Solutions for Your Competitive World

2011 Tourism Outlook

Volume IV

Overview

As the tourism industry looks to 2011, one can only wonder if the economy will improve and travel and spending in their destination will improve.

It has been a very interesting year to say the least while data is telling the analysts that the recession is over, Main Street is clearly saying that it's not. What everyone is saying however is it that the economy has not picked up to pre-recession levels.

The impact for the tourism industry, particularly those in California, is significant because of the relationship between tourism levels, transient occupancy tax and general fund budgets. We are seeing municipalities across the state having to deal with less funding as cities and counties use those funds for other needs. The implications for the tourism industry are significant and many Destination Marketing Organization (DMOs) have sought addition funding from Tourism Business Improvement Districts, of which there are now over 50 in California alone.

Looking ahead, it's clear that the challenges are not over yet. Here's SMG's annual overview of the issues and their potential impact in 2011.

The national and state economies are still weak

Make no mistake, the national economy, while slowly improving, is still very weak. As one might expect the economic outlook is mixed. The table below outlines some specific indicators for comparison.

Table 1
Key California Economic Indicators 2009-2011

	2009	2010	2011F
California			
CPI	-0.3	2.4	2.7
Unemployment Rate	11.4	12.9	10.7
Income Growth % Chg.	-2.8	3.2	4.5
United States			
CPI	-0.4	2.2	2.4
Unemployment Rate	9.3	9.6	9
Income Growth % Chg.	-1.7	3.3	4.9
U.S. GDP	-2.4	3	3

Source: State of California

As you can see the unemployment rate has remained high, creating what many are calling a "jobless recovery". Also note that the personal income growth rate, which influences consumer spending, has also seen a slow improvement. This creates challenges for the tourism industry.

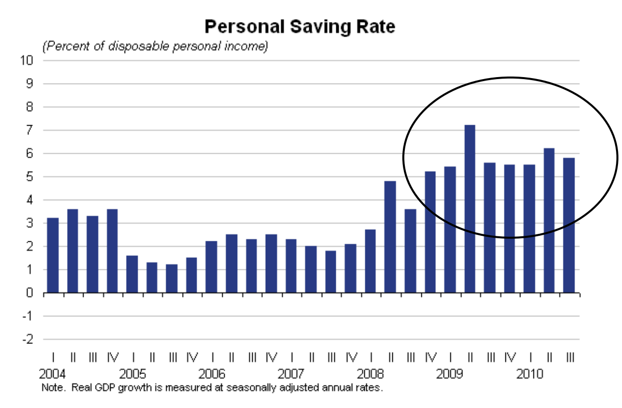
> "At the rate we're going, it could be four, five years before we are back to a more normal unemployment rate," Federal Reserve Chairman Ben Bernanke, *60 Minutes*

Overall growth is projected to be slow as consumers continue to be thrifty and cost conscious with precious disposable income.

Consumer spending

Consumer spending is approximately 70% of the U.S.'s Gross National Product (GNP) with government spending accounting for 30%. But a funny thing has been happening during the past decade, consumers have been spending more, and it is important to understand where this money is coming from. From the looks of it, consumers have been using debt to finance their spending. Figure 1 below shows the personal savings rate of Americans.

