

Tourism industry in turbulent times

Identifying ways out of the global economic crisis



The economic crisis' impact on the tourism industry has become apparent with a delay, but is currently putting existing business models under pressure. The set phrase that travel is the last thing consumers compromise on is no longer valid. Generally declining demand for travel in the leisure and business sectors and changing customer preferences challenge the players in the industry. In this Viewpoint, Arthur D. Little analyses the main impacts of the downturn on the core business segments of brokers, tour operators, accommodations and destinations. Based on a survey among industry experts and by analysing the business models of selected successful companies in all segments, ways out of the crisis are revealed.

Until 2007, the global tourism industry showed steady growth above the anticipated long-term growth rate of 4.1 % p. a. until 2020, as forecasted by the World Tourism Organisation. Worldwide international tourist arrivals reached about 900 million in 2007 with Europe being the most important region, receiving 53 % of inbound tourism in 2008.

How does the global economic crisis affect the tourism industry?

Throughout the last 15 years, the tourism industry has from time to time suffered from exogenous shocks that resulted in significant drops in tourist flows, but was able to recover repeatedly. Due to its global implications and the fact that it directly affects people's financial ability to travel, the current global economic downturn could become the most severe crisis the industry has ever seen (see figure 1 overleaf). Forecasts of the World Tourism Organisation predict a development ranging from stagnation to a decrease of 2 % in international tourist arrivals worldwide for 2009. However, Arthur D. Little's analysis indicates that this picture is too optimistic – especially in regard to the potential additional adverse effects of the H1N1 influenza A virus which has recently dominated the headlines of global media.

Decreasing demand for travel in all customer segments threatens companies' growth perspectives considerably. Reasons include consumers' financial inability, job uncertainty and companies' saving measures on business travel. Moreover, countries' economic stimulus packages do not address investments in travel. Hence, many traditional business models in all industry segments are put under pressure.

How are the key players affected?

Hardly any segment will stay unaffected from the current economic developments. However, some companies succeed in outperforming the industry average – despite but also thanks to the implications of the global economic crisis.

