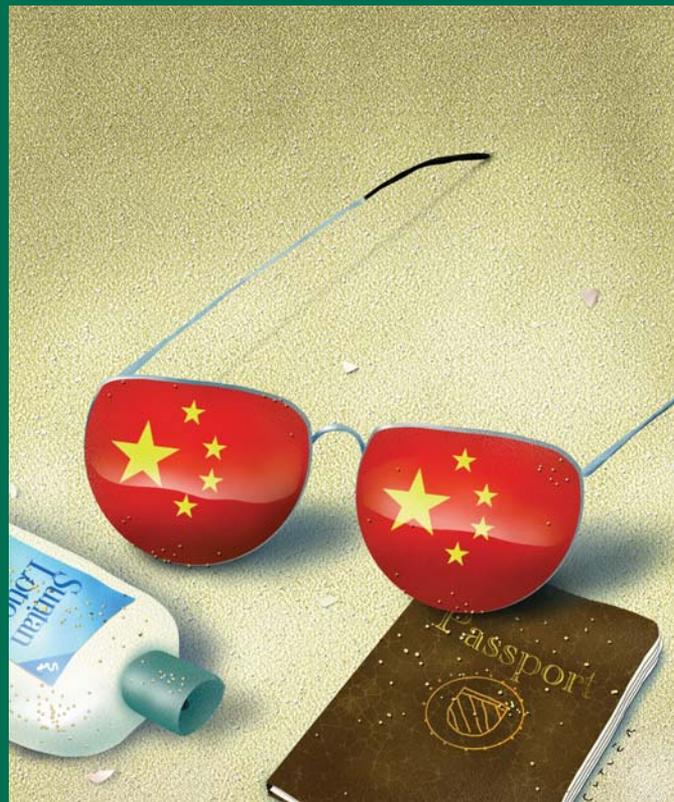


REPORT

Taking Off

Travel and Tourism in China and Beyond



THE BOSTON CONSULTING GROUP

The Boston Consulting Group (BCG) is a global management consulting firm and the world's leading advisor on business strategy. We partner with clients in all sectors and regions to identify their highest-value opportunities, address their most critical challenges, and transform their businesses. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organizations, and secure lasting results. Founded in 1963, BCG is a private company with 71 offices in 41 countries. For more information, please visit www.bcg.com.

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China's Rocketing Demand for Travel Services

Not long ago, most Asian tourists were from Japan, South Korea, or Hong Kong—the region's more affluent markets. But that is rapidly changing. By 2013, China is expected to surpass Japan as the second-largest travel and tourism market in the world. Travel within China, which currently accounts for most Chinese travel and travel spending, is projected to grow by 16 percent per year and to be worth RMB 3.9 trillion by 2020. (See Exhibit 1.) Meanwhile, the country's outbound travel market will have grown to triple the size of Japan's.

Yet China's travel industry is still in its infancy. Travel remains a highly discretionary expense, secondary to upgrading a home or owning a car. It is also a highly regulated sector and a challenging one for foreign players. Intense competition with little innovation or differentiation characterizes all areas of the industry, from travel agencies and hotels to airlines. Only a handful of companies understand the needs of Chinese travelers, 95 percent of whom claim they are poorly served on both the domestic and the international front.

This report is an “all aboard” call for growth-minded travel companies. In a survey conducted by The Boston Consulting Group in the third quarter of 2010, we found that the rapidly rising demand for travel in China, together with the lack of offerings for Chinese tourists (both within China and abroad), presents a rare opportunity to gain a first-mover advantage—which can be enormously valuable in a market where consumers are desperate for brands that meet their needs.¹ Equipped with better insight into targeted segments, travel providers could develop differentiated products for affluent travelers, as

well as for the burgeoning segment of middle-class tourists emerging in China's large and smaller cities.

While the hangover from the global recession continues to dampen spending on travel by Western consumers, Chinese consumers are eager to venture forth—and to spend. Last year, in a survey of more than 4,000 consumers in seven countries, only about one-quarter of U.S. and European respondents said that they planned to trade up on vacations, whereas more than one-third of Chinese intended to do so—a gain of 16 percentage points over the previous year. Indeed, vacations were the highest-rated category for trading up among Chinese respondents.

Travel Within China

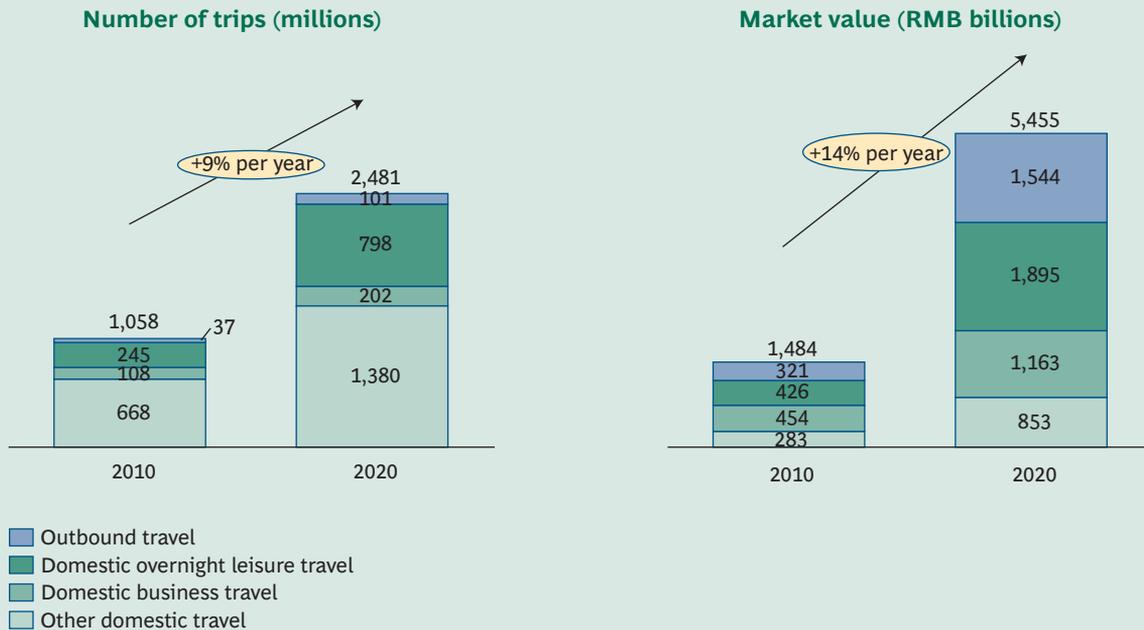
Today, the reason for most domestic travel in China is to visit friends and family. Some urban Chinese travel for leisure, yet fewer than one-third spend the night away from home. But travel companies should get ready for a big change: we expect the market value of leisure trips to more than quadruple by 2020 and the demand for domestic accommodations to double.²

What about business travel? Although it accounts for fewer trips, spending per trip is higher. (Business travelers in China spend even more per trip than affluent leisure trav-

1. We interviewed 4,250 Chinese travelers—domestic and outbound, business and leisure—in 15 cities regarding their attitudes toward travel, travel frequency and patterns, travel planning, and decision criteria, as well as their dissatisfaction with current travel-service providers.

