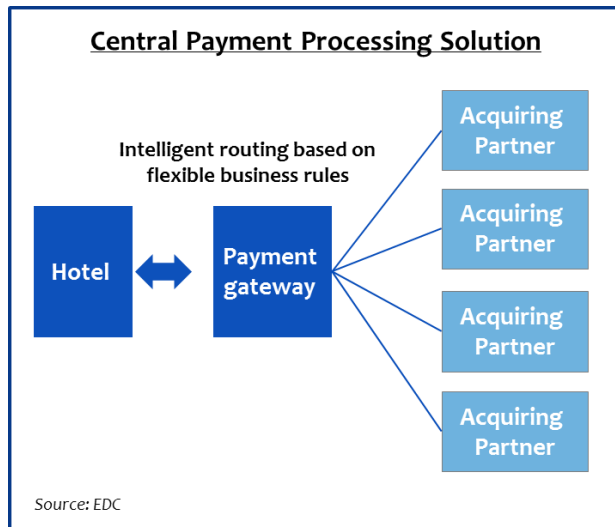
- ▶ **Accor** - 'Welcome' service allows guests to check in online two days prior. Check-out simply consists of handing in the key to indicate that the room is free
- ▶ **Intercontinental** Hotel Group launches mobile check-in and check-out via mobile app
- ▶ **Hilton** Group - mobile check-in and check-out via mobile app incl. Room selection – app constantly active during checked-in period providing service offerings
- ▶ **Starwood** Hotels piloting Bluetooth for key less room entry via mobile app and Apple Watch
- ▶ **TUI** Smart Band at resort hotels enabling access & payments to entertainment and fitness facilities with spend monitoring via app
- ▶ **James** Hotels app uses iBeacons to provide guests concierge like experience, providing location-based suggestions for dinner, shopping, and activities

On the other hand, the number of cross-border travelers are climbing year over year. According to China Tourism Academy, over 130M Chinese tourists were traveling outside of mainland China in 2016 and that number will continue to grow. This group is critical because Chinese guests typically prefer to pay with their local payment methods (e.g. China UnionPay, Alipay, WeChat). Hotel brands outside of China cannot accept those payment methods due to their property-centric legacy payment systems. Instead, they have redirected their Chinese guests from their brand.com to a Chinese OTA, which charges them commission fees. Facing similar issue with other international guests, hotels need to be able to offer a broad range of payment methods to boost sales conversion and thereby revenue.

In addition to the international credit card brands (e.g. MasterCard, Visa, American Express, Diners Club, JCB, China Union Pay, etc.), many hotels are considering accepting locally preferred alternative forms of payment (AFOP) by major local markets to increase conversion rates. AFOPs are particularly relevant in countries like India and Russia where many customers do not have international credit cards, or countries like Germany or the Netherlands where a large segment of customers prefer to use domestic debit cards or bank transfers.

Alternative Form of Payments (selected examples)





To overcome the payment acceptance hurdle, many large hotel chains are seeking to move away from their property-by-property payment model and replace it with a centralized system that can intelligently route transactions to specific acquirers based on business rules. The chain would then become the merchant of record, who is responsible for contracting with payment service providers (e.g. acquiring banks), managing the entire payment process, disbursing funds to individual property, controlling fraud and handling disputes.

With the benefit of multiple acquirer relationships under a centralized payment system, the chain could easily accept various payment methods, achieve additional ancillary revenue streams and reduce operating complexity. Additionally, it could be a solution for creating an omnichannel experience as the chain has better control over the look and feel of the payment page across all guests' touchpoints.

3.2 MULTI-CURRENCY

Global hotel chains often face the challenge of handling prices in different currencies when selling hotel rooms, which limits their control of the final pricing due to currency fluctuations. While international credit cards can easily handle the currency conversion in most countries, there are two issues: (1) a foreign exchange conversion incurs additional fees for the guest and/or for the hotel; (2) a segment of the customers are more comfortable with the prices presented in their local currency.

Hotels can potentially tackle this hurdle in two ways.