Figure 1
U.S. Personal Savings Rate

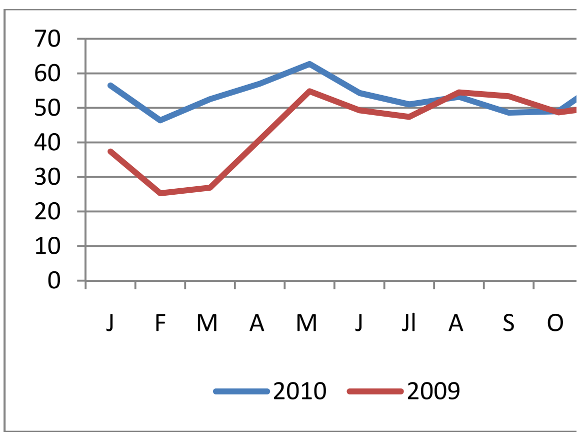


Look at how over time the savings rate has risen since the second quarter of 2008. What the above chart tells us is that up until the recession consumer spending happened because consumers saved less, spent more and went into debt more to maintain their spending and lifestyle levels. Technically what has happened is that consumers have spent above their economic levels because many aspire to a lifestyle that is above their means. That spending goes for things like home purchases, auto purchases and yes, vacations. For years and years the local shopping center has fueled the economy. Now that is no longer the case.

Consumer confidence

Consumer confidence, which is a measure of current and future prospects, has seen year over year increases and is currently at 54, which is well below its historical averages Consumer confidence has a long way to go for it to get to pre-recession levels,

Figure 2
Consumer Confidence



Source: Conference Board

Overview Summary

- The national economy is still struggling with high unemployment and low growth
- The marketplace continues to evolve as consumers continue to ask “do I need it or do I want it” and spend accordingly
- Consumer confidence continues to remain lower than historical levels.

The state of California - the mess continues☹

Without a doubt, the state of California continues to be in big trouble and the new Governor knows it. A state with more natural assets and one of the highest tax rates is simply unable to function. One thing is for sure they won’t be able to solve anything anymore with smoke and mirrors. Here are the big issues.

1. State budget deficit ☹

This is really bad. Outgoing Governor Schwarzenegger has called an emergency special session of the legislature to deal with a projected budget shortfall of $25 billion.

> “Legislative analyst Mac Taylor said he expects California to face annual budget problems of about $20 billion each year through 2015-16.”
> Source: Huffington Post

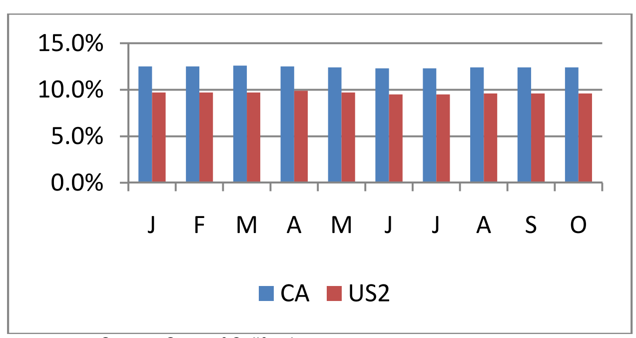
Incoming Governor Jerry Brown has also called his own budget deficit summit to present state lawmakers with the facts. Any way you look at it, it’s problematic.

What was once a vanguard state has become a basket case with budget shortfalls and furloughs for as far as the eye can see. The impact could include more budget cuts and increased taxes, creating a double whammy for both the California economy and the tourism economy. Most importantly the current situation creates big doubts in the minds of California residents and puts a damper on consumer spending

2. Unemployment ☹

Put simply, unemployment is killing us. Currently the unemployment rate for the state of California is above 12%, which is 2 full percentage points above the national average.

Figure 3
U.S. & California Unemployment Rate



Source: State of California

3. Subprime mortgage collapse hangover ☹

As has been widely reported over the past several years, the subprime mortgage collapse hit California particularly hard with many homeowners forced to default on their homes. This in turn has had significant repercussions on the overall California economy.

First is the loss of homes for many California residents which in itself is personally and financially devastating. Secondly is the loss of equity for many homeowners. Some reports have indicated that homeowners have lost as much as 30%-40% equity in their homes. As such many are now saving much more than in the past, one reason for the increased savings rate mentioned previously.