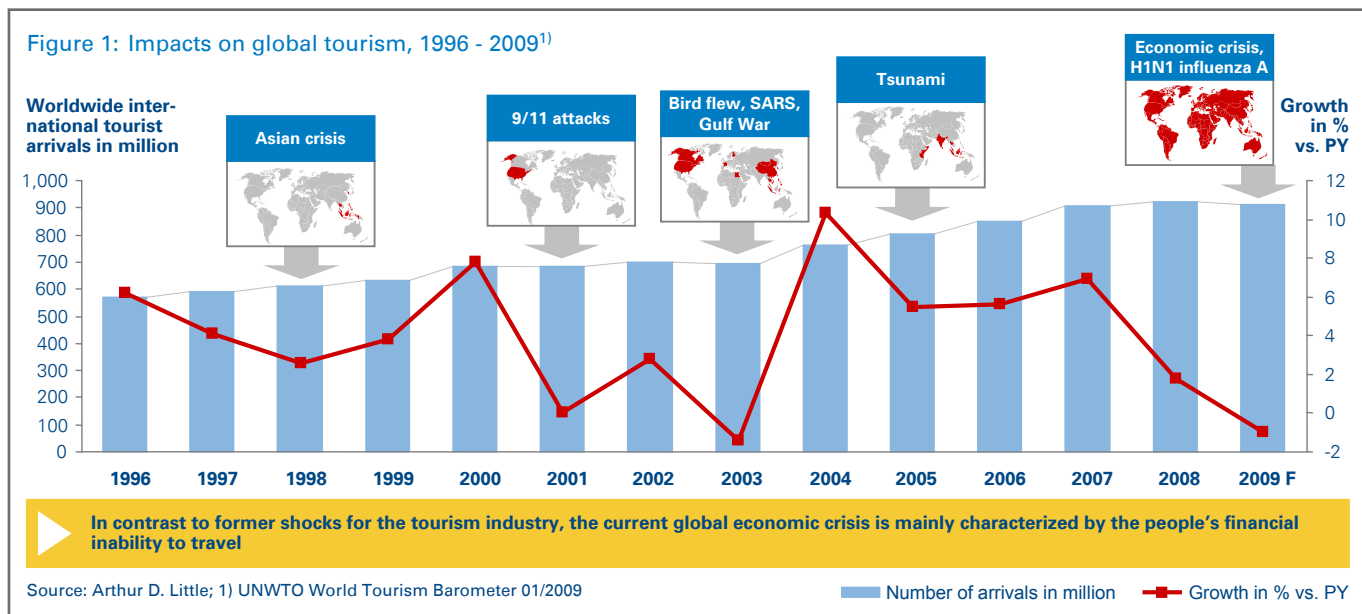
1. Brokers

Since the beginning of the crisis, the atmosphere in *stationary travel agencies* has been tense; they are stuck in the middle: On the demand side, decreasing customer numbers and tour operators' commission-based remuneration systems, on the supply side limit agencies' room for manoeuvre. In the first quarter of 2009, the cumulated decline in revenues already added up to about 10 % compared to the same period of the previous year; prospects for the future are pessimistic¹.

In the *online broker* segment, competition among the individual companies is intensifying due to the segment's slightly decreasing growth rates and the entrance of new market participants. Single players' performances have diverged significantly in recent months.

Last minute is again constituting a major trend and will play a decisive role in months to come. Many customers who report plans to travel have not booked their trip yet, so that especially brokers specialised in last minute offers will see growth opportunities arising.

¹ Ta.ts Reisebürospiegel 04/09, Vertriebsklimaindex 02/09



2. Tour operators

Generalists have already suffered significantly in the winter season 08/09 from the global economic crisis. Leading European tour operators have realized high single-digit decreases in booking numbers. Current figures as well as prospects for the summer season are even worse as it will be the first period to experience the full impact of the global crisis. Tour operators who operate in niche markets and offer special interest products have performed better during the crisis, partly due to the fact that their main target customers are big income earners with higher budgets for travel. In particular, the cruise operators among the specialists are expected to continue increasing their booking and revenue numbers even in 2009.

3. Accommodations

Demand for *luxury accommodation* is very affected by the crisis, as they have lost a huge part of their market: high end business travellers. Due to very high operating costs, drops in occupancy harshly effect the bottom line.

Globally decreasing prices for hotel rooms indicate hoteliers' difficulties to keep up *standard and club hotels'* occupancy rates. Average room rates and revenue per available room (revPAR) have dropped significantly. Even though recovery might be possible in the long-run, the crisis will lead to a market adjustment during which companies with an unfavourable cost structure or missing growth strategies will be put out of the market.

Due to companies' wide-ranging cost-cutting measures, the crisis' global impact on *business accommodation* is severe. In the current buyer's market, travel managers can partially pass on their cost-pressure and renegotiate lower rates. Cheaper accommodation alternatives, a reduction in number and length of business trips, as well as their partial substitution with video and telephone conferences are common adaptations to

companies' travel guidelines. Familiarisation with the new travel habits might incur so that pressure on business hoteliers could exist until well into the future.

Budget accommodation such as cheap hotels, holiday flats, camping sites and hostels has performed significantly above average, especially in the fourth quarter of 2008. For the rest of 2009, demand is expected to further increase slightly, as many travellers are planning to book a reasonably priced accommodation in order to economise on their travel spending.

4. Destinations

Long range destinations are progressively falling behind their former performance. Especially African, Central/Latin American destinations are affected by the crisis. The H1N1 influenza A virus will most likely constitute an additional shock to the demand for long haul trips.

The *medium range destinations* segment is characterized by diverging developments among the different regions. Turkey's and Morocco's growth rates for example have so far balanced the alerting drop in tourist arrivals on the Canary and Balearic Islands. Future growth is prospected for them; also Greece, Portugal and some Scandinavian and Eastern European destinations could join the "winners" of the crisis. The outlook for traditional Mediterranean destinations will very much depend on their reaction to the changing rules of the game. Spain for example is currently investing in pricing measures but might want to initialise a consequent repositioning.