- **Presenting prices upfront in the relevant currency:** brand.com and other channels can present prices in relevant currency based on customer's IP address or country of residence. There are FX solutions provided by banks that enable hotels to lock in FX rate and avoid taking any currency risk when presenting room rates in different currencies. Currently, individual property may have its own banking partner to handle the currency risk

- **Charging the customers at the point of sales (POS) in the relevant currency:** hotels can also charge the customer in the relevant currency via the POS terminal at the time of checkout. This functionality is referred to as Dynamic Currency Conversion (DCC) and is provided by merchant acquiring banks or by independent financial technology providers. This is also a revenue generating opportunity as the service providers typically share the income generated from processing the DCC transactions and rebate a portion of the (typically 3%) conversion fees to the hotels²

Addressing the issue of multi-currency pricing can increase hotel revenue, assuming that some customers would buy more when they could buy in their preferred currency. However, currently the individual property is handling its multi-currency transactions with its own rules and policies, which leads to operational inefficiency and inconsistency in terms of guest experience. By migrating to a centralized payment system, the hotel chain can partner with a smaller number of service providers to streamline the process while reducing the service fee. In addition, with a centralized system, the chain can set global standard rules or policies in how they handle currency exchange and what currency they can handle. This way, travelers would know exactly what to expect, as their experience should be consistent across all properties.

3.3 OPERATIONAL INEFFICIENCY

Due to the property-centric model, hotel chains typically have numerous overlapping acquiring relationships (by geography, channel, or payment method). Payment service providers (PSPs) are sourced at the property level. Henceforth, this multi-vendor arrangement has made the hotel payment processing management extremely complex. There are different rules, policies, merchant acceptance fees, payment methods accepted, etc. In addition to creating inconsistent experience for the guests, the property-centric model has cost the hotels extra resources and money to manage the multiple relationships while not having a corporate wide view of the pricing or other terms and conditions.

When the payment process is done centrally, the chain can reduce operational complexity by optimizing the number of relationship with service providers. An obvious lever used in many other sectors to reduce costs is by running a Request for Proposal (RFP) process to select their PSP(s) and their acquiring bank(s) with the idea of consolidating their relationships to an efficient number of payment partners. Certain PSPs are also taking on the role of acquiring banks and providing a one-stop shop for the acceptance of different payment methods across multiple channels. Hotel chains can consider having the proper number of contracts, connections and relationships with service providers. This would give them the power to optimize merchant acceptance fees while at the same time decreasing the complexity of managing service providers

² Elavon

3.4 PCI COMPLIANCE AND SECURITY

Card fraud is currently not a significant issue for the hotels because payment transactions are done at the property in a face-to-face environment at checkout. However, it may become a bigger concern as more payments are coming from the direct prepaid model or mobile app. Experience from other sectors shows that card fraud rate is higher in card-not-present (CNP) transactions when compared to card-present.

However, many hotels are more concerned about the card security, especially in the context of PCI DSS compliance, the cost of becoming / remaining PCI DSS complaint and/or the cost of any security breach. For example, one large international travel supplier indicated that the initial cost to become PCI DSS compliant far exceeded \$10M. Being PCI DSS complaint does not only impact the cost but also the revenue. For example, to be PCI DSS compliant, hotels do not store validation code data. This can become a revenue issue when the hotel tries to charge the customer's card for one night in case of a no-show. Since the hotel needs to process the card transaction without the card validation code, card issuers typically decline this transaction, and the hotel can therefore not collect the funds.

Currently, hotels rely on the connectivity with multiple players. This means while their CRS or PMS may be PCI DSS compliant, the interface between their existing systems may not.

By migrating toward a guest-centric, centralized payment system, hotels can have a better view of the global situation and set up the appropriate fraud prevention policies, processes and tools. Also by reducing the number of connections and players involved, it would be less costly and easier to manage PCI DSS compliant issues as well as address the problem related to sensitive payment data.

3.5 POTENTIAL FUTURE BEST PRACTICES

Below are some potential future best practices as hotels move toward a guest centric approach. Hotels may consider the following...

- Set up an appropriate foundation which includes
 - Defining appropriate payment policies focusing on guests and costs (e.g. which payment methods are relevant in which countries, channels, etc.)
 - Setting up streamlined payment processes (e.g. how to handle disputes and exceptions, how to optimize transaction routing, etc.)
 - Setting up a payment dashboard to manage payments
- Select the right PSPs and merchant acquiring banks (e.g. some of the major PSP/Acquirers have local payments acceptance technology ready to roll out)



Consolidating PSP and banking relationships are likely to reduce costs, but hotels should be mindful that the level of fees is only one selection criteria

- Ensure that quality of PSP / acquiring bank is also delivered (e.g. settlement times, reporting requirements level of up-time, speed of authorization processing, escalation process in case of down-time) and that the PSP / acquiring bank can support the relevant customer experience (e.g. range of payment methods, choice of currency, etc.)
- Carefully select the relevant mix for each major local market based on market intelligent when deciding the acceptance of AFOPs
- Ensure consistent experience across all guests' payment touchpoints
- Educate hotel owners of the value of a cohesive payment strategy

4 B2B PAYMENTS

The second phase in the development of Future Best Practices involves the “back end” needed to make it work for the hotel and its check-in teams. From a guest arrival experience, the process must be smooth and transparent. The B2B Payments group focused its efforts on non-commissionable bookings – involving payments between OTAs, travel agents, corporates and travel management companies (TMCs) and hotels.

