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If I were Barry Diller...

A Commentary on the USA Networks' Acquisition of Expedia.com | By Max Starkov

On July 16th USA Networks (NASDAQ: USAI) announced that it had agreed to acquire a controlling interest in Expedia, Inc. (NASDAQ: EXPE) through the purchase of up to 37.5 million shares or approximately 75% of the currently outstanding shares. As part of the deal Microsoft has agreed to transfer all of its 33.7 million shares and warrants in Expedia for approximately \$1.5 billion in a complex no-cash deal. USA Networks also agreed to buy National Leisure Group (NLG), a leading provider of cruise and vacation packages. Based on its Travel Group portfolio, USA Networks intends to launch the USA Travel Channel, an interactive cable TV channel that will allow viewers to buy travel products it features.

If I were Barry Diller, I would have acquired Expedia. No doubt about that. But I would have considered adopting a comprehensive vertical eBusiness strategy aimed at establishing USA Networks' Travel Group not only as the ultimate B2C online leisure travel player but also as the dominant force in the travel vertical as a whole.

Mega Player in Online Leisure Travel

USA's acquisitions of Expedia and NLG, in addition to USA's interest in the Hotel Reservation Network (NASDAQ: ROOM) will form the USA Travel Group, undoubtedly the biggest player in the online leisure travel market. Its portfolio of companies collectively handled 16% of the \$14 billion worth of online travel bookings in 2000. The group is expected to generate \$4 billion in gross online bookings in 2001.

In comparison, USA Travel Group's biggest rival in the online travel space, Travelocity (NASDAQ: TVLY), which is 70% owned by Sabre (NYSE: TSG), the largest Global Distribution System (GDS), expects annual gross travel bookings of \$2.5 billion (\$2.4 billion for Expedia). Travelocity has to adopt a very aggressive acquisition and distribution campaign of its own to extend its brand online and offline. The B2C online travel market will definitely see some further consolidation in the coming quarters.

Vertical eBusiness Strategy

Being the biggest player in the B2C online leisure travel space will not be sufficient for USA Networks to sustain a long-term competitive advantage. Online leisure travel is just one of the segments of the travel industry's eBusiness platform, whose "three pillars", eProcurement, eCRM and eDistribution, hold tremendous opportunities for growth, expansion and profits. None of the group's existing portfolio companies address lucrative travel markets such as corporate travel, hospitality, conventions and meetings.

USA Travel Group has to build a balanced portfolio of market segments and revenue sources. Other major industry players and USA's rivals, such as Cendant and Sabre, boast very diversified travel portfolios that could cushion the effects of an economic downturn. It's common business sense. In times of economic weakness people may cut big-ticket expenses like overseas travel or family vacations in Hawaii, but corporations will continue to have sales meetings and sales calls, seminars, product presentations and launches that require employees to travel. Associations will continue to hold their annual conventions and meetings.

I strongly believe that the latest acquisitions should lead to a more comprehensive vertical eBusiness strategy aimed at establishing USA Travel Group not only as the ultimate B2C online leisure travel player but also as the dominant force in the travel vertical as a whole. This strategy will allow USA Travel Group to establish itself in some very lucrative travel markets: corporate travel, hospitality, conventions and meetings, etc. It calls for strategic investments in next-generation technology solutions that solve inefficiencies in travel distribution and procurement. This strategy will provide the whole group and its portfolio companies with a tremendous long-term competitive advantage and will reward USA Networks with hefty returns.

Here is a summary of my vision of the vertical eBusiness strategy USA Travel Group should consider despite of, or perhaps because of, the current economic environment:

Corporate Travel Procurement

This is a \$185 billion market in the U.S. alone. Business travel ranks among the top three corporate expenses. The economic downturn is forcing corporations to better control T&E expenses and to mandate self-booking systems. Booking travel in a self-serve mode trims down travel management fees and leads to significant savings. Gateway Inc. achieved a remarkable 98 percent usage of their self-

booking engine, provided by e-Travel. Honeywell managed a 72% adoption rate of their GetThere (Sabre) system within 8 months and saved millions of U.S. dollars in fees and lower Web-only fares.

