

The impact of future travelers' preferences on the tourism industry

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Tourism is a highly sensitive reflector of the general state of the economy, falling rapidly in response to a downturn but then bouncing back to growth more quickly than most. This time, however, insiders are wondering whether the industry will return to its traditional growth path in the wake of the global economic downturn. Travelers have changed and the industry will have to change with them. Based on extensive discussions with industry experts, this article explores the evolution of travelers' preferences and the current state of the industry, and looks at what the future holds for the business of tourism.

The tourism industry acts as a sensitive barometer for the occurrence of dramatic events of global proportions. Take the 1989 Asian economic crisis, the 9/11 attacks in 2001, the bird flu outbreak, the second Gulf War, the spread of SARS in 2003 or the Indian Ocean tsunami in 2004: worldwide international tourist arrivals dropped dramatically in the months following all of these events. It is no surprise then that the acute 2008-2009 economic crisis is hitting the tourism industry very hard, with an expected year-on-year global decline of minus 8 % (see Table 1).

So far the tourism industry has always bounced back. Once the ripples of a dramatic event had died out, the industry returned to its steady long-term growth rate of more than 4 % annually. But today industry executives are less sanguine about the future of tourism. They wonder what the future will look like and how the industry can get back onto a growth path.

In this article we will look at possible futures for the tourism industry from two perspectives. First, we take the demand perspective – we explore how travelers' preferences are going to evolve. Second, we take the supply perspective – we analyze the current state of the industry and look at its future directions. We then combine these two strategic perspectives to formulate recommendations for action. The article is based on two research studies we conducted recently, including one at the ITB, the world's biggest tourism fair (see side box).

About the research

We use the term "tourism" to refer to travel for recreational, leisure or business purposes. Tourism is one of the major business sectors globally. According to the World Travel and Tourism Council (WTTC), the combination of direct and indirect activities of travel and tourism accounts for nearly 10 % of global GDP, 11 % of world exports and 9.5 % of world investment.

Building on the work we have been doing with the key players in the tourism industry, we recently conducted two specific research studies. The first was conducted at the end of 2008 and addresses the future of traveling from a consumer perspective. The second was conducted at the world's biggest tourism fair, the ITB in Berlin, in the spring of 2009 and provides an industry snapshot, as we collected data from more than 150 companies, including brokers, tour operators, accommodation providers and managers of destinations.

This article also refers to secondary sources such as the UNWTO's World Tourism Barometer, the ITB World Travel Trends Report, the World Economic Forum's Travel & Tourism Report, Statistisches Bundesamt, FUR Reiseanalyse/RA 2007, Official Airline Guide (OAG), IPK International, CN and GfK.

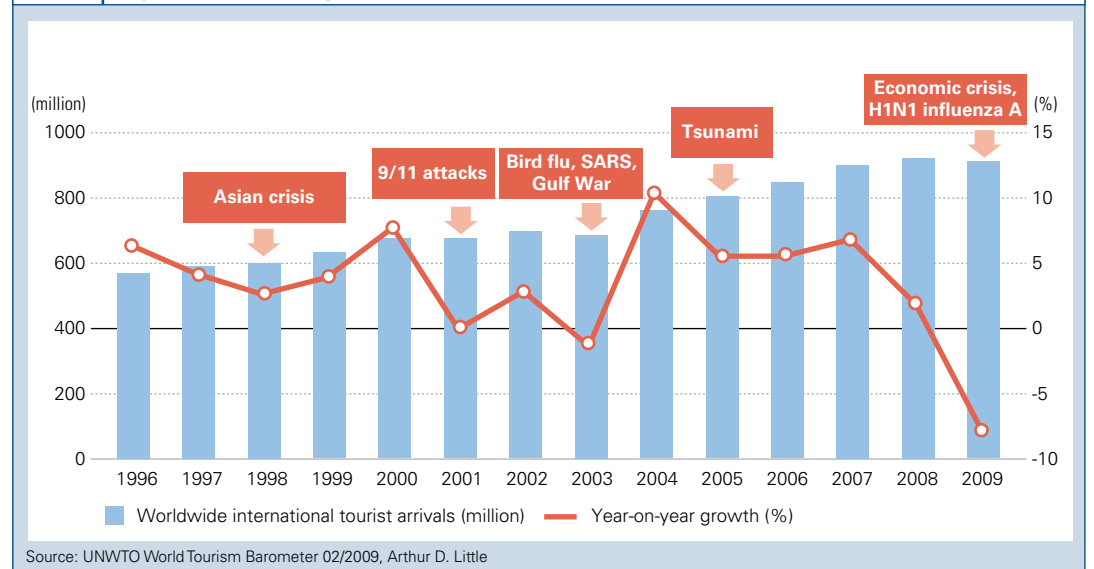
Both the tourism demand and supply sides differ significantly among regions and cultures. This article focuses on Europe, which is the biggest market, representing 60 % of worldwide tourism demand, valued at US\$857 billion in 2008.