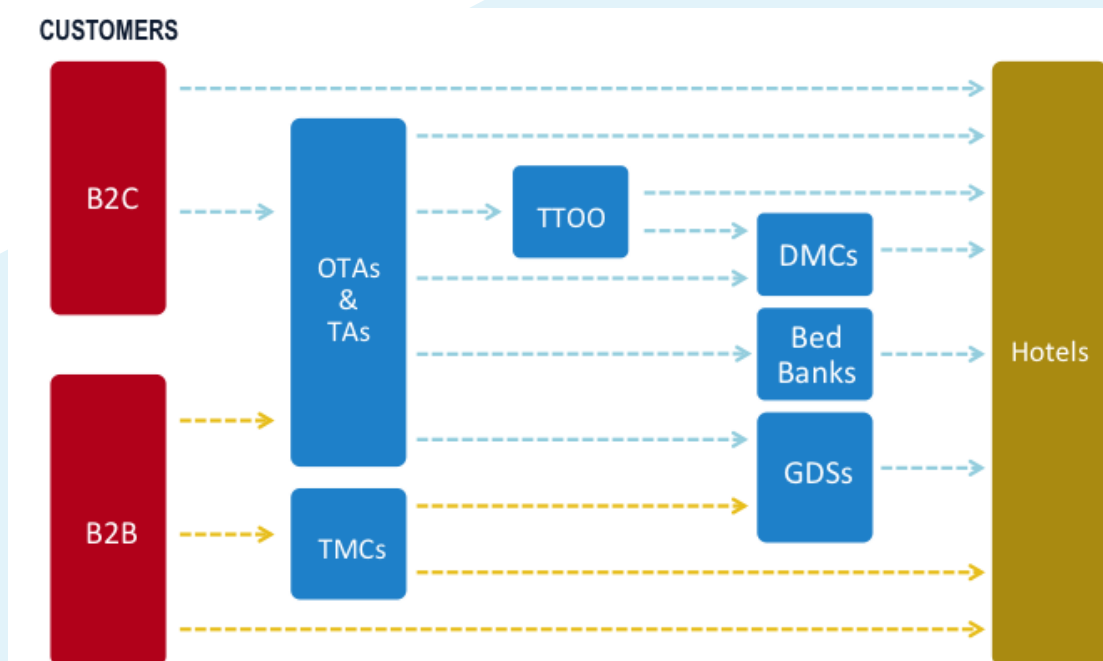
The structure of B2B payments in the travel industry essentially stems from the type of relationship between trading partners. Generally speaking, trading relationships fall into two broad categories or models:

1. **Agent Model.** The agent model arises when a given travel company acts as an “agent” of a service provider, which in turn pays the travel company a **commission** in return for each reservation received through it. A typical scenario involving payment of commissions would be when an end customer makes a reservation in a hotel through an OTA and pays directly at the hotel upon check-out. After that, the hotel will need to pay the OTA a commission for that booking. Commission payments are addressed in Section 5 of this report
2. **Merchant Model.** In the merchant model, the travel company acts as the merchant of record of a transaction. The customer pays upfront to the travel company for the reservations made and later the travel company pays the hotelier the amount agreed. Under this model, the transaction may encounter three different payment scenarios:
 - a. **Payment on net dd credit terms.** Where *dd* is the number of days that the travel company will take to pay the service provider upon receipt of an invoice. This kind of relationship requires a contractual relationship between the travel company and the service provider specifying the payment terms and conditions. This is very common between tour operators and hotels, travel agents and wholesalers and travel agents and certain hotels that they have significant business volume with their so called “static inventory”
 - b. **Payment at check-out.** Because of the decentralization of the hotel industry (around 500k hotels and thousands of travel companies worldwide), it is not feasible to establish contractual relationships among all potential trading partners. To leverage this potential marketplace without requiring an actual contract between all trading partners, the concept of guaranteed booking was developed. Under this model, a hotel will accept a booking from any travel agent around the globe provided that a reliable payment guarantee accompanies the booking. Upon customer check-out, the

hotel will be responsible for executing the guarantee to make the payment effective (no shows are an exception to this rule, where it is possible to charge a % of the total booking amount prior to check-out). In this context, credit cards became a major ally of the travel industry, as they are the simplest and most efficient way to guarantee a booking. Credit cards and, especially, virtual credit cards (VCCs) have become the most widely used payment vehicle in the travel industry in the context of dynamic contracting, where there's no contractual relationship between trading partners