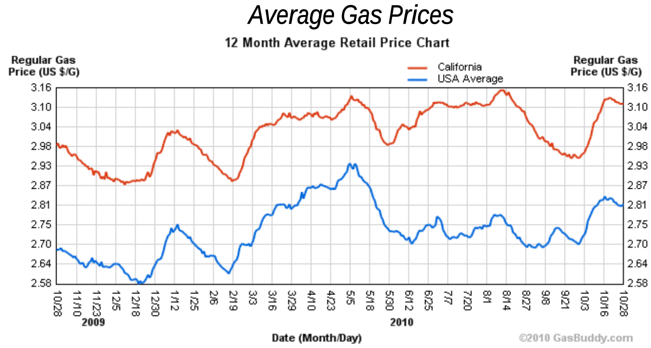
Despite these challenges there have been a few bright spots; mortgage rates continue to decrease, averaging 4-5% for a fixed 30 years loan.

Bright Spots ☺

1. Gas prices - the one bright spot (for now)☺

2010 has seen gas prices stay below the $3/gallon level and have remained fairly constant, though gas prices in California continue to be well above national levels.

Figure 4
Average Gas Prices



Source: California Gas Prices.com

2. People are shopping ☺

Thanksgiving weekend shopping saw the average shopper spend $365 up from $343 last year, according to the Los Angeles Times[1]. This number is supported by the fact that more people are shopping this year, 212 million vs. 195 million last year. So consumers are starting to spend a bit more, but are still looking for value.

3. Stock market continues to rise ☺

The stock market has had a good year, picking up 9% in gains going from approximately the 10,471 back in to 11,410 at the end of the year.

DJIA	
December 10, 2009	10,471
December 11,, 2010	11,410
Change +9%	▲

California still matters.

Very simply, 84% of California's domestic leisure visitors are residents of California. Given that direct travel spending in California was $87.7 billion in 2009, the California market is one that is very important to both state and nation tourism destinations. The economic health and the ability for California consumers to travel is important to many communities.

What's the national travel industry saying?

The U.S. Travel Association is projecting that domestic leisure travel is expected to increase 1.6 percent in 2011, with a corresponding increase in leisure travel spending of 4.5 percent.

The outlook for business travel is improved with domestic business travel volume projected to grow 2.6 percent next year.

Companies are making travel based on the current environment and business travel is no exception. [2]

On the international front inbound travel is projected to increase nearly 3.7 percent in 2011. Travel spending growth among international visitors is projected to increase by 5.2%. Growth in overseas travel (excluding Canada and Mexico) is projected to remain stable at about 1 percent. Overseas travel visitation in 2010 will remain below pre 9-11 levels (23.5 million versus 26.0 million).

[1] http://www.latimes.com/business/la-fi-retail-sales-20101203,0,29816.story

Airline outlook is poor

Commercial airlines' prospects are poor. The outlook for 2011 indicates that profits are projected to decline by 40%. The International Air Transport Association is expecting airlines worldwide to post a net profit of $9.1B down from $15.1B. This despite the fact that revenues are increasing 5.8% to $598 billion.

It is expected that passengers will be paying pre recession prices, which is projected to extend the industry's recovery into 2011. This year rates have increased 10% through October which is up 12% over 2009.

The increasing in pricing is being driven by an increase in fuel prices which account for approximately 30% of airline operating costs. So keep an eye of the price of oil and that should give a sense of where airline prices are going. This could impact destinations that get a larger portion of their business from destination travel. Hawaii anyone?

Lodging - still rough waters ahead

Lodging demand in 2010 is picking up from the year prior. According to Smith Travel occupancy through October was 64%, up from 61.7% the year prior and down from 68.5% in 2008[3].

Selected Occupancy Rates
October YTD

Cities	2010 Occupancy*	2009 Occupancy	2008 Occupancy
Los Angeles	69	65.6	73.8
San Diego	68	65.5	72.9
San Francisco	77	73.3	77.7
CA	64	61.7	68.5
U.S.	59	56.9	62.7

Source: Smith Travel

Average daily rate was down slightly in 2010, $110 vs. $111in 2009 and still well below the $124 of 2008.

