Strategic Marketing Group
Solutions for Your Competitive World.

2012 Tourism Outlook

Volume V

Dear Travel Industry Partner,

On behalf of the Strategic Marketing Group, I would like to take this opportunity to provide you with a complimentary copy of the **SMG 2012 Tourism Outlook**. This is our annual review of what has happened in the industry, with some of our thoughts on how your organization might take best advantage of a very changing marketplace. We hope you enjoy.

What's Inside This Issue

Overview

As the tourism industry looks forward to 2012, the question on everyone's mind is how much longer can these economic times last? The 10 previous postwar recessions ranged in length from 6 months to 16 months, averaging about 10 1/2 months. The 2007-09 recession was the longest in the postwar period, at 18 months[1].

Despite this, some destinations are seeing business levels pick up, however since the hangover from the recession is still being felt, one can only wonder if the economy will improve this year, and travel and spending in his or her individual destination will see an increase.

It has been a very interesting year to say the least. While data is telling analysts that the recession is and has been over, Main Street is clearly saying that it's not quite over yet. What everyone is saying however, is that the economy has still not picked up to pre-recession levels. Everyone also believes Washington has not helped the situation, given the ongoing bickering.

*This is the **longest recession in the postwar period** at 18 months.*

The impact for the tourism industry is significant, particularly in California, 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 Organizations (DMOs), both inside and outside of California, have sought additional funding from Tourism Business Improvement Districts (TBIDs) or some similar assessment mechanism. Currently there are now over 55 Tourism Business Improvement Districts in California alone.

[1] Minneapolis Federal Reserve Bank, http://www.minneapolisfed.org/news_events/rel/news_display.cfm?id=4690

The National and State Economies Are Still Weak

Make no mistake, the national economy, while slowly improving, is still struggling and has failed to send a clear directional message of sustainable improvement. As one might expect, the economic outlook is mixed. The table below outlines some specific indicators for comparison.

Table 1
Key California Economic Indicators 2009-2012

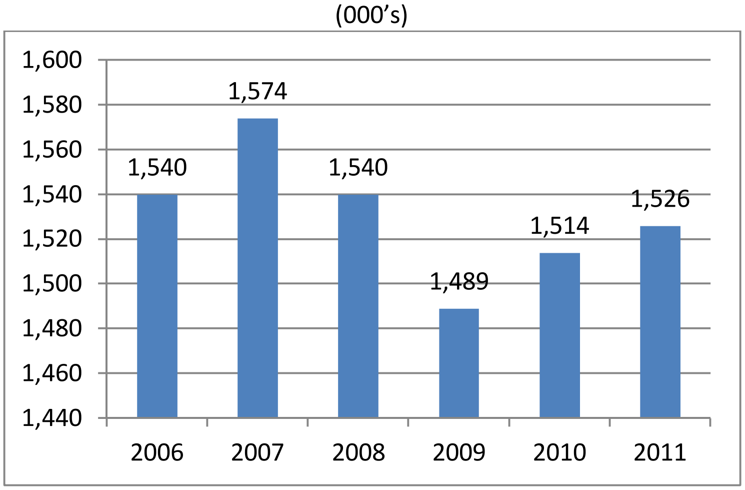
	2009	2010	2011	2012 F
California				
CPI	-0.3	2.4	2.7	1.9
Unemployment Rate	11.4	12.9	12.5	12.1
Income Growth % Chg.	-2.8	3.2	4.5	4.4
United States				
CPI	-0.4	2.2	2.4	1.9
Unemployment Rate	9.3	9.6	9	8.6
Income Growth % Chg.	-1.7	3.3	4.9	3
U.S. GDP	-2.4	3	3	2.5

Source: State of California

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

As you can see, the unemployment rate remains high, creating what many are calling a "jobless recovery". This is specifically the case in California, which has a persistently high unemployment rate. Much has been discussed in the press about there being a structural unemployment, in which many who lost their jobs will remain unemployed because their skills are no longer relevant, due to technology improvements or their jobs can be done more cheaply by others. Within the California hospitality and lodging industry, the employment picture is improving but still remains off the pace from its previous high point in 2007.