- c. **Pre-payment.** The concept of pre-payment in the travel industry equates to payment at the time of booking. This payment modality is becoming increasingly popular, as many prominent hotel chains require it to offer their best dynamic rates. Albeit dynamic pre-paid rates currently account for less than 20% of the industry, some experts predict that they will dominate the industry in the next 5 – 10 years

The B2B Working Group focused on identifying the major sources of pain points in the merchant model. As a first step, the group sought to understand the prevailing interrelations between different players in the industry and the resulting payment ecosystem. The figure below shows a simplified view of the trading partner relationships that rule B2B payments in the hotel industry.



This simplified view may be more complex with an actual transaction, as, for example, some bedbanks purchase inventory from other bedbanks, some OTAs may have bedbank capabilities, etc. Hence, it's not unusual for a booking to go through a series of more than three transactions and payments before reaching a hotel. In between, the governing relationships between intermediaries

may be a blend of the merchant and agent models described above.

Over 90% of the payments in the B2B merchant model are made using two prevailing payment methods:

- **Money transfers** (in a variety of forms, namely wire, SEPA, ACH, etc.)
- **Credit cards**, primarily in the form of virtual credit cards (VCCs), but also in other forms like lodge cards, plastic cards, etc.

The Working Group conducted extensive research across multiple hoteliers and different types of travel companies revealing existing major pain points.

4.1 MONEY TRANSFER PAIN POINTS

The main virtue of money transfers as a B2B payment method is their low cost. On the other hand, their top shortcomings are as follows:

1. **Need at the customer's end to keep an up-to-date database of supplier's bank account numbers.** This is especially challenging in an industry with over half a million suppliers worldwide and characterized by continued changes of ownership
2. **Irreversible transaction.** Potential exists to make a transfer to the wrong bank account, which cannot be reversed. Consequently, customers incur both the administrative cost of reclaiming payments to the wrong bank account plus the cost of actually not being able to recover a portion of it
3. **Unsuited as a method of guaranteeing a booking.** As a result, money transfers are used almost exclusively to pay for bookings when there exists a contractual agreement between the customer and the supplier (e.g. in the tour operating industry)
4. **High cost for international payments**, especially when paying small amount to suppliers in long haul destinations. This has been somehow mitigated with the advent of emerging more cost efficient (as compared to wires) bank transfer methods
5. **Complex reconciliation** at the supplier's end, often requiring meticulous manual matching. This issue is especially notorious when a money transfer has been used to pay for multiple bookings or invoices and some of them have been short paid
6. **Complex dispute resolution**, following the above reconciliation issue
7. **No working capital benefit** for the customer, as payments by money transfer don't bear credit facility

8. **Breakage.** The issue of breakage arises when a supplier forgets to send an invoice (hence never gets paid) or mistakenly invoices the customer a lower amount than required. Customers and suppliers have a differing vision of this issue either as a benefit or as a problem. In any event, it is a source of inefficiency as breakage is commonly identified sooner or later and ends up requiring exceptional manual processing

4.2 CREDIT CARDS PAIN POINTS

Unlike money transfers, credit cards are especially well suited to guaranteeing a booking. However, the analysis of the data provided by hoteliers and travel companies reveals that B2B credit card payments in the travel industry are not exempt from issues.

The major pain points that the Working Group were able to uncover after lengthy discussions with employees in the Accounts Receivable (AR) departments of hotels and in the Accounts Payable (AP) departments of travel companies can be classified into the following categories:

1. **Fax transmission of credit cards.** Fax is still the most widely used method to send credit card details from an intermediary to a hotel to guarantee a booking. As a result, the following issues are common place:
 - a. Faxes sometimes do not reach the hotel in due time because of errors in the customers' fax database, hotels' fax machine broken down, etc.
 - b. Faxes containing credit card details end up stored in non-PCI compliant ways (often a drawer at the reception desk)
 - c. Credit card details must be input manually into the PMS, causing not only overhead but also being a source of errors
 - d. Overwriting the credit card sent from the travel company with the card requested to the guest for incidentals
 - e. Lost credit cards. Travel companies report thousands of incidents monthly due to this issue, which is especially aggravated when the time of booking and the time of check-in are far apart
 - f. Credit card details not being transferred to the PMS of the hotel and causing confusion when the customer is also requested a credit card at check-in or check-out
2. **Manual processing of credit cards.** Most credit card payments are processed manually. This results in many issues, mainly but not only:
 - a. Hoteliers spending time to manually process credit cards

