



## Overview

As destination marketing executives look to 2010, they can only wonder whether it will get better or stay the same for their destination and destinations across California.

What a year! Wall Street melt down, subprime mortgage collapse and an economic slowdown all converged to present one of the most challenging years for the economy in general and the tourism industry specifically. Looking ahead the challenges are not over yet as there are significant issues facing the tourism industry that could continue to change consumer behavior and spending for a foreseeable future. Here's an overview of the issues and their potential impact in 2010.

### The National and state economies are still weak

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

**Table 1**  
**Key California Economic Indicators 2008-2010**

	2008	2009	2010F
<b>California</b>			
CPI	4.1	-0.3	2.1
Unemployment Rate	7.2	11.6	12
Income Growth % Chg.	2.0	-1	1.4
<b>United States</b>			
CPI	3.7	-0.2	2.4
Unemployment Rate	5.8	9.2	10.2
Income Growth % Chg.	2.9	0.1	1.8
U.S. GDP	1.1	-3.5	1.4

Source: State of California

As you can see the unemployment rate has risen, creating what many are calling a "jobless recovery". Also note the personal income growth rate which influences consumer spending has decreased, which creates challenges for the tourism industry.

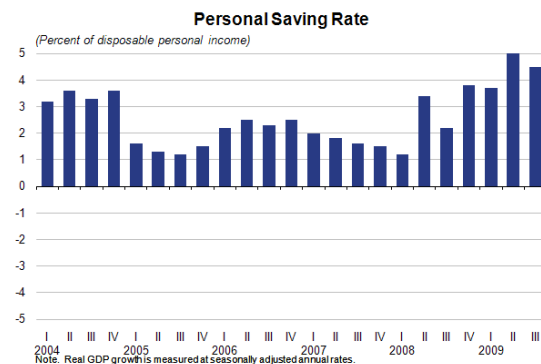
Overall growth is projected to be slow as the economy transitions from being an import oriented one with low consumer savings rates to a more export oriented one with higher savings rates.



## Consumer spending

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

**Figure 1**  
**U.S. Personal Savings Rate**



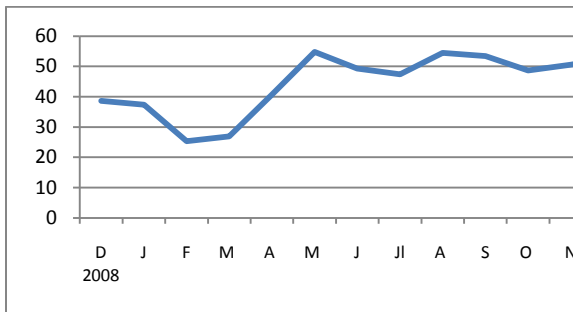
Look at how over time the savings rate has risen since the second quarter of 2008. What the above chart tells us is that up until the recession consumer spending happened because consumers saved less, spent more and went into debt more to maintain their spending and lifestyle levels. Technically what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

## Consumer confidence

Consumer confidence, which is a measure of current and future prospects, has seen slight increases since its lowest point last fall. Consumer confidence has a long way to go for it to get to prerecession levels,

though it does seem as if it may have bottomed out. It is critical for consumers to have a more optimistic outlook before they consider spending.

**Figure 2**  
**Consumer Confidence**



Source: Conference Board

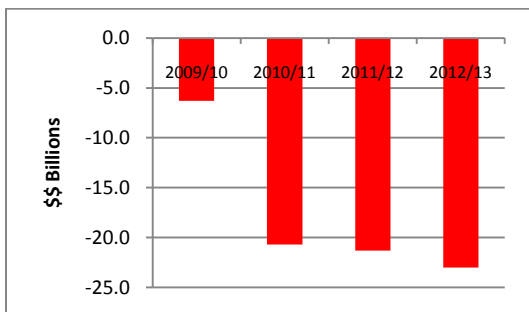
**The state of California - the mess continues ☹**

Without a doubt, the state of California is in big trouble, and the legislature and the Governor have not been able to fix the problem. A state with more natural assets and one of the highest tax rates is simply unable to function. One thing is for sure they won't be able to solve anything anymore with smoke and mirrors. Here are the big issues.

**1. State budget deficit ☹**

This is getting really bad. Governor Schwarzenegger has projected another budget shortfall of between \$18B and \$21B for FY 2010/11. This is on top of the current budget which needed to be cut \$21B. Unless the Governor and the legislature do something drastic the budget situation continues.