Worth considering is Seattle-based Highwire Inc., a rising star in the corporate self-booking systems, which earlier this year inked deals with some of the largest business travel accounts in the country, Microsoft and Deloitte & Touche.

Conventions and Meetings Market

This \$120 billion U.S. market desperately needs ASP-based solutions for real-time booking of convention housing and group block space. 100 million group and block space hotel transactions (i.e. one-third of all hotel bookings) are made in a very inefficient, low-tech manner (phone, fax, email) and require expensive "human touch" throughout the process. Hotels and meetings planners alike are dying for solutions that automate the convention registration and housing process, allow real-time bookings of block space, etc.

Several B2B players in this field are worth looking into: PlanSoft, b-there and Passkey.

Hotel and Lodging Market

This \$100 billion U.S. market is very fragmented and underserved. Approximately 310,000 hotels worldwide are not bookable via any of the GDS, mainly due to the high integration, maintenance and transaction costs.

Hotels are looking for non-GDS cheaper distribution of their perishable inventory via the Internet. Almost 50% of hotels offer online reservations on their websites. According to Forrester Research, online hotel sales are expected to grow to \$5.7 billion in 2004. Pegasus Solutions, originally established as a switch between major hotel brands and the GDSs, is already distributing hotel inventory through non-GDS channels on a mass scale, through websites and affiliates.

Hotel representation and marketing companies like Utell (owned by Pegasus) play a very important role in providing independent hotels with global distribution.

On the other hand, the hospitality industry is in need of inexpensive ASP-based systems for hotel inventory management, yield management and online distribution. The ASP model provides affordable, transaction based Property Management Systems (PMS) and Central Reservation Systems (CRS) in a single-image inventory environment. The largest ASP-based CRS operations company, with customer base of 10,000 hotels and 40 million hotel reservations a year, which also launched its ASP PMS system recently, is again Pegasus Solutions.

In this space, due to its uniqueness, Pegasus Solutions is definitely worth considering.

Other Opportunities

The list of opportunities goes on and on. Some other emerging technologies and applications include: eCRM solutions utilizing next-generation smart agent technology; dynamic pricing of travel inventory based on real-time supply and demand; automated ASP-based Hotel Loyalty Programs; innovative recommendation engines that improve dramatically the look-to-book ratio (e.g. Triplehop.com), eProcurement solutions (e.g. Florida-based GoCo-op), mobile applications for presence-based and location-based services, "push" notifications and alerts, etc.

So, if I were Barry Diller, I would know what to do.

Max Starkov is Chief eBusiness Strategist, Hospitality eBusiness Strategies in New York City and advises companies in the Travel and Hospitality verticals. Mr. Starkov has an extensive eBusiness experience. He co-founded and served as CEO and Director of two eBusiness companies: Whale Media, Inc. (B2B travel

technology infrastructure provider to the hospitality, corporate travel and convention and meetings markets) and Travelbreak.com, Inc. (B2C online travel marketplace). Under his leadership Whale Media won the prestigious 2001 Microsoft RAD Award for its ASP technology for the hospitality industry. Max has 17 years experience in pioneering and building successful travel businesses and eBusiness strategies for national and multinational leisure and hospitality companies. He has written numerous reports, industry research, and articles including: "If I were Barry Diller" (commentary on USA Networks' acquisition of Expedia), "Independent Hoteliers: eBusiness Levels the Playing Field"(co-author with Jason Price), "If I were a Partner at Crosspoint Ventures" (investment opportunities in the travel industry), "If I were Henry R. Silverman" (commentary on the Cendant-Galileo deal), "Twelve Inexpensive Ways to Promote your Website". "Independent Hoteliers: How to Level the Playing Field Amidst Softened Economy"(co-author with Jason Price). Max has an MBA degree, Beta Gamma Sigma Honors, from Fordham University in New York and an MS in Economics degree. You can contact Max at max@hospitalityebusiness.com.