- b. Wrong charges due to manual errors (wrong amounts, duplicate charges on the same card, etc.). This type of error is aggravated by the (counterintuitive but true) ability of a merchant to force a transaction on a payment terminal and charge an amount higher than the credit limit of the credit card
 - c. Card for reservation A mistakenly used to pay for reservation B. This is one of the hardest type of errors to identify and resolve, taking on average 2 – 3 months to clear up
 - d. Disputes and chargebacks ensuing all the above errors
 - e. Depending on the issuer of the card, multiple pre-auth operations carried out by hotel receptionists prior to the arrival of the guest may cause depletion of the travel company's credit line
 - f. Unexpected foreign conversion fees when hotels settle a card in a currency different than the card's currency
- 3. **Cost.** Credit card fees can be quite expensive for merchants as compared to money transfers. This factor has severely limited their adoption to pay invoices. In addition, credit cards payment can also involve costs at the customer's end when the settlement occurs in a currency other than the funding currency of the card (FX fee) and when the card is settled in a country other than the issuing country (cross-border fee). Increasingly, hotels already paying commissions are pressuring against additional interchange charges related to VCC fees
- 4. **Bill-back.** OTAs normally do not require hotels to send an invoice after settling a card upon customer check-out. Because of this, hoteliers may not send tax compliant invoices to travel companies when a booking is guaranteed with a credit card. This process may not only be the source of tax compliance issues but also may cause problems if a TMC requires the invoice details from the hotel to re-invoice its corporate customer. This issue does not arise in the context of money transfers, as this payment method is typically used to pay suppliers after they send an invoice
- 5. **Lack of level-3 data.** The difficulty to obtain level-3 data linked to a booking prevents leveraging some interesting B2B applications, such as VAT refund
- 6. **Breakage.** As with money transfers, breakage may occur in the context of credit card payments if a supplier forgets to charge a card or undercharges the amount. Conversely, customers may also mistakenly fund a card with an amount higher than required, giving suppliers the opportunity to charge a higher amount
- 7. **Limited currency support.** VCC issuers typically only support a subset of all the currencies supported by the card schemes. Consequently, the cards are often issued in a currency

different than the currency that they will be settled which results in 3 types of problems and resulting costs:

- a. When the card is settled, the travel company will be charged a foreign currency conversion fee.
- b. Travel companies must calculate the amount they put in a card based on their card's currency, which often is not the same as the settlement currency. Because of currency fluctuations between the time of issue and the time of settlement, the charge might be declined, causing an incident.
- c. FX exposure. If the time of booking is far apart from the time of settlement, the currency fluctuations in the above scenario may be significant for the travel company.

4.3 PROPOSED SOLUTION

Having identified various industry pain points, the Working Group reviewed existing functionality and providers to identify a potential solution which could become the industry's future best practices. In designing the future, the Working Group's objectives included a solution which:

- Eliminates the need to use fax to send credit cards to a merchant
- Eliminates manual processing of the credit cards at the merchant's end
- Guarantees that a proper tax compliant invoice is always available to the customer irrespective of the payment method
- And ultimately, leverages the best of both worlds, credit cards and money transfers, and any other present or future payment method (bitcoins, etc.) that can be encapsulated in a digital container

Ideally, the solution should be payment method agnostic as different payment methods provide different benefits in a given transaction type. Any solution deployment should minimize modifications on the hotels' PMS and CRS systems as well as in the booking systems of the travel companies. If any, technology changes should be minimal and transferred to the travel companies' end when possible, as hotels outnumber travel companies by an order of magnitude.

As the Working Group reviewed the existing situation and potential application of a new solution, they identified challenges that needed to be addressed given industry-specific connectivity challenges:

1. **Lack of a switch.** There are two ways to send a transaction (payment, invoice, etc.) from one node in a network to any other: Either implementing a direct link between all nodes or using a switch that every node connects to and which provides virtual end-to-end connectivity