2. Findings on Chinese domestic leisure travel assume overnight stays.

Exhibit 1. China's Travel Market Will Grow Significantly over the Next Decade



Sources: BCG Chinese Consumer Travel Survey, July 2010; National Bureau of Statistics of China; BCG analysis.

elers.) We expect growth in business travel to remain stable at about 10 percent per year over the next decade, while the overnight leisure market is likely to surpass the business segment, accounting for nearly half the market for domestic travel by 2020.

International Travel

Compared with the already significant domestic-travel market, the Chinese market for international travel is still young. But it is expected to grow by 17 percent per year over the next decade, driven by rising incomes and aspirations.

Slightly more than two-thirds of all international travel today is to Hong Kong or Macau, but Chinese tourists are increasingly venturing out to other parts of Asia and even to “long haul” destinations (defined as those that require more than six hours of flying time). As incomes grow over

the next decade, we expect that nearly 20 million trips will be made to long-haul destinations.

Chinese international travel will become a major source of growth for travel providers in destination countries. Our findings indicate that by 2020, 25 percent of international travelers arriving in Japan and South Korea will come from China, while arrivals in Europe from China will quadruple. China will become one of the largest sources of growth for Europe’s travel market, accounting for more than half the incremental arrivals from countries outside the EU. In North America, travelers from China will rank third in number after travelers from the U.K. and Japan.

Before long, overall Chinese tourism in the West will dwarf even tourism from Japan, yet few U.S. and European travel providers really understand what Chinese tourists want or how to capture a greater share of their spending.

The Profile of the Chinese Traveler

The rapid escalation in social and economic mobility in China has brought a relatively rapid increase in discretionary income available for travel. Chinese travelers (including the affluent segment) are therefore more eager than Westerners to increase their spending on travel. But Chinese travelers differ from their Western counterparts in ways that are significant for the companies that serve them. For instance, demand for travel in China comes mostly from active young adults eager to visit new places, whereas demand in the West is driven by senior citizens, who tend to have more time and money for travel.

First-Time Travelers

Today, fewer than 200 million urban Chinese consumers have taken an overnight leisure trip. With an average of 25 million people taking their first-ever such trip every year, however, that number will more than double by 2020. Middle-class and affluent consumers, most of whom have never traveled overnight, are spearheading this explosion. Over the next decade, this population will increase from 150 million to more than 400 million, and two-thirds of these people will reside in smaller cities. By 2020, there will be nearly 800 urban locations (cities and the urban portions of counties) where real disposable income per capita is greater than Shanghai's today. Middle-class and affluent travelers, especially those from smaller cities, will create a huge opportunity for the travel industry.

Group Travelers

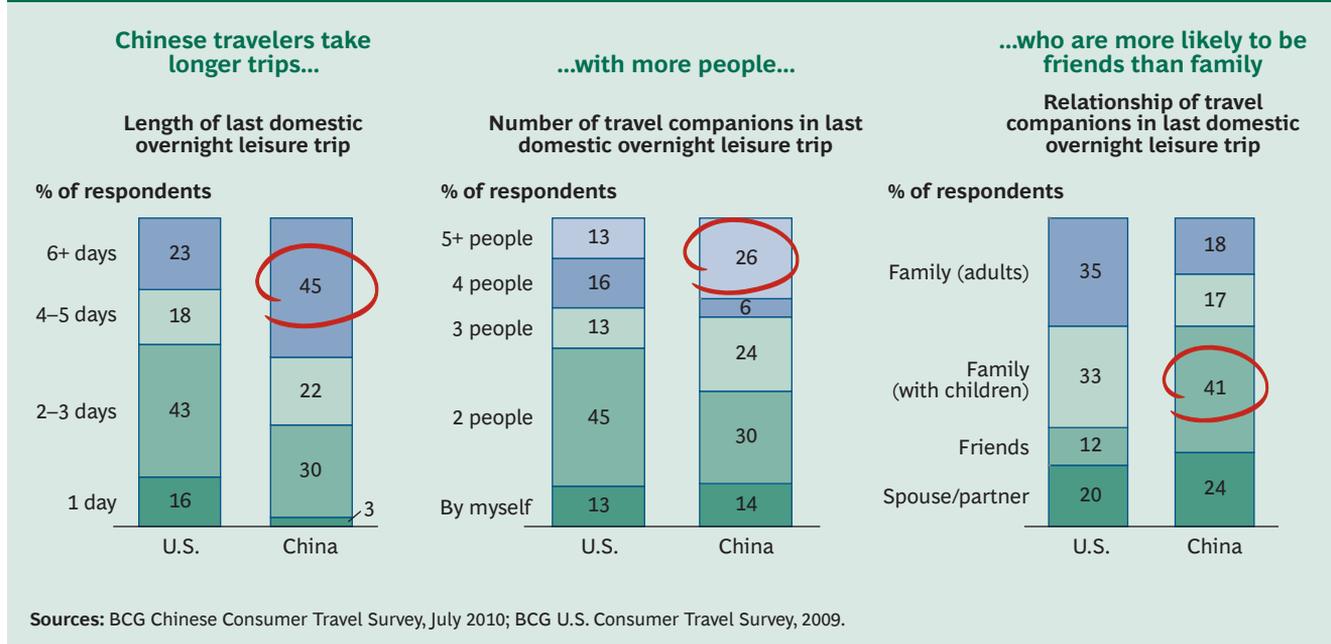
Whether traveling in China or overseas, the Chinese are likely to take longer trips than Westerners and to travel

with large groups of friends. (See Exhibit 2.) In our surveys of Chinese and U.S. travelers, about twice as many Chinese as U.S. domestic leisure travelers said that they take trips longer than six days in duration; 26 percent of Chinese travel with more than five people, whereas only 13 percent of U.S. travelers do so. Of the Chinese who travel in groups, nearly half said that they travel with friends rather than family members, whereas only 12 percent of U.S. group travelers made that claim.