Figure 1
California Hospitality and Lodging Industry Employment
(000's)



Source: State of California

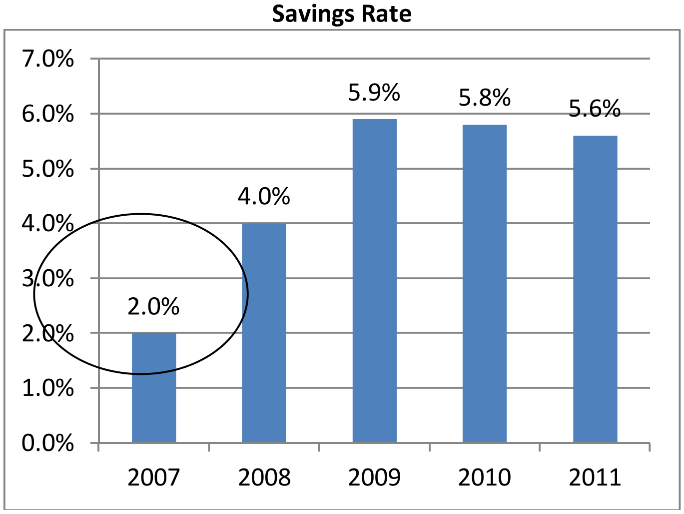
Also note the personal income growth rate, which influences consumer spending, while experiencing a slow improvement in the past two years, is projected to be flat in California for 2012, and actually recede in the nation as a whole. This fact creates challenges for the tourism industry.

Consumer Spending

Consumer spending is approximately 70% of the U.S.'s Gross National Product (GNP), with government spending accounting for 30%. As such the consumer has been the key to the national economy; up until the recession consumers were fueling spending, for the most part they were using debt to finance their spending. Since the recession, the savings rate has increased as consumers have cut back spending and in many cases have looked to reduce their debt levels. Figure 2 below shows the personal savings rate of Americans.

*Consumer spending **represents 70% of GNP** but consumers are saving more and looking to reduce their debt levels.*

Figure 2
Savings Rate



See over time how the savings rate has risen since 2007. The above chart tells that up until the recession, consumer spending occurred because consumers saved less, spent more and went into further debt to maintain their spending and lifestyle levels. Technically what happened is that consumers spent above their economic levels because many aspire to a lifestyle above their means. Such spending is used for home purchases, auto purchases and yes, vacations. For many years the local shopping center has fueled the economy. Now consumers have become much more judicious in their spending and have really focused on getting increased value for their dollar.

Consumer Confidence

The Consumer Confidence Index[2], a measure of current and future prospects, has seen year over year increases and is currently at 56 for the month of October, which is above last year's 40.9. Despite the increase, these levels are well below historical averages. Consumer confidence has a long way to go for it to get to pre-recession levels. According to Lynn Franco, Director of the Conference Board "Confidence has bounced back to levels last seen during the summer (July 2011, 59.2). Consumers' assessment of current conditions finally improved, after six months of steady declines. Consumers' apprehension regarding the short-term outlook for business conditions, jobs and income prospects eased considerably. Consumers appear to be entering the holiday season in better spirits, though overall readings remain historically weak."[3]

Another Indicator to keep your eye on is the **Leading Economic Index (LEI)**, also issued by the Conference Board. This index for the U.S. increased 0.9 percent in October to 117.4 (2004 = 100), following a 0.1 percent increase in September, and a 0.3 percent increase in August.[4] In that same report Ken Goldstein, economist at The Conference Board laid it out pretty well: "The LEI is pointing to continued growth this winter, possibly even gaining a little momentum by spring. The lack of confidence has been the biggest obstacle in generating forward momentum, domestically or globally. As long as it lasts, there is a glimmer of hope."

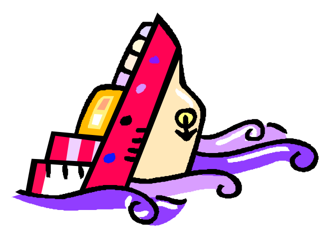
The lack of confidence has been the **biggest obstacle** in generating forward momentum, domestically or globally. As long as it lasts, there is a glimmer of hope.

Ken Goldstein,
The Conference Board

Overview Summary

- The national economy is still struggling with high unemployment and low growth.
- The marketplace continues to evolve as consumers have sharpened their focus on wanting real value for their dollar. This continued focus is forcing smart destination players to continually rethink what they offer in terms of what consumers needs are.