Future travelers' preferences

Until 2007 the tourism industry showed a steady annual growth of more than 4 %, with worldwide international tourist arrivals reaching about 900 million in 2007. The economic crisis that erupted in 2008 put an end to that, with a decline of 8 % expected for 2009. This global average hides much stronger declines in specific markets such as Spain (see side box).

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Table 1 Impact of events on global tourism



The impact of the economic crisis on tourism in Spain

According to the UNWTO, Spain is the second most important tourism destination worldwide, with nearly 60 million international visitor arrivals in 2007. The tourism industry, which includes the activities of traditional service providers such as airlines and hotels, is highly critical for Spain's economy. In 2008, it accounted for US\$102 billion of revenues and more than 3.6 million jobs in a population of 43.6 million. It accounts for 23 % of the country's total export earnings.

The Spanish tourism industry is in serious trouble today. According to Exceltur, Spain's association of tourism companies, the tourism industry saw a 7 % decrease in activity in the first quarter of 2008. Its President estimates a 5.6 % decrease in tourism GDP for the whole of 2009. Data published recently by the Ministry of the Interior show that the number of tourists visiting Spain in the first quarter of 2009 was down 16.3 % compared to the same period in 2008. The year 2009 is best described by slogans such as "the worst year since...", "the highest decline since..." or "the lowest revenues in (so many years)."

Declining fortunes at major destinations such as Spain translate into hardship for operators in major source markets, such as Germany and the UK. TUI Travel, the global leader in tour operation, reported a 12 % year-on-year decrease in turnover for the second quarter of 2009. Thomas Cook, one of its key competitors, is facing similar challenges.

The key question is: is this decline just a temporary trend interruption, or has the nature of demand changed irrevocably? Does the economic crisis merely translate into a lower yet transitory financial ability to travel, or will the preferences of "traveler 2020" have evolved fundamentally?

Clearly, being mobile is a prominent human desire that will not disappear. As soon as a set of fundamental needs are satisfied, people develop the appetite to spend their free time exploring a difference to their daily lives. But, while this enduring desire leads to continuous business for the travel industry, the way people express it fluctuates over time.

Our latest analyses show that travel habits and needs have changed significantly in recent years. Traditionally "typical travelers" came from Europe or North America. They were middle-aged people, collecting information about their trip through travel agencies. They showed a consistent consumption pattern – for example, a preference for a top brand airline coincided with the choice of a hotel. They bought their trips in a package, i.e. a flight, hotel and leisure program were supplied by a single source. Satisfaction of individual needs drove their choices, with little concern for the social or natural environment.

The "traveler 2020" will be very different. Our trend analysis shows six major differences:

1. Travelers will be more international. The share of travelers from Asia Pacific and the Middle East will continue to grow. From 1990 to 2007, their share of outbound trips increased from 16 % to 23 %. In that same period the share of travelers from the Americas declined from 23 % to 17 %.