The Chinese propensity for longer trips may partly be a result of holidays that occur consecutively, but that is becoming less of a factor as the government takes steps to even out the demand for travel. The preference for traveling in large groups reflects the age of the market—most Chinese travelers are under 40, whereas senior citizens represent a larger share of the travel market in other countries.

The Chinese also take less time to plan a trip. In response to the question “How much time in advance did you begin to plan your last domestic leisure trip of four days or more?” 39 percent of U.S. travelers said that they started planning more than three months ahead, whereas only 4 percent of Chinese travelers began that early. Of course, the larger the travel group, the more difficult it is to coordinate schedules months ahead of time. But the Chinese also love a bargain, and travel agents don't announce special deals until one or two months before the departure date. Yet another factor may be force of habit. In the past, travelers from China's big cities could buy train or bus tickets no more than four days in advance; in smaller cities, travelers often had to wait until the day of the trip. Finally, it's a little unusual and somewhat frowned upon in China to tell your boss six months in advance that you plan to take a vacation.

Exhibit 2. Chinese Travelers Take Longer Trips Than Western Travelers and Travel in Larger Groups



Modes of Travel

In contrast to the U.S., where most travelers either fly or drive, in China, trains and buses remain the most popular modes of transportation. The dominance of rail and bus means that being located close to train and bus terminals, city centers, and tourist attractions is an important factor for tour operators and hotels. But since China's cities are changing rapidly, companies should know the area before making a large investment.

Automobile travel is increasing in China, especially for shorter trips, but it is unlikely to become the dominant form of travel in the near future. Roadside facilities are still sparse, accident insurance protection is inadequate, and driving itself can be unpleasant because of pollution and the prevalence of hazardous driving habits.

Travel Planning

China has nearly 400 million Internet users, so it is not surprising that Chinese travelers are embracing do-it-yourself travel arrangements for domestic leisure trips. Because most Chinese have had little experience with leisure travel, they seek out online travel sites for recom-

mendations, information, and reservations. More than half of our survey participants ranked online information as their most trusted source for travel planning, while only a third favored word of mouth. This is probably because many people do not know anyone who has been to the places they want to visit. For travel outside China, people prefer to rely on travel agents, not only for the convenience (government regulations require travelers to some destinations to obtain visas, and applying can be an uncertain and tedious process) but also because agents help bridge cultural differences and language barriers.

Travel and Shopping

Although traveling is expensive for most budgets, the Chinese are willing to pay for it. They typically spend up to 8 percent of their income on a single domestic trip—more than travelers in other emerging markets spend and far more than the 2 percent that travelers in developed countries spend. But in terms of absolute spending, the Chinese spend only \$150 each per domestic trip—about one-third of the \$300 to \$500 each that Westerners spend.

On nondomestic trips, the Chinese are willing to spend much more than they do when traveling domestically,

even excluding transportation costs. And they allocate their spending differently from Westerners. Whereas U.S. travelers prefer to spend the lion's share of their travel budget on accommodations and meals, the Chinese devote nearly half to shopping. China's strong gift-buying culture stimulates some of this spending. As one consumer told us, "I travel overseas only once a year, so my family and friends all know when I go. If I don't buy gifts for everyone, I feel very embarrassed." (See the sidebar "Shao Jin Travels Often and Loves to Shop.") Moreover, Chinese travelers are asked by their friends to make purchases for them. More than half the outbound travelers in our survey said that they carried lists of products to buy for friends.

Chinese tourists purchase luxury items mainly overseas and in Hong Kong and Macau, rather than in duty-free shops in Chinese airports. Burberry claims that one-third of the sales in its London stores are made to Chinese shoppers. In Hong Kong, the Louis Vuitton and Chanel stores also have long queues of Chinese tourists.

What Constitutes Value?

Trading up beats trading down across most travel categories in China, especially for meals and entertainment and slightly less so for accommodations. However, the Chinese tend to trade down for transportation—where a larger cash outlay is required. Nevertheless, in our survey of travelers from around the world, the Chinese were more willing than Westerners to pay for better services in air travel. A significant number of Chinese respondents said that they would pay extra for 13 out of a list of 25 service items, whereas Western travelers said that they would pay more for only 3 or fewer items.

However, companies offering premium services to Chinese travelers should realize that Chinese and Western views on value can differ. For example, baggage delivery from the airport to the hotel ranks second among desired premium services for Chinese travelers, while it is not even among the top ten for U.S. travelers. This is probably because automobile travel, which essentially elimi-

Shao Jin Travels Often and Loves to Shop



- ◇ 28 years old, married without children
- ◇ Lives in Shanghai
- ◇ Annual income: ~RMB 150,000
- ◇ Extensive experience with overseas travel—as many as two trips per year. Recently visited South Korea, the Philippines, and Indonesia

Her recent trip to South Korea



Shopping list
"I always bring one on a trip. My Korea list included cosmetics and gifts."

Trip planning
"I visited Korean websites to get more information about what to buy and where to shop."

Why she likes to shop on trips

- ◇ "Prices in Korea are more competitive than in other Asian countries. Sometimes even a Louis Vuitton wallet can be cheaper than it is in Hong Kong."
- ◇ "Family and friends often ask me to shop for them when they find out that I'm going on a trip."
- ◇ "I was able to purchase birthday presents for all my best friends during my Korea trip."
- ◇ "If it's my first time visiting a country, I love to bring home some souvenirs."

Source: BCG consumer interviews and analysis.

¹Includes meals, local transportation, and other entertainment activities.

²Includes meals, local transportation, sightseeing, and other entertainment activities.

nates baggage as a factor, is much less common in China than in the U.S. Furthermore, since the Chinese often travel in groups with a full schedule of activities, they appreciate not having to deal with their baggage. The Chinese are also more likely than Westerners to prefer special treatment at airports, and they enjoy the sense of

exclusivity conferred by access to lounges and priority security lines. (See Exhibit 3.) Rather than try to nudge Chinese travelers in the direction of Western preferences, companies should consider whether the services that the Chinese prefer might offer the potential of larger profit margins.