2. **Universal ID.** For the switch to be able to properly route transactions between nodes, it is necessary that each node be univocally identified. Today however, all industry players use their own IDs to refer to their trading partners
3. **Authentication.** A universal non-proprietary system for authenticating trading partners during a transaction must be in place
4. **Reliability.** No transaction must be ever lost despite potential system downtime of any player
5. **Traceability.** All transactions must be traceable from the time of issuance to the time of delivery
6. **Security.** Communications must be secured against fraudulent interception
7. **Compliance validations.** Ideally, when a transaction is delivered to a node in the network, it should be guaranteed to be compliant from several perspectives. The solution should guarantee:
 - a. Conformity with the standard contents expected for that transaction
 - b. Conformity to customer specific constraints (for instance, customers requiring specific information fields in an invoice)
 - c. Legal compliance (also relevant in the context of invoicing)
8. **Payment method transparency.** In line with the goal of leveraging any payment method (present or future) that can be encapsulated in the form of a digital container, the solution should be payment method agnostic from a communications point of view. The introduction of new payment methods should have no impact on the communication protocol between the nodes and the central switch
9. **Legacy systems.** It is not realistic to expect hundreds of thousands of players to be technically ready to implement the standard. Many of them will rely on legacy systems that can't be replaced overnight
10. **Plug & Play connectivity.** To guarantee that as soon as a new node is plugged into the network's central switch, it is automatically connected to all the rest without them having to do anything at their end

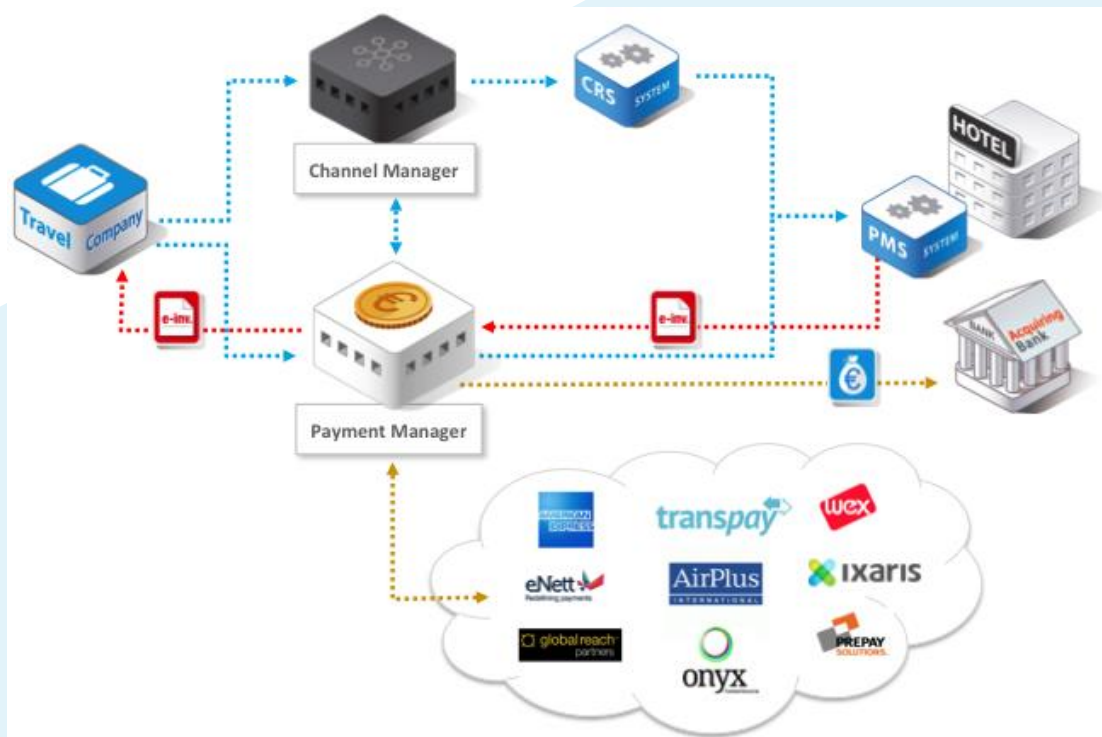
The challenges illustrate that the solution to seamless all-to-all direct connectivity in a complex network takes more than just implementation of standards. In fact, this kind of challenges had previously been identified in other highly transactional industries, e.g. retail, health, automotive, etc. These industries pioneered over 40 years ago the development of the Electronic Data Interchange

(EDI) standard in order to tackle the connectivity problem. However, they quickly realized that the standard by itself could not cope with all their requirements. The solution they eventually found was the introduction of a new element: the concept of Value Added Network (VAN).

VANs are “intelligent” switches operated by independent third parties, which on top of providing plug and play end-to-end connectivity between all network nodes, also dispense trading partners of implementing many of the complex value-added functions related to communication requirements in an industry.

The VAN concept has been adopted for years in the travel industry under the form of Channel Managers (CMs) and Global Distribution Systems (GDSs). These platforms play a key role in the hotel distribution ecosystem providing seamless connectivity between industry stakeholders.

The Working Group’s vision of how the VAN concept could be leveraged to streamline B2B payments in the travel sector is inspired on the idea of implementing an industry-specific payment channel which is to B2B payments what channel managers are to booking distribution. The picture below illustrates this idea.