The State of California - The Ship is Still Sinking ☹



Without a doubt, the state of California continues to be in big trouble and everyone knows it. A state with more natural assets and one of the highest tax rates is simply unable to function. One

[2] The Conference Board http://www.conference-board.org/data/consumerconfidence.cfm
[3] Ibid
[4] Ibid

thing for sure, they won't be able to solve anything anymore with smoke and mirrors, yet they keep trying.

Here are the big issues.

1. State Budget Deficit ☹

*Legislative analyst Mac Taylor said he expects California to face annual budget problems of about **$13 billion** next fiscal year.*

Despite all the efforts of new Governor Brown, the California budget deficit is still a really major problem. Mac Taylor, a non-partisan legislative analyst for the state, projects the budget deficit will be $13 billion next year. I suppose one could say this is a much improved picture from last year's budget deficit of $25 billion last year, but now the governor has proposed trying to close that gap with targeted tax increases, which he is prepared to take to the voters in November 2012. It will be interesting to see if California voters are willing to put any additional funds into a governing system that many see as broken. Without wholesale reform of California's many problems, tax increases are problematic.

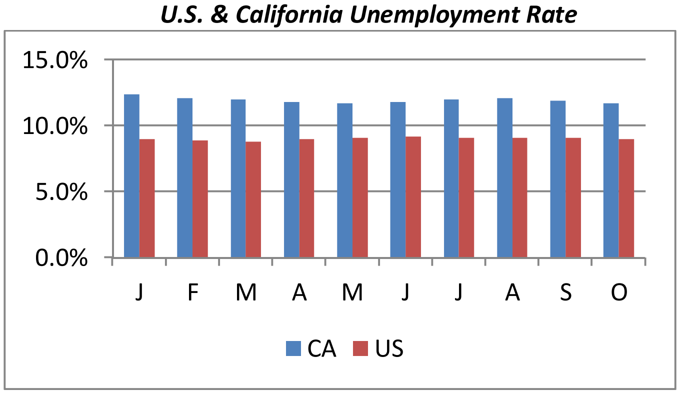
Added to this issue is a legislature that is polar opposite with the Democrats on one side and the Republicans on the other, each generally opposing anything the other side is for. Mind you, neither side has put forward any kind of future vision for the state.

Unfortunately, what was once a vanguard state has become a basket case with budget shortfalls and furloughs 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 continues to place a damper on overall consumer confidence.

2. Unemployment ☹

Put simply, overall unemployment is killing us. Currently the unemployment rate for the state of California is above 11.5%, which is 2 full percentage points above the national average.

Figure 3
U.S. & California Unemployment Rate

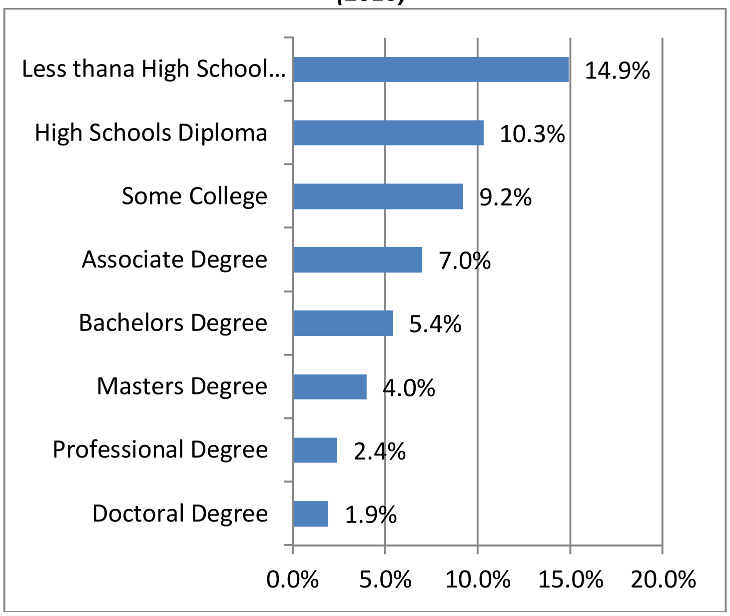


Source: State of California

Despite this overall unemployment rate, there are some interesting things occurring. Clearly those people with more education are experiencing less negative impact than those with less education.