2. Travelers will be older. The share of travelers older than 60 years will increase to more than 25 % in 2020, up from 21 % in 2000.
3. Travelers will be even more digitally oriented than they are today. The internet as a channel will allow a more active traveler. While he or she will opt for the help of brokers, the traveler will be less dependent on them. In 2007 39 % of travelers were already searching for information online and 19 % were booking online.
4. Travelers will be increasingly "hybrid", with a polarization and less consistency in their travel expenditures. A wish to use cheap accommodation will coincide with the desire to have a high-class service offering at a destination in a particular area, for example in health or education. Or they may use a low-cost airline but choose a five-star hotel.
5. Travelers will abandon "packaged tours" in favor of individually tailored services. The share of packaged tours of all booked journeys is expected to decline to 20 % by 2020, compared to 33 % in 2004.
6. Travelers will show a growing concern for sustainability. They will increasingly take ecological aspects into consideration when making travel purchasing decisions.

The combination of these mega-trends points to a strong demand for new service offerings from the tourism industry. Future offerings will be characterized by labels such as convenience, sustainability, community, cosmopolitanism, learning and virtualization. Globalization will bring in more styles, habits, desires and cultures. Changing demographics will bring in older consumers. Travelers will embrace digitalization. In short, traveler preferences and attitudes that have been stable for many years are shifting. Travelers are better educated, less easy to categorize into solid and stable segments, and more concerned about the environment. These shifts go well beyond the temporary effects induced by the economic crisis. They are far-reaching and durable.

As a consequence of the more heterogeneous and fast-changing profile of travelers, the tourism industry's service

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offerings and business models will have to change too. The industry will need to go for customization and individuality when responding to more specific and detailed traveler requests. While the tourism industry is obviously studying these trends, the question remains to what extent it has already translated them into new service offerings. Therefore let's have a look at the supply side.

The fortunes of the tourism industry

A look at the value chain and the actors involved is helpful in assessing how the tourism industry will change (see Table 2). The value chain covers trip planning and booking, the flight, the transfer, the provision of accommodation and the trip experience on-site. The parties active along this value chain are brokers, tour operators, accommodation providers and managers of destination services, including tourist boards.

Table 2 | **The tourism value chain and the main actors**

		Trip planning & booking	Flight	Transfer	Accommodation	(Day-)Trip
Actors	Brokers ■ Travel agencies ■ Online brokers	●	○	○	○	○
	Tour operators ■ Generalists ■ Specialists	●	◐	◐	◐	◐
	Accommodation providers ■ Luxury ■ Business ■ Club ■ Standard/Budget	○	○	◐	●	◐
	Destination managers ■ Long-range ■ Medium-range ■ Short-range	◐	○	◐	◐	◐

Source: Arthur D. Little analysis

In the traditional tourism business model, the tour operator is the dominant actor. He is heavily involved in all activities across the value chain. In order to respond to customer needs for mobility, leisure and excitement, he offers "package tours" combining various travel components to create a holiday. The typical service package consists of buying a holiday at a travel agency, flying to the destination with a charter aircraft, transferring from the airport to the hotel,

staying in the hotel booked in advance and enjoying the service of a local representative. For the sake of convenience, the traveler goes to one service provider, i.e. the tour operator, who neatly puts all items on one bill. The tour operator has all the capabilities and assets to have full control of the value chain and service provisioning, including car hires, transfers, excursions and a high variety of "lifestyle services".

The tour operator concept has been so convincing that a number of successful players became "leaders of the pack" in an industry that used to be very fragmented. Companies such as TUI, Thomas Cook, REWE and Kuoni have been growing steadily over the last 15 years, generating revenues in 2008 of around €18 billion, €10 billion, €4.6 billion and €3.3 billion respectively. These four companies have a combined 80 % share of the European market. They work on a global scale (e.g. TUI operates in 180 countries), run hotels and clubs (e.g. Thomas Cook operates nearly 90 hotels through direct control or via franchise services), operate aircraft (e.g. TUI has a fleet of more than 150 aircraft) and unite travel agencies under their umbrella (e.g. REWE oversees around 2,600 agencies).