Golf - where have they gone?

The golf industry continues to suffer from overbuilding and declining participation. Overall golf rounds played through October 2010 are down 1.8% from year prior. The industry continues to be challenged by the length of a round, the economic environment and rampant price cutting due to reduced demand and excessive capacity.

U.S Golf Rounds	
Public Course	-1.6%
Private Courses	-2.7%
Overall	-1.8% ▼

Source: Golf Datatech

Casino Gaming - feeling optimistic

Over the past 12 months the Nevada Gaming Control Board is reporting that gaming revenue is up .88%. The recent trend is more positive. Gaming is up 7.5% over the past three months and the most recent month of October has seen gaming revenues increase 12%.

Nevada Casino Gaming Revenue	
Past 12 Months	.88%
Past 3 Months	7.5%
Month of October	11.02%

Source: Nevada Gaming Control Board

NEW

The Strategic Marketing Group and Civitas will release the first ever study on California TBIDs in 2011. For more information, contact carl@smgonline.net.

What consumers are saying

Despite all the uncertainty in the marketplace today consumers are slowing increasing their interest in travel. According to Trip Advisor in a recently released survey, U.S. residents are expected to travel more in 2011[4]. Survey findings included the following bright spots:

- Thirty six percent plan to spend more on leisure travel in 2011 than this year, while 42% expect to spend the same amount.
- Ninety percent plan to take two or more leisure trips next year—a slight increase to

[3] Smith Travel, http://ht.ly/3ySlh

[4] Trip Advisor, http://ht.ly/3ySKl

the 89% who said they have done so in 2010.

- Seventy five percent of respondents plan to visit a U.S. city next year, with Las Vegas, New York City and San Francisco the most popular choices.
- Vacation rentals will be a popular lodging choice in 2011, with 47% considering a stay in a vacation rental home – a significant increase compared to 39% one year ago.

The SMG Take

"It's not the strongest of the species that survive, nor the most intelligent that survives. It's the one most adaptable to change.

Charles Darwin

State of California - still broken

For the past several frustrating years I have written how I saw a bunch of things that caused me great concern. Well, I still have those concerns and the state of California gives me no comfort. Despite new elections and new governor I am questioning whether or not California can begin to solve some of its intractable budget problems. Maybe, just maybe the state is so big and politics so complex that legislators in Sacramento can't fix the problems that bedevil the state.

No question about it, we are living in interesting times and as one would expect consumers have adapted accordingly.

The ongoing fallout from the economic recession, the state budget and the impact it will have on the state of California and its impact on consume discretionary spending is still disconcerting.

We must face the facts; this state and its budget are broken. While I certainly applaud everything this governor has done for tourism in California, this continued budget mess is problematic. For one thing how do you fix a $18-$28 *billion* budget gap? Again. I bet there will be significant cuts and tax increases.

Local Governments are Breaking

In addition to federal and state government challenges local governments are also seeing their financial bubble burst. Their new reality is that they too can no longer afford the cost structure they have to put in place.

It's going to take quite a bit of reengineering at the local level to ride through this mess. The bright spot in all of this is those organizations (private and public sector both) have been forced to look at new ways of doing things, developing new business models. Those that survive this recession will have gone through this process.

The *New Normal* – now a reality (we all get it)

The second thing that is really worrying is the changing consumer buying behavior. Consumer spending accounts for 70% of the Gross National Product (GNP). Consumer spending has carried this economy for a good long while and given that personal income growth rates are declining and as we have shown people's personal level of debt has increased, one has to ask where does the spending come from? The new framework for consumers is *do I need it or do I want it?* As such, destinations and businesses are going to have to create real value to entice consumers to spend. This new normal is a significant shift from the pre-recession habits of wild consumption. And it's not likely to shift anytime soon.