In contrast to their medium and long range counterparts, *short range destinations* are performing above the average in all customer segments, thanks to their good price performance ratio and aptitude for trips with a shorter duration – and somehow thanks to the crisis.

What are the ways out of the global economic crisis?

Arthur D. Little completed a variety of expert interviews and analysed the business models of selected high performing companies to identify which characteristics successful organisations have in common to thrive in midst of the economic crisis or to move on from negative to positive outlooks. We have identified four ways out of the crisis (see figure 2):

1. Positioning and differentiation

In times of uncertainty and intensified competition, product and service differentiation becomes even more crucial. While reliability on a distinct quality standard has been a necessity in the upscale segment, it increasingly gains importance in the budget segment, too. Travellers are becoming hybrid: also demanding customers selectively book economic products – but are unwilling to give up on certain quality aspects that they have become used to. Product leadership strategies on the other side must not neglect price sensitivities. The resulting “differentiated cost leadership” strategy must be approached with thought to avoid business models to be stuck in the middle.

Most *business hotels* are known for excellent service but currently suffer from their pricy positioning and narrow client focus. *MotelOne* on the other hand offers quality leadership in the low budget segment (“A lot of design for little money”™). It’s revenues and profits are rapidly increasing (CAGR_{EBITDA} 3y: +109 %), a forceful expansion strategy can thus be financed.

2. Intelligent pricing

Various factors influence product pricing, the number of product choices being one of them. Especially through dynamic packaging, product choices have augmented, while online booking engines have facilitated contact possibilities between

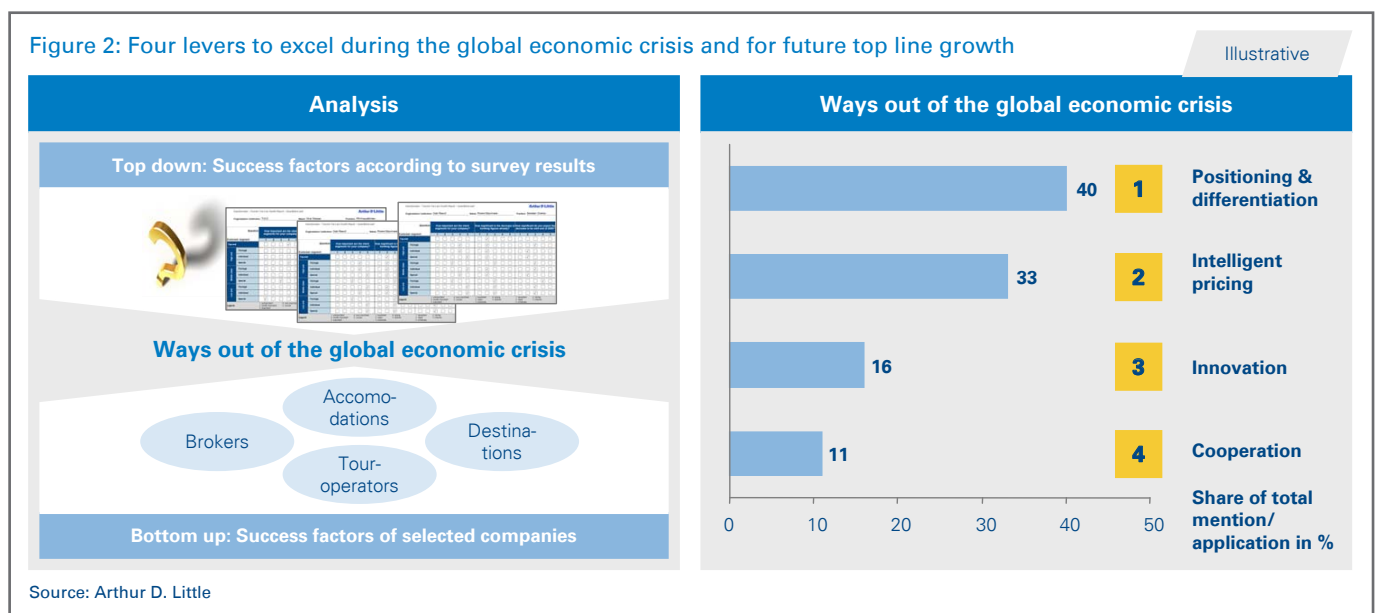
suppliers and the traveller and increased price transparency. To raise revenues in times of crisis, companies must adopt smart pricing approaches, such as an optimisation of ancillary revenues. Active margin management is to be aligned with the market characteristics and the company strategy.

