

Beyond the Borders

For further information:

Ronald Haddock, Zurich: ronald.haddock@booz.com

Kevin Ma, Shanghai: kevin.ma@booz.com

Edward Tse, Hong Kong: edward.tse@booz.com

Booz & Company

12/19/2006

a strategy+business exclusive

Beyond the Borders

As more Chinese travelers leave the mainland to explore the world, the travel industry must figure out what these consumers really want.

by Ronald Haddock, Kevin Ma, and Edward Tse

The global travel industry is bracing itself for a new wave of tourists out of China. Like the droves of Americans who explored Europe in the 1960s and the Japanese who traveled the world in the 1980s, the tastes and preferences of China's new international tourists will have an enormous influence on the entire tourism ecosystem. Within the next five years, we can expect to see tens of millions of relatively young travelers pouring from the mainland, driven by rising disposable incomes, the easing of travel restrictions, and a deep curiosity about the world around them.

Currently, only about 2 percent of the Chinese population travels outside the mainland — well below the 15 percent of Americans who travel abroad. But China is catching up. The International Air Transport Association predicts the mainland's international passenger traffic will grow at an annual rate of 9.6 percent between 2005 and 2009, while various other agencies estimate that China will be among the top four sources of outbound tourists by 2020.

What is unclear, however, is the quality and cost of the experiences these tourists will seek: bus tours of Paris's outer arrondissements, or private tours of the Louvre? Spanish street food or tasting menus at El Bulli?

The earthier options seem to be more popular thus far. Ask for a description of the typical Chinese tourist

and industry types are likely to use such words as *value-conscious*, *shopping*, *gambling*, and *chain-smoking*. Or, as the *Economist* put it in a June 2006 article, "Typically, a Chinese tour group will choose the cheapest hotel — even if it is 50km (30 miles) outside a city — travel by bus and eat only Chinese food.... Posh hotels, resorts and restaurants will have to wait for their Chinese windfall."

These descriptions contain elements of truth, but they don't offer a complete picture. Indeed there will be a dramatic rise in the number of Chinese tourists, but they won't all be as frugal or provincial as many in the industry expect. As the *New York Times* recently noted, a significant subset of the overall population of Chinese tourists will be quite affluent and willing to spend accordingly. Consider this: China's 31 million international travelers spent \$15.2 billion in 2005. At nearly \$500 per person, mainland travelers spent more per capita than international tourists from France, Japan, or the United States.

Chinese Travel Trends

Successful tour operators are offering upscale packages that promise deeper knowledge of a city, region, or country. They are also introducing lifestyle-oriented products, like fine-dining and wine tours that have proven popular with other nationalities and adapting them to the increasingly sophisticated tastes of mainland travelers.

Ronald Haddock

(haddock_ronald@bah.com) is a vice president and director of Booz Allen Hamilton in Greater China. He has been in Asia since 1997, serving multinational corporations and local clients from Booz Allen's offices in China, Korea, and India.

Kevin Ma

(ma_kevin@bah.com) is a senior associate with Booz Allen Hamilton in Shanghai. He has extensive experience with multinational corporations and Chinese companies in the travel and tourism and high-tech industries in the Asia Pacific region, with a focus on Greater China.

Edward Tse

(tse_edward@bah.com), a vice president with Booz Allen Hamilton, is the firm's managing partner for Greater China. In 1993, he was the partner in charge of China's first authorized office among all the leading global strategy consulting firms. Since then, he has advised hundreds of Chinese and foreign companies across the full range of strategic issues facing companies in China.

Shopping continues to be popular among mainland travelers. But China's growing manufacturing muscle poses a challenge for overseas retailers: How do you sell to a tourist from a country that makes just about everything? One option is to appeal to Chinese consumers' brand-conscious nature, with a focus on items with labels that can be shown off. Smart sellers will remember the trend in China in the 1980s and 1990s of leaving tags on sunglasses and jackets to show off the brand; this practice has waned, but the impulse remains. For this reason, Louis Vuitton handbags, Swiss watches, and Chow Sang Sang gold are very popular. Service will also matter: Hong Kong retailers, for instance, often provide service in Mandarin and accept the renminbi (the language and currency of the mainland, respectively).

No review of Chinese travel would be complete without a discussion of gambling, a top travel pastime. The preferred destination continues to be Macao, the only place in China where gambling is legal. Chinese gaming revenues have revitalized the former Portuguese colony, sparking foreign investment, labor shortages, and a property boom. Macao's success has inspired countries as diverse as Australia, North Korea, and Singapore to launch or intensify efforts to attract mainland gamblers. However, the profitability of this business will be hit by higher marketing costs and greater competition. Larger construction and maintenance costs will also play a role, as customers come to expect a luxurious, Las Vegas-style experience.