Additionally the new normal is including way more use of the Internet and digital marketing to reach segments and niches of consumers. A technology centric approach is the place for marketing strategies to be. If your organization does not have technology at the center of its marketing efforts you might be missing out.

Tourism funding – the fuel that makes it all happen. Is your destination's TBID in place?

Every city or county funded bureau should be concerned about the issues of local funding. If your organization is getting funding for a local source (city or county) you need to be concerned. if you are not already. In the past, the state has balanced its budget by taking away funds at the county and local level. At the local level funds are often taken from tourism promotion to support city services. For those of you who don't have a business improvement district (BID) for secure marketing funds you might want to think about it, because if it comes down to funding your DMO or raises for police and fire, guess who wins that one? I'm laying odds on police and fire.

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What you need to consider

The fundamental question we now face is how do you sell a vacation with a slow growth jobless recovery going on?

First, before you even sell your individual destination or travel product it is important to legitimize the concept of taking a vacation. Simply telling customers your destination is better may not be enough if consumers are wondering if they should take a vacation at all.

Second, you have to drive home the value proposition of your destination and clearly communicate those benefits to your customer. Consumers are now looking at a return on investment of those vacation dollars. *Think of it as investment shopping.*

Focus on the core

Now is the time to focus on the core market that has an interest in your destination. Look at the activities that you destination has and reach out to those niches, be it road cyclists, mountain bikers, surfers, foodies, etc. Now is not the time to sell a soft vacation. You need to give people very specific reason to visit, either through activities or special events. Remember also that in targeting the core you efforts are reaching a smaller but more passionate segment, so if you are looking for volume look for more niches and segments of passionate people and reach out accordingly.

More technology - with a balance

There is no question there is a need to shift more resources to online and social marketing efforts. However, it is important to do this with a balance. You still need to concentrate on the basics of brand building, but at the same time focusing the bulk of your efforts online makes sense, as that's where consumers plan – and purchase - travel.

Get efficient

Here are a couple of recommendations for you to improve your efficiencies.

Look for efficiencies within the budget - Consider the following: Can you identify the top 5 marketing programs in terms of their effectiveness? If you can, you should consider reducing or eliminating everything else. Every department should ask itself "what are the lowest performing marketing programs?" and if they don't fit with your long term strategy it may be time to cut the cord.

Leverage your marketing dollars – Can you reduce duplication with other organizations? Work with your partners to determine ways to combine efforts in advertising, public relations and other marketing tactics. By working with partner organizations (lodging associations, chambers) you have the capacity to leverage your marketing dollars and send a more impactful (and unified) message. Whether it's a new marketing coop or simply a shared creative for a single campaign, you can adjust the level of leverage to suit you and participating partner's needs.

Renegotiate contracts – While no media vendor will like losing business, it's in their interest to find a way to keep you as an existing client. Thus discussing changing ad units, insertion periods and other options is another way to improve your organizations' media efficiencies.

Measure – You say your ROI metrics are lacking? Then develop some objectives and determine a way to measure the success of said objectives so you can clearly evaluate whether your marketing programs were successful or need to be adjusted. This is especially important if you're working in a cooperative setting, as every partner will need to see ample evidence that their buy-in is worthwhile.

Final thoughts

On the upside, consumers are resilient and they seem to always find the money for fun. Nowadays they are assessing that fun through the prism of whether they *need* it or simply *want* it. They may not vacation five times a year but they will find a way to vacation several times this year. But it has to make sense from an ROI perspective.

My suggestion is that you be aggressive. Stay focused on your core segments and marketing programs. Keep spending to build your organization's online capabilities and marketing programs. Keep refining your marketing message and do what works. At the same time don't be afraid to be innovative, squeeze more out of what resources you have. Make what you have work harder.

Finally, continue to focus on the experience and work to differentiate your destination. People are looking for something different to take their minds off all the distractions and irritations in their lives. It's your destination's job to do just that.

Have a great new year.

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