Sixt lost customers through a significant reduction of its service offering (mileage limit of 200 km per day) without corresponding price discounts. *TUI* on the other hand succeeds in successful price differentiation along its various brands and product lines, as well as in active margin management. Various price editions are introduced during the touristic season, production processes and product handling are margin-based. One of the brands, *LTUR*, performs very well in the current situation.

3. Innovation

In times of crisis, cost-cutting measures are crucial – but not sufficient. For a long-term revenue optimisation, innovation plays an important role in order to prepare the product and technology portfolio for the recovery. Today, most destinations and highly specialised offers in the areas of sports, culture or education are on the market and can easily be copied. Therefore, innovation in technology and customer service is crucial to offer products of unique characteristics, e. g. e-ticketing, mobile information, booking services and a customized internet booking engine represent effective means to add value for the customer. Social media offers on a website will raise attention and provide authentic background information, while a direct online channel strategy can offset the overall decline in revenues.

The *Atlantic Kempinski Hotel* has lost its 5*superior rating and exclusive image due to missing investments throughout the last decades. The cruise operator *Carnival* on the other hand has implemented online planning tools for the organisation of



specialised events paired with extensive user-generated content in online forums and blogs. Carnival recently reported double-digit growth rates in bookings.

4. Cooperation

The horizontal integration of tourism companies has led to the formation of a consolidated industry with a few leading companies in Europe. The same companies have extended their activity to other parts of the value chain. But not only size, also strategy matters – as the current Arcandor insolvency and resulting effects for Thomas Cook Group plc demonstrate. Especially for the smaller players, intelligently selected product bundles are of strategic importance. Therefore, partnering – in particular along the travel value chain – is gaining importance and becomes a success factor during the economic crisis. Synergies from joint activities such as procurement, advertising and sales save costs for both parties; a jointly exercised channel and account management, internationalisation and new applications can lead to innovative business models and thus create possibilities to grow during the crisis.

While *conglomerates* without clear synergies or product linkages, e. g. TUI AG (tourism and shipping), Arcandor AG (tourism and department store) are currently depreciated on the stock market or in financial distress, the online broker Weg.de was able to increase revenues by 20 % in the first quarter of 2009. The company cooperates along the travel value chain in advertising and sales, and even uses the expertise of its competitor Expedia in dynamic packaging solutions.

Conclusion

Arthur D. Little's analysis shows that especially in the days of the global economic crisis, companies are the architects of their own fortune. In consequence Arthur D. Little recommends companies to review and actively implement the identified ways out of the crisis not only to ensure performance in the downturn but also to pave the way for future top line growth. The proposed key-measures are:

1. **Positioning and differentiation:** Ambition Driven Strategy as a powerful approach to mobilise all energies through scenario thinking and analysis of competitive forces
2. **Pricing:** Margin Management and Pricing Excellence analysed from an empirical and behavioral perspective to create win-win situations
3. **Innovation:** Innovation based on a full and benchmark based approach covering the whole process range of the innovation cycle
4. **Cooperation:** Partnering as a strong model to amplify competencies and energies based of common strategic pillars

We would very much enjoy discussing with you our insights into the impact of the global economic crisis on the tourism industry and the challenges and opportunities arising for your company.

Contacts

Ralf Baron

Director
Travel & Transportation
+49 211 8609511
baron.ralf@adlittle.com



Nathan Zielke

Manager
Travel & Transportation
+49 611 7148132
zielke.nathan@adlittle.com



Michael Zintel

Manager
Travel & Transportation
+49 611 7148128
zintel.michael@adlittle.com



Additional author of this Viewpoint is Lars Schäfer, Consultant Arthur D. Little

Arthur D. Little

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