Exhibit 3. Chinese and Western Travelers Rank Value-Added Services Differently

Chinese will pay more for some air-travel services



Ranking by country

	China	U.S.	U.K.
Option to change flight times	1	2	6
Baggage delivery to the hotel	2	13	9
Higher weight allowance for checked baggage	4	10	7
Lounge access	7	16	11
Priority security/passport control	10	17	18

Source: BCG survey of 4,300 travelers in seven countries.



Traveler Segments

The characteristics of Chinese travelers connected to infrastructure, regional, and cultural factors are unlikely to change in the near future. But other aspects of China's travel market are beginning to evolve as the Chinese become more seasoned travelers. As a result, a dynamic process of market segmentation is occurring, with significant differences between inexperienced and experienced travelers.³ (See Exhibit 4.)

Inexperienced Travelers

Chinese consumers who have had little opportunity for leisure travel beyond annual family visits are beginning to venture out. They tend to start with trips to nearby regions and then to extend their travel to more distant parts of the country. Next comes a vacation to Hong Kong, Macau, or another Asian country and eventually a long trip to a Western destination.

Our survey indicates that many Chinese consumers are still in the very early stages of this evolution. We found, for example, that approximately two-thirds of domestic travelers from Nanjing and Chengdu travel to nearby regions, while the remaining third still limit their travel to within their home province.

The inexperienced segment of China's travel market is enormous. It constitutes 70 percent of all domestic overnight travelers and 77 percent of outbound travelers. Seeking good value for the price, inexperienced travelers generally prefer packaged tours that offer a full schedule of sightseeing activities. They want to visit all the must-see sites, including the historically significant, the culturally important, and the scenically beautiful. In particular,

Chinese tourists are attracted to places that reflect their heritage—for example, the willow tree at King's College, in Cambridge, England, made famous by a twentieth-century Chinese poem taught to schoolchildren in China.

Experienced Travelers

As Chinese travelers become more experienced, they are likely to arrange their own transportation and accommodations through online search and booking sites rather than rely on a travel agency, especially for domestic leisure travel. And whereas inexperienced travelers tend to pack their schedules with sightseeing activities in order to get the most value (as they perceive it) for their money, experienced travelers are more willing to spend time and money on activities such as entertainment and shopping—an inclination that also influences their choice of destinations. Indeed, we've found that the more experience a Chinese traveler has, the less organized activities matter. For all market segments today, sightseeing wins out over relaxation for domestic travelers, but by 2020, we expect relaxation to become the dominant travel goal. (See Exhibit 5.)

Travel businesses should give particular attention to the special needs of the affluent subset within the experienced segment. Our survey found a strong correlation between leisure travel and income level; not surprisingly, as income grows, so does the incidence of leisure trips. Experienced travelers with higher incomes are much more

3. We define inexperienced travelers as those with fewer than three years of travel experience who have taken fewer than three trips in the past 12 months. Experienced mass-market and affluent travelers have made more than three trips in the past 12 months.

Exhibit 4. As Market Segments Continue to Evolve, Affluent Travelers Are Becoming Increasingly Important

	Inexperienced travelers	Experienced mass-market travelers	Experienced affluent travelers
Attitudes and aspirations	<ul style="list-style-type: none"> Travel is for sightseeing—the more the better Traveling around the world is a lifetime dream 	<ul style="list-style-type: none"> Travel is to explore cities outside nearby regions Outbound travel is an indication of status and special occasions 	<ul style="list-style-type: none"> Travel is good for relaxation and stress relief Prefer to return to places that offer relaxing activities and a slower pace of life
Trip activities	<ul style="list-style-type: none"> Packed schedules of must-see sites Historical sites and museums 	<ul style="list-style-type: none"> Sightseeing and relaxing entertainment 	<ul style="list-style-type: none"> Entertainment, shopping, and luxury accommodations rather than overscheduled sightseeing
Trip planning	<ul style="list-style-type: none"> Travel agencies for packaged tours and booking assistance Word of mouth, TV, and websites 	<ul style="list-style-type: none"> Fewer packaged tours and more independently planned trips Online search and booking 	<ul style="list-style-type: none"> Websites are the main channel for travel planning Premium theme-based tour packages for outbound trips
Share of total travel spending¹			
2010	◇ 56%	◇ 23%	◇ 21%
2020	◇ 33%	◇ 26%	◇ 41%

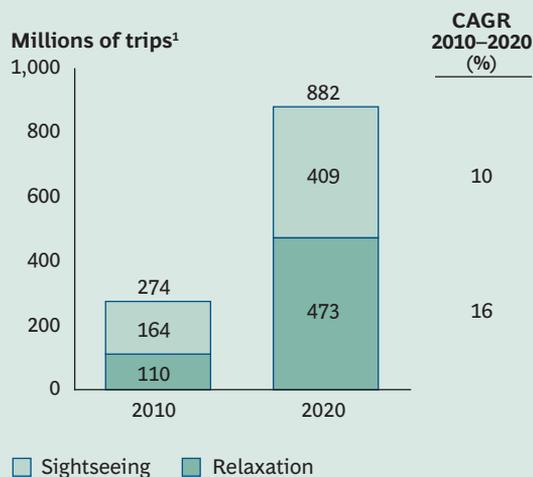
Sources: BCG Chinese Consumer Travel Survey, July 2010; BCG consumer interviews.

Note: We define inexperienced travelers as those with fewer than three years of travel experience who have taken fewer than three trips in the past 12 months. Experienced mass-market and affluent travelers have made more than three trips in the past 12 months.

¹Share of the total value of the domestic and outbound overnight leisure markets.

Exhibit 5. By 2020, Travel for Relaxation Will Become More Popular Than Sightseeing

Primary reason for leisure travel



Sources: BCG Chinese Consumer Travel Survey, July 2010; National Bureau of Statistics of China; BCG analysis.

¹Includes domestic and outbound overnight leisure trips.

willing to trade up for better meals and entertainment. Furthermore, rather than visit popular sites that are overrun with tourists, affluent travelers seek out memorable experiences, such as a week in a quaint farmhouse in rural Heilongjiang province in the northeast of China. Experienced affluent travelers also look for something different when they travel, such as sports-themed trips, wildlife adventures, and cruises.