The question is whether this time-tested business model will survive the shift in travelers' preferences that we described above. To answer that question, let's take a closer look at each of the four actors shown in Table 2, the impact of the current crisis on their business, the measures taken to cope with that impact and what the future may hold for them.

Brokers

Brokers are travel agencies or online platforms selling packaged tours or single components of a trip. Brokers' revenues in the first quarter of 2009 were 10 % below those in the same period in 2008. For the full year 2009, revenues are expected to decline by 15 %.

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They hesitate to make long-term commitments and prefer last-minute deals. Accordingly business is shifting toward online brokers (see side box).

Broker case example: Expedia and Orbitz

Expedia and Orbitz, two of the internationally most frequently used online booking sites, abolished booking fees on flight offers in May 2009. Expedia also eliminated change and cancellation fees on all hotel, car rental and cruise reservations. Subsequently Orbitz lowered booking fees for hotel reservations.

As a result, Orbitz's air transaction volume in the second quarter of 2009 grew by 22 % compared to the first quarter, but its revenues decreased by 19 %. As direct-to-consumer distribution is strengthening and thus threatens the online brokers' position, the fee waivers have stimulated indirect online travel bookings. They are a meaningful differentiator for Orbitz and Expedia, but also erode their revenues.

Short-term, all players in the broker segment are responding actively to the crisis through price measures such as best-price guarantees or the abolition of booking fees (e.g. by online brokers such as Expedia and Orbitz), and through special promotional campaigns, such as joint sales. The sustainable path to the future, however, is linked neither to price nor promotion, but to going increasingly online. Players such as Weg.de and others are enhancing their internet booking machines and offering more sophisticated, complete and easy-to-use services.

Tour operators

Over recent years a differentiation has emerged between generalist and specialist tour operators. Generalists offer the whole travel portfolio while specialists focus on specific target groups (e.g. high-income couples with no children, families or singles) or products (e.g. golf trips, culture or adventures).

The economic crisis is affecting the two types of operators differently. Generalist operators have suffered from a

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significant drop in bookings in the latest winter and summer seasons. Middle-class and low-end customers especially are breaking away as customer groups. Recently, generalists have experienced intensified competition, with some operators reporting a 10 % decline in bookings. Specialist operators are much less affected. For example, cruise operators, both sea and river, have shown steady growth in recent years, with some reporting double-digit growth. Specialist services will continue to grow in the future.

Operators are responding to the crisis with a variety of product, promotion and price measures, such as extended cancellation insurances, fringe benefits (e.g. baby accessories), campaigns, lotteries, early-bird discounts and price reimbursements. However, none of these makes a real difference in today's marketplace. The operator's sustainable future success will be the result of its flexibility, i.e. its ability to respond to changing market conditions and the particular needs of specific user groups. These needs may refer to willingness and ability to spend and to the way of selecting a destination or trip type. An operator's flexibility may be linked to the type and number of assets it operates. For example, does it operate a network of partners or is it a self-sufficient player running its own travel agencies, hotels and aircraft? Whatever the set-up of assets, flexibility will be the winning differentiator in the years to come.

Accommodation providers

Accommodation is classified into five segments: luxury, club, business, standard and budget. The economic crisis is hitting hard at the middle segments (club, business and standard). For example, occupancy rates in club and standard hotels in Europe fell by nearly 4 % from the beginning of the crisis to around 65 % in June 2009. Germany counted one million fewer overnight stays in business hotels in 2008 compared to the previous year, which contrasts sharply with the traditional growth projections of 3 % in this segment. Clearly the budget segment is the current winner. For example, German business travelers' stays in one-star and two-star hotels increased by 60 % in 2008 compared to 2007. At the other end of the spectrum, demand for luxury leisure accommodation will stay constant or even increase slightly.