Figure 4 below illustrates the unemployment rate by level of education. Given there is a likely a higher propensity to travel among those with higher education levels, it is clear that destinations that attract visitors with a higher level of education may not be as impacted by recessionary forces as other destinations.

Figure 4
Unemployment Rate by Education
(2010)



Source: Bureau of Labor Statistics

*It is clear that destinations that attract visitors with a **higher level of education** may not be as impacted by recessionary forces as other destinations.*

3. Subprime Mortgage Collapse Hangover ☹

As 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.

*The **subprime debacle** has had major ramifications in everything from losses in homes, equity to the Occupy Wall Street protests. Its impact will be felt for long while.*

First, the loss of homes for many residents is in itself personally and financially devastating. Second is the loss of equity for many more homeowners. Reports indicate that some 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.

The overall foreclosure rate in the United States is one house in 563. As can be seen in Figure 5 on the following page, Nevada and

California have the worst foreclosure rate in the Western United States.

Table 2
Western States Foreclosure Rates

State	Foreclosure Rate
Nevada	1 in 180
California	1 in 243
Arizona	1 in 259
Idaho	1 in 432
Oregon	1 in 455
Utah	1 in 506
US Average	**1 in 563**
Washington	1 in 1,049

Source: Realtytrac

*To the dismay of many, **California and Nevada lead the west** in home foreclosure rates.*

Despite these challenges, there have been a few bright spots. Brightest is the fact that mortgage rates continue to decrease. According to Freddie Mac, the rate on the 30-year home loan ticked down to 3.99 percent from 4 percent.

Bright Spots ☺

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

2011 has seen gas prices decrease and have remained fairly constant, though gas prices in California continue to be well above national levels.

*Fuel prices not only impact automobile travel but airline travel as well, a **double impact for many destinations** when prices rise.*

Figure 5
Average Gas Prices

Source: California Gas Prices.com

2. People <u>are</u> shopping ☺

Thanksgiving weekend purchases saw the average shopper spend $398 up from $365 last year, according to the National Retail

Federation[5]. This number is supported by the fact that more people, 226 million, are shopping this year, vs 212 million last year. So consumers are starting to spend a bit more, but are still looking for value.

3. Stock Market Continues to Rise ☺ But Europe is looming ☹

The stock market overall has had a good year, picking up 6% in gains, from approximately 11,410 back December 11, 2010 to 12,150 on December 13,2011.

DJIA	
December 11, 2010	11,410
December 13, 2011	12,059
Change +6%	⇡

Despite this optimism, the European economic crisis looms large. It will be critical for European leaders to solve this crisis as it has a ripple effect that will spread to the United States.

The California Summary

- The California economy is still struggling with high unemployment and low growth, with no political solutions for needed reforms in sight.
- Gas prices have fallen slightly and the Dow Jones has increased, but overall positive growth in California is still not here.
- Despite these challenges California still matters. Eighty-four percent 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 very important to both state and national tourism destinations. The economic health and ability for California consumers to travel is important to many communities.

[5] National Retail Federation

What's the national travel industry saying?

Domestic Travel

The U.S. Travel Association is projecting that domestic leisure travel is expected to increase 1.5 percent in 2012, with a corresponding increase in leisure travel spending of 3.2 percent.

The outlook for business travel is also improved, with domestic business travel volume projected to grow 1.7 percent next year.

Companies are making travel plans based on the current environment and business travel is no exception. [6]

Domestic leisure and business travel and projected to increase by 1.5% and 1.7% while international arrivals ***are projected to increase by 4.7%.***

International Travel

On the international front, inbound travel is projected to increase nearly 3.4 percent in 2012 and travel spending among international visitors is projected to increase by 4.7%.

Airline Outlook is Shaky

Overall passenger demand for 2011 was better despite the poor economic outlook. According to the International Air Transport Association, passenger demand grew 5.9%. The outlook for 2012 indicates profits are projected to weaken, based on the global economic situation. The industry is forecast to grow passenger travel at approximately 4.6% (down from 5.9%), with yield growth falling to 1.7%, down from 3.0%

Next year, domestic U.S. carriers will likely further cut capacity, following an estimated 2 percent year-over-year decline in the last quarter of 2011. Additionally, further consolidation of the industry may be likely as American Airlines recently filed for bankruptcy protection and may therefore be in the sights of other carriers as an acquisition.