By 2020, we estimate that there will be nearly 100 million travelers in the experienced affluent segment in China. These people will account for approximately one-third of all trips and more than 40 percent of the total value of the domestic and outbound leisure markets.

All Segments Are Underserved

As we've noted, China's travel and tourism industry is only beginning to develop. Many companies serving tourists were until recently (or still are) state owned, and they are just learning how to serve consumers in a competitive environment. Because of regulatory constraints and because most Chinese can't afford to travel, foreign companies in China have focused largely on expatriate customers or on the very affluent domestic segment. As a result, a huge portion of the market has been underserved. The first thing travel and tourism companies in China must do to capture the potential of this growing market is to understand the specific needs and preferences of the segments they want to target and develop a competitive plan and a sustainable business model. We've singled out a few (among many) examples of underserved needs that offer opportunities for all sectors of the travel industry.

Troubles on the Domestic Front

Middle-class domestic travelers in China care more about basic services, such as the price and cleanliness of their accommodations, than they do about value-added extras. This is only a little less true for the affluent segment, which ranks price below a hotel's amenities and cleanliness. Such basic requirements are taken for granted by Western travelers, but Chinese travelers in our survey said they were going unfulfilled, particularly on the domestic front. Most of the complaints about hotels in China concerned a lack of cleanliness and basic comforts.

The concept of paying for premium hotel services is relatively new to Chinese travelers. Unlike Western consumers, they think of a hotel as a place to spend the night

rather than as an experience to be enjoyed for itself. (See Exhibit 6.) Even affluent travelers in China seek out budget hotels with low prices and basic offerings, although they may enjoy premium-hotel packages when they travel abroad. Of course, as travelers gain more experience, their list of preferences will expand, but even seasoned travelers are particularly demanding about cleanliness and comfort. When we asked Chinese travelers to rate the hotel where they had stayed on their last domestic vacation, multinational-brand premium hotels scored lowest. (See Exhibit 7.) Presumably, premium hotels in China are not meeting Chinese consumers' very high expectations for value.

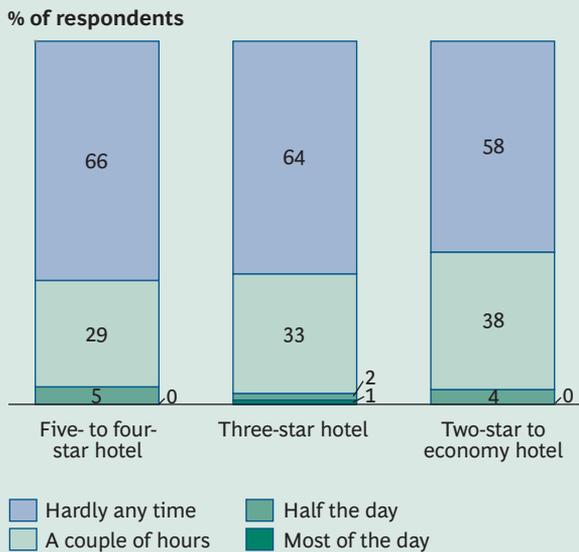
Challenges in International Travel

Chinese travelers are more willing to trade up when they travel abroad. They feel that they need a higher level of service to deal with language barriers and unfamiliar cultures, and they view international travel as a special treat—an occasion to splurge. The luxury end of the consumer retail industry has already begun to invest in serving this growing market by hiring Mandarin speakers in their stores and providing language lessons and exchange programs in China for local staff. Some retailers have VIP programs that require important customers to be greeted by their first name at all the company's locations around the world.

However, we don't see the same level of attention to the affluent segment in the travel sector, except for some casinos in Las Vegas and Macau, which have become very sophisticated in serving Chinese high rollers. Hotels at many popular destinations for Chinese tourists in the U.S. and Europe have yet to provide special services, although

Exhibit 6. For Most Chinese, a Hotel Is Just a Place to Spend the Night

“Outside of sleeping, how much time do you spend at your hotel each day?”



Source: BCG Chinese Consumer Travel Survey, July 2010.

a few are offering third-party translation services through a hotline. Most airlines lack signs in Chinese, and restaurants in hotels overseas rarely offer menus in Chinese, Chinese breakfast items, or information about Western cuisine and customs.

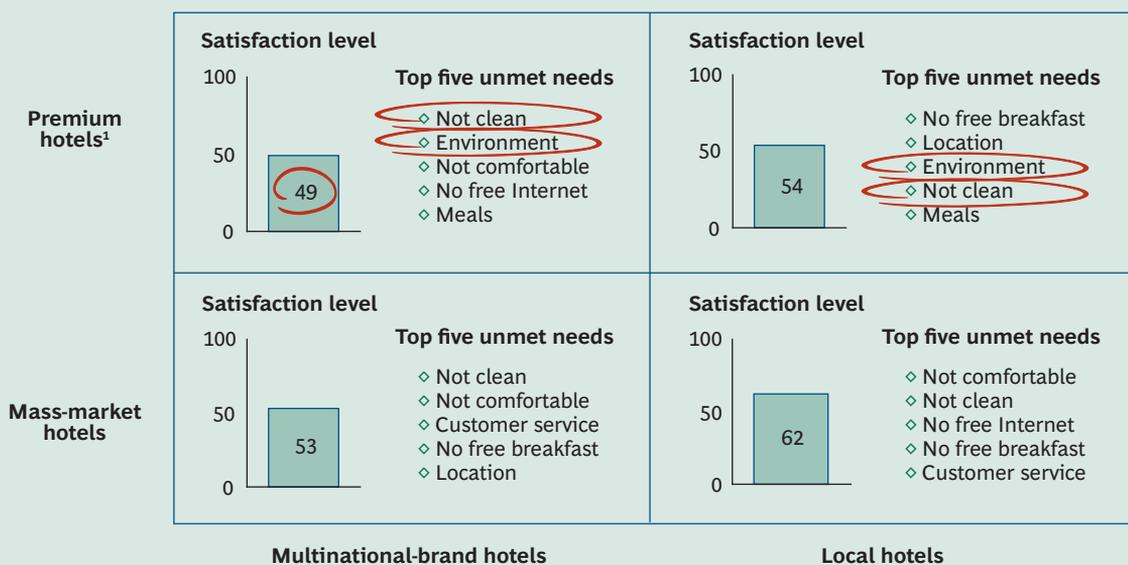
Differentiated Premium Services

In light of the increasing willingness of experienced affluent travelers to trade up and their dissatisfaction with most current offerings, the window of opportunity is wide open for travel providers that can offer unique products and services for this segment. So far, however, most offerings are either undifferentiated and targeted at the mass market or they lack sufficient quality to appeal to affluent travelers. Here are just two examples.

