

Priceline.com

and the Search for a Business Model that Works

Priceline is one of the Web's most well-known companies. Its "Name Your Own Price" reverse-auction pricing system is a unique business model that uses the information sharing and communications power of the Internet to create a new way of pricing products and services. At Priceline, consumers can enter a bid for travel, hotels, rental cars, and even home financing. Priceline then queries its databases in which participating suppliers file secure discounted rates not generally available to the public. The company then determines if it can fulfill the customer's offer and decide whether it wants to accept the offer at the price designated by the consumer. Unlike other trends in online information which emphasize transparency, Priceline's business model is based on opaqueness, where consumers and suppliers have incomplete information about price, brand, and timing. In return, customers receive a much lower price than other sites can provide.

Priceline offers a compelling value proposition to customers, allowing them to save money by trading off flexibility about brands, product features, and/or sellers in return for lower prices. Vendors also can gain additional revenue by selling products



they might not otherwise be able to sell by accepting below-retail price offers, without disrupting their existing distribution channels or retail pricing structure. Priceline is an example of using the Web to achieve efficient price discrimination: suppliers can charge some consumers much more than others for the same product. Priceline acts as the middleman to make that happen. In 2008, Priceline sold about 4.9 million airline tickets (up 40%), 41 million hotel room nights (up 46%), and 10 million rental car days (up 14%).

Business models are never as simple as seem. If they were, they could be easily copied. Priceline's business model has several elements. Priceline hides the names of suppliers so they won't damage their brand image and this in turn has increased support among the suppliers of the inventory (hotels, airlines, car reservation companies, and others) by buying the inevitable excess capacity of the travel industry, acting in a sense as electronic liquidators. Hiding the name of providers prior to purchase is acceptable to a wide swath of the travel market who does not care about brand names as much as price. Playing at Priceline is sort of like gambling in Las Vegas—you never know ahead of time exactly where you will end up. A third element of Priceline's business model is a powerful technology infrastructure that can match offered bids with available sellers in a customer friendly way. A superb customer experience results. These other elements can be difficult for competitors to imitate, as experience has shown in the case of Expedia, which has its own "name your price" site named Hotwire, but that has not met with much success. Perhaps most important, Priceline's business model provides customers with the lowest cost travel services on the Internet.

Priceline offers a classic example of a company that started with a unique business model, struggled to make a profit, tried to scale it up to a wider variety of consumer products, failed, and then returned to the original model while refining its key elements. By 2009, it had developed a strategic edge over several very formidable competitors and was showing strong growth in a down market. Despite the economic downturn of 2008–2009, which caused other travel sites' revenues and profits to plunge, Priceline's revenues expanded to \$1.9 billion in 2008, up 34% from 2007. And its net profit jumped 24% to \$193 million. For the first quarter of 2009, revenues continued expanding by 14%, and profits by 15%.

The original vision of Priceline's founder Jay Walker was called "demand collection." Walker poured millions into the concept of a one-stop shopping center for goods and services from trucks, to toothpaste, to vacation travel. But for much of its early history, Priceline was not profitable. In 1999, it lost over \$1 billion. It pared losses to \$15 million by 2001, but then, as travel declined after the September 11, 2001, World Trade Center tragedy, regressed in 2002, posting a \$23 million dollar loss. Key executives resigned. Headlines such as "Priceline on the Ropes" and "Curtain Call for Priceline.com" predominated. However, in 2003, Priceline recorded its first ever annual profit, recording \$10.4 million in net income. The good news has continued since. From 2004 to 2008, Priceline's revenues shot from \$900 million to \$1.9 billion, and its net profits from \$31 million to \$193 million.