Placing Bets in the Industry

Companies within the travel and tourism industry stand to benefit from an abundance of opportunities, but must remain cognizant of the danger of significant pitfalls. For travel operators — whether theme parks,

hotels, or cruise lines — the challenge will be to develop products that appeal to Chinese tastes. Hotels will need to keep costs down to meet mainland travelers' value expectations. But at the same time, opportunities exist both for hotel groups that can migrate customers from the lower and middle tiers into more expensive properties, and for chains that can develop a strong brand in China and use it to attract mainland tourists when they travel abroad. Companies that find the optimum combination of home comforts, such as food, entertainment, and in-room amenities, and international service standards will also do well, particularly in midrange to high-end facilities.

Like hotels, cruise lines must gain an understanding of the Chinese market, as well as educate Chinese travelers by introducing them to the concept of cruising. Because cruising is a new vacation option for mainland tourists, cruise lines will need to sell the market on the romance of the sea and the ship as a destination, and give consumers a sense of the entertainment and other diversions available on board a modern ocean liner. Cruise lines will need to find a balance between the familiar and the new, which will enable guests to experiment or to play it safe, as their mood dictates. And they'll need to figure out where Chinese tourists want to voyage, for how long, and at what time of year. Industry leader Carnival Corporation's Costa brand entered the mainland China market with an up-market offering in 2006, sailing from Shanghai and from southern China. Royal Caribbean, playing catch-up, recently announced plans to begin sailing from Shanghai in 2007. Given the novelty of cruising as an outbound travel vacation option, both will need to target their offerings at specific, clearly defined markets and communicate value to

first-time customers who will be comparing cruises to land-based vacations.

Airlines will face their own challenges. Strategically, they must serve profitable markets, either directly or through alliances and networks. This means obtaining and retaining access to attractive routes and landing slots at key airports, as well as ensuring that the government and regulators maintain an equitable operating environment. Tactically, air carriers must support their routes with the management expertise needed to meet clearly defined service and cost targets. International airlines can expect challenges from private domestic carriers, like Hainan Airlines Company, which will use their internal routes as springboards to international markets. They should also anticipate a competitive environment that features one or more mainland-based mega-carriers.

The relative inexperience of mainland travelers offers a significant opportunity for travel agents, particularly those who can assemble distinctive elements more deftly than can individual travelers. The fragmented nature of the mainland market, consisting primarily of small, local agents, represents an opportunity for an organization with sufficient vision and resources to establish a national presence that enhances service standards, increases professionalism, and achieves economies of scale. Mainland Chinese travelers today are not very well served and will need a lot of help to understand new offerings such as luxury cruises. However, the growing popularity of the Internet poses the same threat to travel agents — and the same opportunity for e-travel companies — in China as it does elsewhere. Research by the World Tourism Organization shows that the Internet is already an important source of information for mainland tourists, and this trend is unlikely to abate.

Finally, financial-services providers such as insurance companies will be watching the development of this market attentively. Travel insurance and credit cards are closely linked to the travel industry and have been important revenue and profit generators in markets around the world. Of particular interest will be outbound travelers from China, who spend far more than domestic travelers and therefore represent more oppor-

tunity for insurance companies and credit card issuers.

Companies looking for growth in China's outbound travel sector will not be disappointed. Pent-up demand is considerable, disposable incomes are rising, and travel restrictions are being eased. In many ways, the market is still in its infancy, with few clear leaders. However, optimism must be tempered with a clear understanding of China's scarce and often unreliable data, its fragmented market, and the diverse characteristics of its tourists, as well as the need for real consumer education. Companies that commit to learning about consumers' tastes and preferences, demonstrate a willingness to educate people about their products and the joys of international travel, and possess the resources to create distinctive products that meet local needs will benefit from the wealth of opportunities in serving China's new breed of travelers. +

Resources

Frederik Balfour, "Macao Set to Trump Las Vegas in Gambling Biz," *Business Week*, September 5, 2006: American casino companies are seeking conference, business, and luxury expenditures in Macao. www.businessweek.com/globalbiz/content/sep2006/gb20060905_054377.htm?chan=search

The International Air Transport Association, "Five Year Forecast Shows Rapid Growth in Asia and Central Europe," October 31, 2005: Summary of projected growth in international air traffic for 2005–2009. www.iata.org/pressroom/facts_figures/traffic_results/2005-10-31-03.htm

"Outward Bound," *The Economist*, June 22, 2006: An overview of the current state of Chinese tourism in Europe. www.economist.com/business/displaystory.cfm?story_id=7088698

Craig S. Smith, "Chinese Speak the International Language of Shopping," *The New York Times*, November 7, 2006: The impact of increasing numbers of both Chinese tourists and Chinese immigrants on retail offerings in Paris.

<http://query.nytimes.com/gst/fullpage.html?sec=travel&cres=9C04E6D9113FF934A35752C1A9609C8B63>

strategy+business magazine
is published by Booz & Company Inc.
To subscribe, visit www.strategy-business.com
or call 1-877-829-9108.

Originally published as “Beyond the Borders” by
Ronald Haddock, Kevin Ma, and Edward Tse.