Travel Packages. The affluent travelers in our survey were less satisfied than those in other income segments with packaged tours offered by travel agencies. (See Exhibit 8.) Frequent complaints related to the quality of the guides and the sameness of the tours available. Our survey participants noted that they could detect little differ-

Exhibit 7. Multinational-Brand Premium Hotels Are Not Meeting Expectations

“How satisfied were you with your hotel on your last leisure trip in China?”



Sources: BCG Chinese Consumer Travel Survey, July 2010; BCG analysis.

¹Guests spend more than RMB 500 per day on accommodations and other hotel services.

ence between two European tour packages—one priced almost twice as much as the other. Aside from a slightly more relaxed schedule and somewhat better hotels in the more expensive package, the two tours comprised activities more than half of which were identical. We heard similar complaints about tour packages to South Korea. The lion’s share were undifferentiated, low-price, and targeted to the mass market. And because these packages provided insufficient details on itinerary, many consumers ended up disappointed with the choice they had made. One respondent noted, “I regretted the tour I selected. We spent too much time on activities I wasn’t interested in, and I didn’t enjoy the trip at all.”

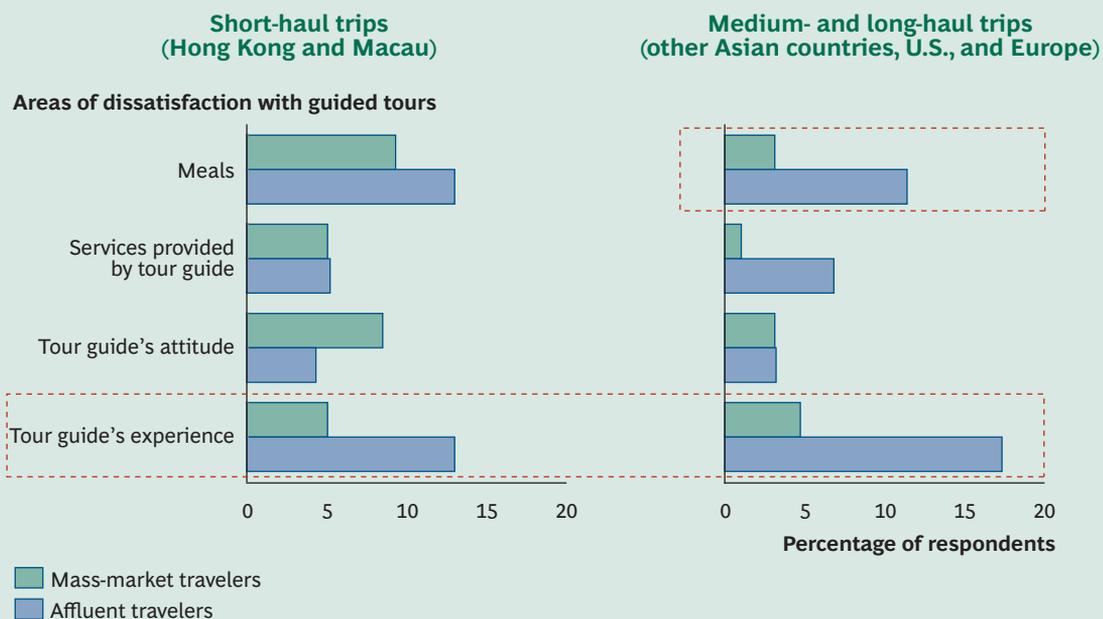
Shopping. Up-market travelers like to plan their purchases in advance, and they look for offerings that are not available at home, as well as for brands that they regularly purchase. Duty-free stores abroad, where 40 percent of the affluent travelers in our survey shop and spend more than in other channels, are particularly popular. In China, these stores lag far behind their international counterparts in luxury brands and service, and they are mostly restricted to airports (unlike duty-free stores in other countries), so consumers have only a limited win-

dow to shop in them. Therefore, most Chinese travelers wait until they are overseas to spend their money. As the Chinese government relaxes control of the duty-free market, local duty-free stores have the opportunity to improve their services and offerings and capture the affluent segment’s increased spending on travel.

Online Travel Planning

As we noted earlier, a trip represents a significant outlay for Chinese travelers, so they want to make sure that they get good value and that all their needs will be met. But the travel industry in China is fragmented and undifferentiated, and there is a general distrust of travel agencies and advertisements. Moreover, for most Chinese, a critical mass of travelers among family and friends is not available to provide recommendations. So Chinese travelers—especially experienced travelers—spend a good deal of time searching for and comparing information and prices on their own. And most of this planning—researching destinations, booking transportation, and reserving hotel rooms for domestic travel—is done online.

Exhibit 8. Affluent Travelers Are Not Satisfied with Packaged Tours



Source: BCG Chinese Consumer Travel Survey, July 2010.

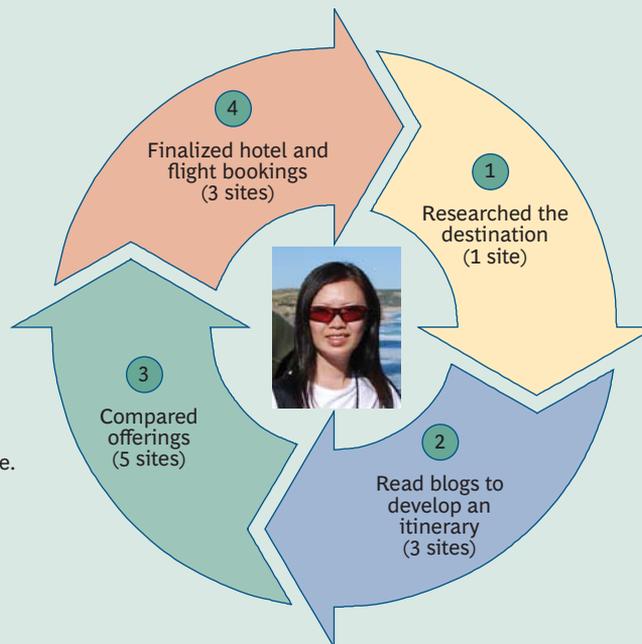
However, there is a price to pay for using this do-it-yourself channel. Downloading and interpreting the complex information that appears on the Web, comparing prices, and determining which reviewers to believe can consume hours and even days for most Chinese. Furthermore, as more sites join an already crowded field, it is becoming more difficult to find reliable brands online. The experience of a traveler we interviewed from Shanghai is typi-

cal: she visited ten travel websites when planning her most recent trip to Xiamen, a major city that's just an hour's flight away. (See the sidebar "Mrs. Tu Wants to Simplify Her Trip-Planning Process.") There's a growing market in China for one-stop, user-friendly travel sites that provide information travelers can trust and service they can rely on.