The goal is to clearly separate the booking channel from the payment channel, so their respective technical constraints don’t interfere with one another.

From a travel company's perspective, payments should be handled transparently by simply sending a payment instruction to the "payment manager" box providing information such as:

- Booking ref
- Hotel ID
- Amount to be paid
- Currency
- Due date
- Payment method
- Payment partner
- Billing requirements
- Hedging requirements
- VAT/tax refund requirements

Upon receipt of a payment instruction, it would be the Payment Manager's responsibility to execute it in the specified payment terms in quite the same manner as a channel manager handles the delivery of a booking to the corresponding CRS.

Practical implementations of the "Payment Manager" concept are currently underway and involve a number of B2B Working Group participants.

For remaining transactions, the B2B Working Group supports the development of the intelligent payment design in the aforementioned VAN recommendations. The group has identified technical specification and process flow for payment and booking data. Participants in the Working Group have begun more advanced discussions on application of existing technologies to this proposed protocol. The Working Group strongly asserts that the design must not be proprietary but rather is an open industry protocol and discussion.

To implement this approach for future best practices of B2B payments in the hospitality industry, the Working Group has recommended the creation of a successor working group, the Open Payment Alliance, to enable the industry to create the specification and protocols necessary for implementation of its recommendations

5 COMMISSIONS

The agent model of hotel booking continues to be a very strong distribution mechanism for hoteliers. Unlike the airline industry, which decided to step away from a commission model 20 years ago, the hotel industry has retained agency commissions as a primary process for connecting properties with travel management companies (TMCs), online travel agencies (OTAs) and other intermediaries.

- Intermediaries continue to exert significant influence over which hotels they refer business and expect a timely and accurate remuneration from the supplier (hotelier)
- Hotels are increasingly focusing attention to their distribution costs; however, they acknowledge the value of these commissionable intermediaries

The Working Group views agency commissions to continue to be a future best practice for the processing of payments in the industry. The group accepts the validity of this practice with both prepaid and postpaid transactions. The group also has identified proposed solutions for greater efficiency of this distribution process in the future.

Over the past few years, agency commissions have continued growth to their highest levels, even as major hotels chains have launched intensive strategies to increase direct sales through their own websites. The rising power of OTAs is the main reason for commission rate growth, but more traditional distribution channels such as global distribution systems (GDSs) have also significantly increased their hotel bookings.

Commission payments are not universal in the business travel world. Negotiated rate agreements between hotels and their corporate clients have traditionally been on a net basis, but company travel managers are increasingly switching to negotiating commissionable rates that do not incur a booking fee charged by their hotel intermediary.

In the Working Group's assessment, the commission payment model has enabled more cost-effective distribution for a number of reasons:

- No contract is needed between the partners to do business
- No credit or other financial instrument is necessary
- Financial exposure and risk is typically limited to the amount of the commission payment
- The transaction is transparent: the intermediary brings business to the property; the traveler pays the property directly and the intermediary is paid after check-out for the role it played in generating the booking

- The management of commission has largely been outsourced by both hotels and distributors to companies whose role is to collect, distribute and reconcile these payments
- Commission payments are usually electronic and generate automated reporting for both the hotel payer and the distributor payee

Even though the commission model has demonstrated success, the HEDNA Commission Working Group was formed by bringing together major hotel chains, TMCs, GDSs and third-party commission management specialists. The mission of the group has been to identify where improvements need to be made to the commission model and how to achieve those improvements. Priority has been given to smoothing the commission process for business travel bookings made through GDSs.

5.1 AREAS FOR IMPROVEMENT

The Working Group sets out seven areas where improvements to commission payments can be achieved.

1. **GDS display.** An area for improvement is related to inconsistency in display on GDS screens. No mandatory field for displaying commissions exists, so at times no information at all is presented if a commission field is not included. Even when there is a field, there is no fixed format for what information is given. Variations in what the display might state include:
 - a. A “Y” or “YES” if the rate is commissionable and an “N” or “NO” if it is not commissionable
 - b. The percentage payable on the commission, although it is usually unclear whether this applies to the room rate with taxes included or excluded
 - c. The actual value of the commission, although not all GDSs provide this information
 - d. A message saying “no information”, which leaves the intermediary uncertain whether the rate being booked is commissionable or not

The Working Group recommends:

- *Make the commission field mandatory in GDS hotel displays*
- *Split room rate and taxes when loading prices into the GDS to ensure commission is consistently and correctly calculated on the rate net of taxes*
- *Encourage all GDSs capable of displaying the actual amount of commission payable*

In the interim, the group suggests that major hotel chains consider regularly communicating their commission payment policies through HEDNA, GDS information pages and portals for specialist outsourced commission management services.