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As a result of the crisis, accommodation providers are currently engaged in a price war through such devices as last-minute offers, family premiums, business flat rates and additional benefits. These measures may give the impression of a blurring of boundaries between the five segments. Looking beyond the crisis, however, we do not expect the emergence of a new segmentation. The current segments reflect a natural segmentation of the market. However, high-quality providers have to be careful not to risk their positioning, if eroding margins eventually lead them to lower their service levels and postpone maintenance work. As with tour operators, flexibility will be the determining capability of successful accommodation providers. They must be able to adopt their offerings – in an economical way – to travelers' changing needs (see example in side box).

Accommodation case example: Motel One

Motel One identified the trend towards budget hotels with a decent standard early and took the opportunity through innovation. With the slogan "A lot of design for little money," it sought quality leadership in the low-budget segment. For example, it established a functional lobby and room concept and integrated design and lifestyle in a formerly rather faceless segment.

While average RevPAR (revenue per available room) in the German hotel business fell by 14 % at the beginning of 2009 compared to the same period in 2008, Motel One's increased by 10 % as a result of its clear target-group focus. In the last three years its revenues and EBITDA have increased by 41 and 100 % respectively. While most hotel chains are currently taking bottom-line measures, Motel One plans an expansion to European metropolises and additional openings in Germany. Motel One's CEO was recently named "Hotelier of the Year 2009."

The Motel One example shows that the basic assumptions about the success factors in this industry may have to change with changing external conditions. By clearly understanding customer demands and consistently addressing them, companies such as Motel One can attain long-term competitive advantage and eventually market leadership.

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Destination managers

For destinations, a distinction is made between long-range (long-haul flights), medium-range (more than 500km) and short-range targets (less than 500km). The impact of the economic crisis differs with each target. Long-range destinations are the hardest hit, with year-on-year declines ranging from 15 % for Africa to 7 % for the Far East. The picture for medium-range destinations is mixed: markets such as Turkey and Morocco are growing while others, such as mainland Spain, the Canaries and the Balearics are showing a sharp decline. Unsurprisingly, short-range destinations are performing the best.

The main response of destination managers to the crisis is similar to that of other actors in the tourism value chain: reducing prices and stepping up promotion. Kenya, for example, cut visa costs by half. However, while more attractive prices are leading to the rediscovery of closer destinations, we do not expect a dramatic shift in travelers' preferences in the long run as far as destinations are concerned.

The changing rules of the game

The measures that tourism companies can take to cope with today's challenges (i.e. the impact of the economic crisis) and prepare for tomorrow's opportunities (i.e. travelers' evolving preferences) fall into three categories:

- **Short-term operational measures:** These are responses to fluctuations on the demand side. They do not involve real change but serve as counter-measures to the crisis. Typical examples are product alterations, price adaptations and promotional activities.
- **Mid-term strategies:** These are moves that involve the development of innovative products, expansion into new segments or the use of new marketing channels.
- **Business model changes:** These relate to more radical shifts in the way the company intends to make money, such as changing the scope of its activities along the value chain, interfacing differently with third parties (such as customers, suppliers and partners), acquiring

novel assets or capabilities, or changing the cost structure or pricing format.

Using the results from the snapshot we took at the ITB fair in Berlin, we find that the measures tourism companies are taking today fall either into the first or second category, with none in the "business model change" category (see Table 3).

Table 3	Measures to cope with today's challenges and prepare for tomorrow's opportunities
	<p style="text-align: right;"><i>Examples</i></p> <p>Business model changes</p> <p>Mid-term strategies</p> <p>Short-term operational measures</p> <ul style="list-style-type: none"> ① Repositioning, portfolio enhancements ② Active margin management and process adaptation ③ New marketing channels, e.g. ambient media ④ Strategic cooperations along the travel chain ⑤ Improvement of reward systems A Abolition of booking fees, best-price strategy B Extended cancellation insurance C Prolongation of early-bird discounts D Rate discounts E Promotion campaigns, e.g. posters, lotteries, vouchers, e-learning F Online sales push, opaque sales channels
	Source: Arthur D. Little analysis

Do these results mean that the tourism industry is not on the verge of radical change? Will the future of tourism be a continuation of the past, once today's cyclical setback has been overcome? Will its historic business model survive? Before answering these questions, let's consider two things.