As this reduction in capacity continues, expect consumers to be paying higher prices which will, when included with all those add-ons, create softer demand.

Increasing pricing is always driven by an increase in fuel prices, which account for approximately 30% of airline operating costs. So keep an eye on the price of oil; that should provide a sense of where airline prices are going. This could negatively impact locations that receive a larger portion of their business from destination travel.

Lodging – Picking up

The U.S. hotel industry will see less growth in 2012 than previously predicted because of the continuing economic situation and a better than expected 2011. According to Smith Travel "The industry-wide occupancy percentage is now expected to be 60 percent next year, an increase of 0.2 percent. Average room rates now are forecast to rise by 3.7 percent, to $105.29, in 2012". STR previously predicted a 4.9 percent gain. "Hotel operators are now likely to see revenue per available room rise by 3.9 percent to $63.18 next year", the firm said. It had earlier projected a 7 percent jump.

Demand for California lodging is improving as overall occupancy rates have ***increased 6.4 percentage points over 2 years.***

Overall occupancy in California is outpacing the US as a whole and increased nicely to 68%, up four points from 2010.

Table 3
Selected Occupancy Rates- October YTD

Cites	2011 Occupancy	2010 Occupancy	2009 Occupancy	2008 Occupancy
Los Angeles	73.3	69	65.6	73.8
San Diego	70.8	68	65.5	72.9
San Francisco	80.8	77	73.3	77.7
CA	68.1	64	61.7	68.5
U.S.	61.8	59	56.9	62.7

Source: Smith Travel

Average daily rate was up in 2011, $117 vs. $111 in 2010, but still well below the $124 of 2008.

Golf – Really Struggling

The golf industry continues to suffer from both overbuilding and declining participation. Overall golf rounds played through October, 2011 are down 3.8%, year to date. This has increased from the industry being down 1.8% from year prior. The industry continues to be challenged by the average length of a round, the economic environment, and rampant price cutting due to reduced demand and excessive capacity.

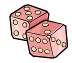
U.S Golf Rounds

Public Course	-3.6%
Private Courses	-4.3%
Overall	-3.8%

Source: Golf Datatech

Within California the picture is brighter, total rounds played are flat when compared with the prior year. However, this is still significantly off the peak years. Anyone want to buy a golf course?

Casino Gaming - Feeling optimistic



The Nevada Gaming Control Board reports that gaming revenue is up 1.4%, during the past 12 months. However, gaming is down 1.4% during the past three months but then up the most recent month, October, by 8%.

Nevada Casino Gaming Revenue	
Past 12 Months	1.4%
Past 3 Months	-1.4%
Month of October	8.0%

Source: Nevada Gaming Control Board

What consumers are saying……..

Despite all the uncertainty in the marketplace today, Trip Advisor[7] in its annual travel trends survey notes findings that include the following bright spots:

*Consumers are saying they are going to spend more on travel. The question is "**will they**"?*

Å Thirty nine percent or respondents plan to spend more on leisure travel in 2012 than this year, while 49% expect to spend the same amount.
Å Ninety percent plan to take two or more leisure trips next year---about the same as in 2010.
Å Seventy-nine percent of respondents plan to spend a minimum of $3,000 on vacations in the coming year.
Å The top three cities respondents plan to visit include Las Vegas, New York City and San Francisco, the most popular choices.
Å Vacation rentals will be a popular lodging choice in 2012, with 36% considering a stay in a vacation rental home.
Å Top eco-friendly traveler actions for 2012 include participating in a hotels linen or towel re-use program 71%, switching off air-conditioning or heat when leaving the room 51%, selecting a hotel specifically for its green credentials 12%.

Technology will also play an increasingly important part of travel planning:

Å 44% plan on using their mobile phone or smart phone more as a travel resource in 2012.
Å 47% will use their mobile devices for their travel needs at the destination.
Å 37% percent will use a mobile device for restaurants, 27% percent will use one for attractions research and 26% will use one for accommodations research.
Å 31% plan to use travel apps on their mobile phone device or smart phone

[7] Travel Trends survey http://www.multivu.com/mnr/49249-tripadvisor-announces-2012-travel-trends-forecast

The SMG Take

What a long strange trip it's been.
- *The Grateful Dead*

State of California – Maybe Getting Better? End Not in Sight

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 a new governor, I question 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 consumers discretionary spending, is still something to worry about. Even scarier is the failure of the legislature to make tough reform decisions that will improve the business climate, which would then improve the confidence people might have.