Priceline commenced operations on April 6, 1998, with the sale of airline tickets. To purchase a Name Your Own Price ticket, a customer logs onto Priceline's Web site,

specifies the origin and destination of the trip, the dates he or she wishes to depart, the price the customer is willing to pay, and a valid credit card to guarantee the offer. The customer must agree to fly on any major airline, leave at any time of day between 6 a.m. and 10 p.m., accept at least one stop or connection, receive no frequent flier miles or upgrades, and accept tickets that cannot be refunded or changed. Upon receiving the offer, Priceline checks the available fares, rules, and inventory provided by its participating airlines and determines whether it will fulfill the order at the requested price. If so, it notifies the customer within an hour that his or her offer has been accepted. On the consumer side, a central premise of Priceline's Name Your Own Price business model is that in many product and service categories, there are a significant number of consumers for whom brands, product features, and sellers are interchangeable, particularly if agreeing to a substitution among brands or sellers will result in saving money. On the vendor side, the Priceline Name Your Own Price business model is predicated on the assumption that sellers almost invariably have excess inventory or capacity that they would sell at lower prices, if they could do so without either lowering their prices to retail customers or advertising that lower prices are available. Priceline believed that its business model was ideally suited to industries characterized by expiring or rapidly aging inventory (for example, airline seats not sold by the time a flight takes off or hotel rooms not rented), although it did not think that it would be limited to such industries.

Priceline extended its initial airline-only system to hotel reservations in October 1998, and introduced home financing services (name your own mortgage terms). It went public in March 1999, and later that year, it added rental cars and even new cars to the mix. To promote its products and the Priceline brand, Priceline embarked on an extensive (and expensive) advertising campaign, hiring William Shatner to become the voice of Priceline, and it quickly became one of the most recognizable brands on the Web. Problems for the company started when its founder attempted to aggressively expand the company into entirely new consumer product areas, and extend the franchise to the global market place. Priceline licensed the Name Your Own Price business model to several affiliates, including Priceline Webhouse Club, which attempted to extend the model to groceries and gasoline, and Perfect Yardsale, which used the model to sell used goods online, and added long distance calling and travel insurance. Priceline also had ambitious plans to expand internationally, and licensed its business model to companies planning to set up similar operations in Asia and Australia.

However, by fall 2000, the picture no longer looked so rosy. In October 2000, after only 10 months of operation, Priceline's affiliate Priceline Webhouse Club was unable to raise additional financing and had to shut down its business, after spending \$363 million. The financial climate at the time, with its renewed emphasis on profitability, made it impossible for Jay Walker, Priceline's founder, to raise the additional hundreds of millions that would be required before Webhouse might become profitable. Walker did not see the closure as a failure of the Priceline business model, however. Instead, he characterized it as the result of the "fickle sentiments" of investors. Many analysts did not accept Walker's characterization. Instead, they pointed to other factors. First, many of the major manufacturers of food and dried goods chose not to participate in

Priceline Webhouse. So, to generate consumer interest, Priceline Webhouse subsidized discounts on most products itself. Although some major manufacturers, such as Kellogg's and Hershey's, did eventually sign up, many, such as Kraft, Procter & Gamble, and Lever Brothers, did not. The second miscalculation was that bidding on groceries and gasoline did not exactly provide a "hassle-free" way to shop. Customers were required to bid on and pay for groceries online, then use a special identification card to pick them up at a participating supermarket. If the particular items purchased were not available at the store, the customer would either have to go to another store or return at another time. To many, the demise of Priceline Webhouse highlighted potential cracks in the Priceline business model and raised strong concerns about its ultimate extensibility. Priceline's founder Jay Walker resigned in December 2000.