Mrs. Tu Wants to Simplify Her Trip-Planning Process

Mrs. Tu's online search process

- ◇ "I visited more than 10 travel websites to plan my last trip to Xiamen!"
- ◇ "I checked to see if the prices offered on the airline and hotel sites were cheaper and then booked the best deals."
- ◇ "I cross-checked many sites for promotions or attractive deals and studied hotel reviews and guest comments. (But you have to be careful, because some are fake!)"
- ◇ "I'd really love a one-stop website. It would make my planning process much easier."



- ◇ "So I'd know what to expect, I gathered basic information on regional history, geography, weather, and must-see attractions recommended by travel websites that weren't biased by travel agencies or hotels."
- ◇ "I visited several sites to find out where other travelers had gone in order to create my own itinerary and list of dos and don'ts."

Source: BCG consumer interview.

Big Opportunities for Early Movers

Companies that invest in understanding the special characteristics of China's travel market (such as its youth) and commit themselves to serving the needs of its different segments will find themselves with a powerful competitive advantage. Hotels, for example, might reconfigure their rooms and facilities to better serve larger groups, booking agents and promoters could offer multisuite villas to attract groups traveling at the last minute, and local transportation companies could accommodate groups traveling together. But companies seeking lasting advantage will need to do more than rearrange the furniture. Below we note just a few of the companies that have already started down this road.

Tailored Offerings for Specific Segments

The first step for companies committed to pursuing an advantaged position in China's growing travel market is to define the segment they intend to target and develop a nuanced understanding of its needs. Then they can explore ways to develop value-added services that differentiate them from the competition. Their business model should play a key role in providing and supporting this differentiation. For instance, one business model might focus on premium offerings targeted at the fast-growing segment of experienced affluent travelers. Another might develop local offerings to attract the rising numbers of less wealthy Chinese who are interested in traveling.

Caissa, a Beijing-based travel agency founded in 2000, is a good example of the first model. It launched a set of premium products, including theme-oriented overseas-travel packages, priced as high as RMB 100,000 for a ten-day VIP tour of the U.S. But just as important, it estab-

lished the necessary capabilities to support a consistent premium-brand image and service offering, such as elegant offices, professional staff, and high-quality service delivery.

A good example of the second, more affordable model is Italy's Costa Cruises. It entered the Chinese market in 2006—the first international cruise company to do so—and has rapidly won the approval of Chinese tourists and the industry. Costa offers attractive value packages with affordable prices and more appealing activities than mass-market travelers can find with airline packages. For example, it provides five-day, four-night cruises between Shanghai and Japan or South Korea for less than \$400, which is considerably less expensive than a cruise of similar length in North America or Europe. More important for Chinese travelers, these packages are cheaper than a flight to Japan or South Korea. Costa Cruise tourists are spared the hassle of air travel and are provided with ground transportation and visits to several cities, as well as international entertainment, cultural activities, and excellent Italian cuisine. As a result, Costa's Chinese cruises are always nearly totally booked.

Brand Loyalty Through Customer Relationships

Our survey participants listed brand—the promise of quality and service—as the most important factor in their choice of hotel or airline. Indeed, they said that they rarely choose brands that are entirely unknown to them. However, they are always eager to try a new brand if they have heard of it. But the fact that there are so many brands in the market with few differentiating characteristics makes it difficult for travel providers in China to

generate brand loyalty. In fact, only about 10 percent of consumers in our survey said that they would choose a travel agency because they've used it before. When they are deciding among hotels whose brands are equally familiar to them, they are likely to base their decision on price and promotions.

Therefore, establishing brand loyalty is both an imperative and a challenge in China's travel market. International players are rushing to leverage their well-known names. Club Med, perhaps the best-known brand in family-focused resorts, inaugurated its presence in China in 2010 with a ski resort in the mountains of Yabuli, next to Harbin. It held events with local celebrities to increase brand awareness and offered activities for high-end business customers, including the Yabuli China Entrepreneurs Forum, which it hosted. These efforts and others helped Club Med acquire a record number of new customers through its distribution channels, including outlets in Shanghai and Beijing, which the company opened in partnership with travel agencies.

A familiar brand name is important in acquiring new customers, but a good customer-relationship program that enhances a traveler's experience is necessary for maintaining a core customer base and creating a competitive advantage. 7 Days Inn, a low-price hotel chain in China, appeals to younger travelers with a strong online platform of services. Its website (the first to offer online booking) has the highest booking rate in the country. According to the company's annual report, nearly all bookings come from its 14 million members, of whom 82 percent are repeat customers. The chain, which has grown by an average of 140 percent every year since 2006, monitors customer satisfaction, offers a loyalty program to retain core customers, and maintains a strong member community through social-networking applications. It's not just the technology, however, that makes 7 Days Inn stand out from its competitors. It's also the comprehensive customer-relationship program. And it also gets the basics right, with clean rooms and value-for-money amenities.

Hassle-Free Travel Planning

Chinese travelers spend hours planning their trips, and they are looking for a simple, reliable way to reduce

the complexity. This has created a tremendous opportunity for travel providers with well-known brands to provide quick and easy solutions to the tedious process of making travel arrangements. Companies that fulfill this need could also be in a position to define standards, guide customer behavior, and establish barriers to entry.

Establishing brand loyalty is both an imperative and a challenge in China's travel market.

Ctrip, a leading travel site that attracts 25 to 35 percent of Internet traffic for hotel and airline bookings in China, offers value-added services beyond its core products to help customers plan their trips. The comprehensive travel-related information it provides ranges from important facts about the customer's planned destination, to recommended itineraries, to photos and accounts of the experiences of other travelers. It also provides a transparent, reliable, and convenient payment process with Internet banking, mobile, credit-card, third-party, and cash-on-delivery options, as well as hotline assistance.