Local Governments are Really Feeling the Heat

In addition to federal and state government challenges, local governments are also seeing their financial bubbles burst. Their new reality is they too can no longer afford the cost structure they have to put in place and are making some very tough decisions, they don't have the luxury of smoke and mirror fixes.

It's going to take quite a bit of reengineering at the local level to ride through this mess. Asking basic questions like "how do you do more with less?" is something all local governments are going to have to address. Given this dynamic, we anticipate more local governments looking to divert to general fund purposes, Transient Occupancy taxes traditionally used for tourism promotions.

Despite the Challenges, There are Improvements

There is no doubt we are seeing some improvements. Improved occupancy is clear, but the market has changed for good. As I mentioned previously consumer spending accounts for 70% of the Gross National Product (GNP). Consumer spending has carried this economy for a good long while. 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 focused on value; there is no easy money to be made. As such, destinations and businesses must continue to refine the price/value proposition they offer 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.

Some may think creating value is simply cutting your price, but that alone is not the answer, after all someone can get great value if by shopping at Wal-Mart or buying a Lexus. The key is to really think through how to add value and better meet consumer needs at every opportunity.

TBIDs have changed the playing field

There is no doubt the creation of Tourism Business Improvement Districts (TBIDS) has changed the playing field. Many destinations, both in California and other states, have implemented some form of assessment designed to either maintain or in many cases increase the funding available for tourism promotion. In doing so, many destinations have significantly increased funding available for tourism promotion, which has in effect changed the competitive balance, if you do not have additional promotion dollars. It's not much different than baseball teams having new stadiums that generate significant new funding, thus enabling teams to spend more on better players. Teams that don't have a new stadium are at a competitive disadvantage. Likewise those destinations that don't have a new funding source have a built-in competitive disadvantage.

What you need to consider

The fundamental question we now face is how to provide and communicate to consumers the value of your destination, hotel, or attraction. Given that the backdrop for doing so is a slow growth, jobless recovery.

First, before you even sell an 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 for a return on investment of those vacation dollars. *Think of it as investment shopping*.

Strategy, Strategy, Strategy

Focus on strategy. In a day and age when technology has made it easier to both target and track potential customers, it's important to realize that a clear and effective strategy should drive technology marketing and execution, not the other way around. In other words Facebook itself is not a strategy but a tactic. Marketers have become ever more interested in technology marketing applications and we are a big fan, but first you must clearly define what your objectives are, what your strategy will be and how you will implement that strategy, including technology marketing efforts.

Continued Focus on the Core--Loyal Visitors are a Premium

Continue to focus on the core market that has interest in your destination. Look at the activities that your destination possesses 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 reasons to visit, either through activities or special events. Remember also, in targeting the core your efforts are reaching a smaller but more passionate segment, so if you are seeking volume, look for more niches and segments of passionate people and reach out accordingly.

More technology - with a balance

There is no question more promotional resources are being shifted 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. At the same time focusing the bulk of your efforts online makes sense, that's where consumers plan – and purchase - travel.

Get efficient

Here are a couple of recommendations to improve your efficiencies.

Look for Efficiencies - 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.

Also, look for efficiency within your website; it's not just enough to obtain customers, it's also how efficiently you get them to the point where they want to book a trip. If your destination website has a high bounce rate you may want to take a look at designs that provide more reason for your visitor to stay on your site – ultimately finding a reason to visit your destination.

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 marketing dollars and send a more impactful (and unified) message. Whether it's a new marketing co-op or simply a shared creative for a single campaign, you can adjust the level of leverage to suit you and participating partners' needs.

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 are 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 its buy-in is worthwhile.

Final thoughts

We are now entering the fourth year of a very slow economy that has presented us with many challenges, but there is an upside we are starting to see. Consumers always seem to find the money for fun. Nowadays they are assessing that fun through the prism of they value they receive. They may not vacation five times a year, but they will find a way to vacation several times this year and the competition is fierce.

Be aggressive. Stay focused on your core segments and marketing programs. Focus on clearly defining your strategy; don't be afraid to be innovative, squeeze more out of the 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.

Carl Ribaudo
President + Owner
Strategic Marketing Group
Solutions for Your Competitive World