New management sharply curtailed Priceline's expansion and laid off over 1,000 employees. Priceline Chairman Richard Braddock said, "Priceline will entertain selective expansion... with stringent financial controls. We're going to make money on this and move forward." In 2002, Priceline focused on its core business of travel reservations, shedding its auto sales and long distance telephone units. Its only non-travel business today is its 49% interest in Priceline Mortgage. And in 2003-2004, it tweaked its business model once again, adding new discount "retail" airline ticket and rental car services to complement its hallmark Name Your Own Price offerings, in order to compete more effectively with firms such as Expedia, Travelocity, Hotwire, and Orbitz for the business of the consumer who prefers to book a specific airline or rental car. Although these services are not as lucrative as the Name Your Own Price model (it takes 1.5 to 2.5 retail plane tickets to bring in the same gross profit as a single Name Your Own Price ticket), and to a certain extent "cannibalize" its Name Your Own Price tickets, Priceline has made up at least some of the difference in increased volume. To further support this strategy, Priceline acquired a majority interest in TravelWeb, a consortium of five large hotel chains that provides Priceline with access to discount hotel rooms; purchased Active Hotels and Bookings B.V., a European hotel reservation service; and in 2005 extended its retail strategy to the hotel market. In 2006 and 2007, Priceline focused on adding to its full-service travel offerings in the United States, and recognizing that the growth of the domestic online market for travel services had slowed, on building its brand in Europe and Asia. Its international business represented approximately 62% of its gross bookings in 2008.

In 2008, Priceline eliminated the \$5 to \$11 booking fee that nearly all travel sites charge for airline bookings. In 2009, other sites such as Expedia started dropping their fees in response, but this will have a significant impact on their profit margins far greater than Priceline's because in many instances, such fees were the main source of their revenue. Priceline has become the undisputed low cost air reservation site. Priceline has also introduced "social features" to its Web site through an online blog called Ekspert, which provides customers with suggestions for travel, hot deals, and general travel news. In February 2009, Priceline's European subsidiary Booking.com announced a distribution deal with Hilton Hotels Corporation allowing Booking to access Hilton's worldwide portfolio of hotels, and give Hilton access to Booking.com's 30 million monthly visitors (the largest travel booking operation in Europe). Priceline also continues to enhance the customer experience of booking hotels by providing

hotel tours, guest scorecards, Zagat reviews, more hotels (75,000 worldwide), and an expanded Winning Bids feature that reduces some of the opaqueness and uncertainty in their business model by displaying winning bids for hotels, helping customers to better understand the "market price" for Priceline offerings.

Like many other survivors of the dot-com era, Priceline has followed a twisting path to long-term sustainability and profits. However, although Priceline is currently "in the black," a rosy future is by no means assured. Priceline faces industry-wide shrinkage in all forms of travel caused by the fear of terrorism, war, high fuel prices and economic recession. In addition, Priceline faces extraordinary competition, not just from other online middlemen such as Expedia, Travelocity, Hotels.com, Hotwire, and CheapTickets, but also from the direct discount sales by airlines. Priceline is largely restricted to the travel market, having failed to extend the model to other sectors. But, just like discount retailers performing well in a recession, Priceline is in a good position to weather the storm as the industry-leading low cost provider of a unique, differentiated service.

Case Study Questions

1. What are the core components of Priceline's business model?
2. Do you think Priceline will ultimately succeed or fail? Why?
3. How has Priceline (and similar online services) impacted the travel services industry?

SOURCES: "Priceline.com Launches New, Enhanced Hotel Reservation Service," *Priceline.com* June 10, 2009; "Expedia Ends Air Booking and Cancellation Fees," by Kristen Lee, *BusinessWeek*, May 27, 2009; "Priceline's Profit Rises 82%, Boosted by Strong Bookings," *Wall Street Journal*, by Kerry Grace, May 11, 2009; "Priceline's Differences Appeal," by Gregory Zuckerman, *Wall Street Journal*, April 20, 2009; "Booking.com and Hilton Sign Global Distribution Deal," *Priceline.com*, February 23, 2009; *Priceline.com* Incorporated Form 10-Q Quarterly Report for quarterly period ended December 31, 2008, filed with the Securities and Exchange Commission on February 28, 2009; "Introducing Travel Ekspert, A New Travel Blog From Priceline," *Priceline.com*, January 22, 2009; "Place Your Bets in Priceline's Online Casino," by Joe Starkey, *New York Times*, January 13, 2009; "Hot Growth Companies: Priceline Is Really Going Places," by Aaron Pressman, *BusinessWeek Online*, May 29, 2008; "Priceline Outshines Its Rivals," by Rick Munarriz, *The Motley Fool*, May 12, 2008.