Some travel providers are simplifying the planning process and strengthening their brand by extending themselves across sectors. 7 Days Inn uses its customer base and online platform to cross-sell airline tickets and car-rental services. Rather than compete on price, such companies compete on the convenience of a one-stop shopping experience that also allows customers to accumulate membership points. Airlines in other emerging-market countries are likewise giving customers the option of booking hotel rooms, rental cars, and even train reservations through their branded websites.

Serving Travelers from Smaller Cities

With most providers targeting affluent travelers in China's big cities, the needs of middle-class travelers from smaller cities have been largely ignored. These consumers have more limited access to airports and fewer flight options, necessitating troublesome commutes to big-city airports. Smaller cities have few travel agencies, and services are minimal. (See the sidebar "Sun Dan Is Looking for Better Travel Services in Her Small City.") Travelers from smaller cities also encounter a higher refusal rate when applying for visas, especially when making their own arrangements for trips overseas.

Sun Dan Is Looking for Better Travel Services in Her Small City

Complicated visa process

- ◇ “I went to Sanya because I wanted to visit a tropical country without getting a visa.”
- ◇ “I plan to travel to Hong Kong and Europe in three years. I’ll choose a packaged tour because the agency can help me get visas.”

Constraints on driving

- ◇ “My husband and I like to drive because it’s convenient. We hoped to drive to Xinjiang, but it’s difficult to get directions and find good hotels and restaurants along the route. Maybe we will have to give up this idea.”



- ◇ Married with one infant
- ◇ College teacher
- ◇ Lives in Weihai (a tier 5 city)
- ◇ Extensive domestic-travel experience, but no outbound trips

Limited help from agencies

- ◇ “I believe travel agencies can offer more attractive prices than the prices I find online, but there are none nearby.”
- ◇ “I can’t find a travel agency in Weihai that will help me book flights and hotels without joining a packaged tour.”

Willing to trade up but doesn’t know how

- ◇ “It takes a lot of time to search for promotions at four-star hotels. I ended up staying at a budget hotel even though I am willing to pay up to RMB 400 a night.”

Source: BCG consumer interview.

Our survey found that middle-class consumers in smaller cities are more likely to increase their spending on travel and to trade up than their counterparts in top-tier cities. This neglected segment of travelers offers a clear opportunity for companies looking for growth beyond China’s largest cities.

Shanghai Spring Tour, which started out as a low-cost airline and then expanded into the tour operator business, is one company that has recognized the potential of the smaller cities. On new routes, 80 percent of the seats on Spring Airlines are reserved for Spring Tour customers. Thanks to this vertical integration and the company’s low operating costs, Shanghai Spring Tour is able to offer budget travel in China’s western regions, along with tailored services such as free transportation to airports in Shanghai for some customers. The move into smaller cities (including the lowest-tier cities) has brought a considerable number of first-time travelers to the company, thereby introducing a new growth segment. One satisfied customer reported, “I chose Spring Tour for my first leisure trip. The package was much cheaper than other agencies—even cheaper than train tickets.” Companies seeking to duplicate Shanghai Spring Tour’s success

should note, however, that it takes more than discount prices to attract this market. Spring Tour provides direct flights from lower-tier cities and improved access to airports, thus meeting a significant need of people living outside China’s major cities.

Because the travel and tourism sector in China is still relatively undeveloped, it offers some of the best opportunities in the consumer industry. Companies entering now will be able to set standards and guide consumers in their shopping behavior. So far, there are no clear winners among the companies that have already entered the market—but that window won’t remain open forever. Therefore, it is important for players to act now. If you believe your company can benefit from this opportunity, we recommend the following actions:

- ◇ Invest in consumer insight to develop differentiated products and services for mass-market and affluent consumers, as well as for consumers with different levels of travel experience.

- ◇ Identify opportunities to develop a trusted umbrella brand that will attract the loyalty of consumers new to the travel market.
- ◇ Consider opportunities for acquisitions in new, fragmented sectors where you may not have an established operation.
- ◇ Design a well-timed, cost-effective, and innovative expansion into low-tier cities to capture this rapidly growing and underserved market.

China's speedy ascent in the world's travel and tourism sector—from sixth place in 2008 to a projected second place in 2020—presents an unprecedented opportunity for growth at a time when most mature markets remain sluggish. Considering the colossal advantage to be gained by innovative first movers in a market desperately seeking trusted brands, companies in China and abroad can't afford to ignore the challenge of meeting the needs of Chinese travelers.



For Further Reading

The Boston Consulting Group publishes many reports and articles on China that may be of interest to senior executives. Recent examples include:

Big Prizes in Small Places: China's Rapidly Multiplying Pockets of Growth

A report by The Boston Consulting Group, November 2010

The Internet's New Billion: Digital Consumers in Brazil, Russia, India, China, and Indonesia

A report by The Boston Consulting Group, September 2010

Winning in Emerging-Market Cities: A Guide to the World's Largest Growth Opportunity

A report by The Boston Consulting Group, September 2010

2010 BCG Global Report on Consumer Sentiment: A New World Order of Consumption; Consumers in a Turbulent Recovery

A report by The Boston Consulting Group, June 2010

China's Digital Generations 2.0: Digital Media and Commerce Go Mainstream

A report by The Boston Consulting Group, May 2010

The Keys to the Kingdom: Unlocking China's Consumer Power

A report by The Boston Consulting Group, March 2010

China's Luxury Market in a Post-Land-Rush Era

A White Paper by The Boston Consulting Group, September 2009

Lucky 8: Understanding and Capturing China's New Growth

A White Paper by The Boston Consulting Group, July 2009

Sourcing Consumer Products in Asia: Managing Risk—and Turning Crisis to Advantage

A Focus by The Boston Consulting Group, March 2009

The Next Billions: Unleashing Business Potential in Untapped Markets

A report by the World Economic Forum in collaboration with The Boston Consulting Group, January 2009

China's Digital Generations: The 570-Million-Hour Opportunity

A report by The Boston Consulting Group, July 2008

Foreign or Local Brands in China? Rationalism Trumps Nationalism

A Focus by The Boston Consulting Group, June 2008

The Quest for Defendable Scale in China

A Focus by The Boston Consulting Group, December 2007

Winning the Hearts and Minds of China's Consumers

A Focus by The Boston Consulting Group, September 2007



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