First, the tourism industry has been very successful for decades. Years of steady growth have established a sophisticated value chain structure in which a number of players have thrived. Integrated travel companies have established themselves to service the whole value chain, while specialists such as travel agencies have occupied attractive niches. The industry is used to temporary crises and has always bounced back to growth when countermeasures took effect. The responses to the current economic crisis follow that well-trodden path. So a winning formula should not be discarded lightly.

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Second, business model changes are often induced by new entrants from adjacent areas rather than by the incumbents. But the current economic crisis has hit many players in adjacent areas even harder than the tourism players, and they are unlikely to dabble in business model changes now. For example, major European airlines reported a sales decrease of more than 3 % and an average EBIT decrease of 15 % for the first half of 2009 compared to the same period in 2008. Likewise, major European airports report an average decline of more than 6 % and 10 % in sales and EBIT respectively.

However, less proximate players, such as service providers, brokers and technology providers, may enter the market and trigger a reorganization of the current industry set-up. One outcome could be further disintermediation as a result of the greater influence of service providers (such as hotels and airlines). Another could be a new positioning of brokers and technology providers, possibly as single integrated players. We are already seeing "asset-light" service companies using the internet both as their main sales channel and as a production platform for creating new service offerings. In short, once the dust of the current crisis has settled, we will clearly see the effects of new rules of the game.

Insights for the executive

The tourism industry, just as many others, has been hit hard by the current economic crisis. But it is used to temporary crises, such as the 9/11 attacks and SARS, and has always bounced back to growth when its countermeasures took effect. Yet industry executives today are less sanguine about the future of tourism. They wonder what the future will look like and how the industry can get back onto a growth path.

To determine possible futures for the tourism industry, we first took a demand perspective, i.e. we explored how travelers' preferences are going to evolve. Of course, the crisis has reduced people's financial ability to travel, but what is happening now is more than just a temporary trend interruption. The nature of demand is changing irreversibly and the preferences of "traveler 2020" will have evolved fundamentally from today's. Our trend analysis

shows six major differences. Travelers will be more international, older, digitally oriented, less consistent in their choices, geared toward individualized offerings and more ecological. These shifts go well beyond the temporary effects induced by the economic crisis. They are far-reaching and durable. They point to the end of stable customer profiles.

Then we took a supply perspective, i.e. we analyzed the current state of the industry and looked at the future directions its main actors – brokers, tour operators, accommodation providers and destination managers – can take. We looked at the measures they are taking to cope with today's challenges (i.e. the impact of the economic crisis) and to prepare for tomorrow's opportunities (i.e. travelers' evolving preferences). We found that they are taking a variety of short-term operational measures (e.g. abolishing booking fees) and making mid-term strategic moves (e.g. opening new marketing channels). However, we have seen very few attempts at business model change so far.

The reason for the absence of business model change is twofold. First, the tourism industry has been very successful for decades. One does not discard a winning formula lightly. Second, potential new entrants, which are more likely to induce a business model change than incumbents, are probably suffering just as badly from the economic crisis.

Nevertheless, once the dust of the current crisis has settled, new rules of the game will appear. The changes in travelers' preferences are so profound that there will be fundamental changes on the supply side. Integrated service providers, i.e. tour operators, will be challenged in particular. Today, they control many parts of the value chain. They sell packaged products and allow for a one-stop client contact. They cope with the volatility of travelers' needs through a broad product portfolio. But owning assets is expensive and risky, and travelers' needs are ever more fragmented. Accordingly, integrated service providers will have to reinvent themselves. Flexibility will be the key success factor.

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