2. **Commission estimates.** All intermediaries should be able to estimate how much commission they have booked at the end of each day, week or month. Some GDSs have proposed tools to help intermediaries make forecasts of this kind. However, these tools can have only limited value until all commissions are displayed in the GDS.

The Working Group recommends:

- *Encourage further development of commission estimation tools, which are potentially very helpful for monitoring revenue and understanding likely earnings from commission.*
- *Include within the estimation tools a default estimate of payable commission on bookings where the hotel has not fed the commission amount into the GDS. At present, proposed commission estimation tools only provide an estimate for bookings where the commission amount has been stated.*

3. **Formalization of commission policies.** Even though one of the key advantages of the commission system is its simplicity, there are still variations in the model across different hotel chains.

The Working Group recommends:

- *Each hotel chain participating in commission payment processing should publish a detailed commission policy. This policy, at the hotel's discretion could include a standard commission agreement and protocol for processing queries.*

4. **Management of non-electronic bookings.** The overwhelming majority of hotel bookings today are made electronically but there remain a small number of non-electronic bookings (by phone, for example). Administration of non-electronic reservations involves manual work for both the intermediary and the property. The intermediary usually creates a passive segment in the GDS to ensure the booking will be processed through its mid- and back offices.

Fields to create passive segments in the GDS are not mandatory, and that is posing challenges for collecting and reconciling commissions. The information provided may be too low-quality and lacking in detail to be used for this purpose. At the property, a non-electronic booking may have to be manually entered into the property management system (PMS) and registered manually in the central commissioning system, creating a significant risk the work may not be done properly or may not be done at all.

The situation becomes even more challenging if the intermediary is not registered in the agency profiles stored in the hotel's PMS, which means a new profile has to be created.

The Working Group recommends:

- *Create and promote a standard format for passive segments, including key minimal mandatory fields to provide basic information.*
- *Encourage PMS providers to provide a simple process for hotels to create new agency profiles.*

5. **Improved usage of rate access codes.** Rate codes (codes to qualify the different type of rates – public rates, negotiated rates, promotional rates) used by hotel chains or individual properties are non-standardized.

The Working Group believes it would be too complex to create a standard for rate codes. However, intermediaries also use rate access codes (codes used by the intermediaries to qualify their different distribution rates) allowing for the potential to adapt these to indicate whether the rate is commissionable.

The Working Group recommends:

- *Intermediaries and GDSs should co-operate to create and use rate access codes that incorporate a commission element.*

6. **Rating hotels based on their performance in reconciling and paying commissions.** The Working Group debated the impact of transparency for hotels with a good record of reconciling and paying commission to intermediaries vs. hotels with a poor record. In theory, it would be possible to support this kind of publicity by creating a system which rates hotels' performance at paying commission. Such a system would encourage the best performers to continue to perform well and encourage the worst performers to improve.

However, although all members of the Working Group support the idea of introducing more transparency, there is no consensus on how to measure and monitor hotels' performance in reconciling and paying commissions.

The Working Group recommends:

- *This topic remains open for discussion.*

7. **Library of topics related to hotel commission regulation.** There is a general need for shared expertise in taxation and invoicing regulations related to commissions. Yet in spite of the importance of this issue, nothing is generally available today either for hotels or intermediaries.

The Working Group recommends:

- *Create a library of documentation to cover regulation topics. More work will be done on this idea over the coming months*

5.2 CONCLUSION

The commission segment of the Working Group has created its vision for future best practices in the commission payment world. Within the committee and working group structure of HEDNA, a new commission-specific working group has been established to convert these 'future best practices' to actionable and implementable specifications.



If you are interested in discussing any of these payments-related topics, we will be pleased to set up an initial conversation to discuss in further detail the learnings from this study.

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This white paper is primarily based on the findings from the Payments Working Group. The observations and conclusions in this document are not intended in any way or form to reflect the views or perspectives of HEDNA and/or of EDC.

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HEDNA (Hotel Electronic Distribution Network Association) is the premier global forum exclusively dedicated to the advancement of hospitality distribution through strategic collaboration and knowledge sharing. For over 25 years, HEDNA has brought together industry leaders and innovators to explore and influence the world of hotel distribution, providing clarity and insight on the issues that matter.

HEDNA is the hotel distribution industry's leading source for education, collaborative examination and resources. The association's HEDNA University provides introductory and continuing education in hotel distribution, while its Working Groups examine key issues and collect and produce exceptional resources to help guide members.

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