**Figure 3**  
**Projected California Budget Deficits**



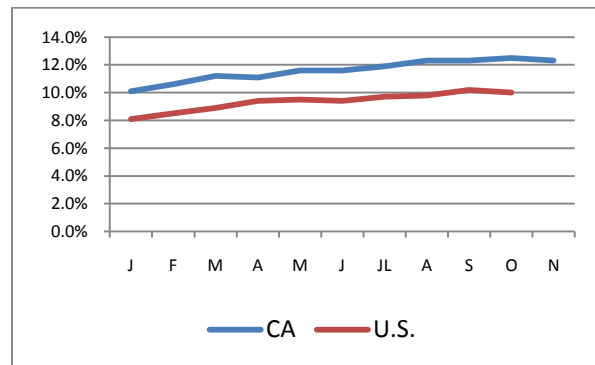
Source: Legislative Analyst

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

**2. Unemployment ☹**

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

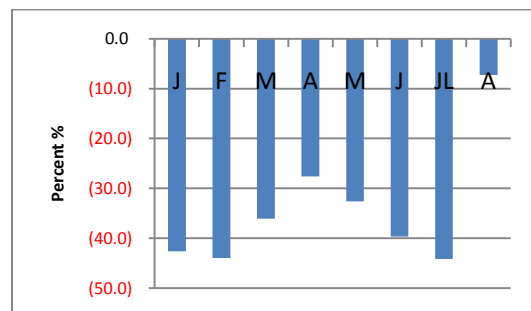
**Figure 4**  
**U.S. & California Unemployment Rate**



Source: State of California

Unemployment has a key psychological impact on consumer spending decisions. When consumers feel their employment is in jeopardy they cut back on their spending, this is clearly seen in consumer spending on automobile purchases. Figure 5 below illustrates the decrease in new car registrations within the state of California for 2009 when compared with 2008.

**Figure 5**  
**CA Auto Registration**  
**% Change 2009. vs. 2008**



### 3. Subprime mortgage collapse hangover ☹️

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

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

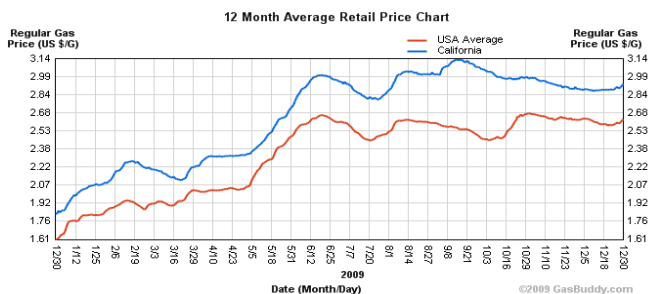
Despite these challenges there have been a few bright spots; mortgage rates continue to decrease averaging 5% for a fixed 30 years loan, and home sales increased 10% in October.

### Bright Spots ☺️

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

2009 has seen gas prices stay below the \$3/gallon level and have remained fairly constant, though gas prices in California continue to be well above national levels.

**Figure 6**  
**Average Gas Prices**



Source: California Gas Prices.com

### 2. People are shopping ☺️

Black Friday Sales (the day after Thanksgiving) saw sales rise by .5%. This number is tempered with the realization that more people are shopping this year, 195 million vs. 172 million last year. So consumers are still spending less – just more of them are doing so. At least they are looking.

### 3. Stock market continues to rise ☺️

The stock market has had an incredible year going from approximately the 6,500 level back in February to 10,500 at the end of the year.

**Figure 7**  
**Down Jones Industrial Average 2009**



Source: Wall Street Journal

### Why does California matter?

Very simply 84% of California's domestic leisure visitors are residents of California. Given that direct travel spending in California was \$97.6 billion in 2008 the California market is one that is very important to both state and nation tourism destinations. The economic health and the ability for California consumers to travel is important to many communities.

### What's the national travel industry saying?

The Travel Industry Association (TIA) is projecting that domestic leisure travel is expected to increase 2 percent in 2010, with a corresponding increase in leisure travel spending of nearly 5 percent.

The outlook for business travel is improved with domestic business travel volume projected to grow 2.5 percent next year and business travel spending to increase 4 percent.

Companies are making travel based on the current environment and business travel is no exception. <sup>1</sup>

On the international front inbound travel is projected to increase nearly 3.0 percent in 2010. Growth in overseas travel (excluding Canada and Mexico) is projected to remain stable at about 1 percent. Overseas travel visitation in 2010 will remain below pre 9-11 levels (23.5 million versus 26.0 million).

<sup>1</sup> Travel Industry Association



## Airline outlook is improving (maybe..)

Commercial airlines' prospects are hoping to improve. The outlook for 2010 is projected to be only slightly better than 2009 and 2010, might only be slightly better.

Some domestic carriers like Delta Air Lines and Fort Worth-based American Airlines see demand for business and premium travel starting to rebound.

But one thing is certain for the airline industry next year: there will be fewer flights. Capacity cuts will continue in 2010 as airlines try to figure out which flights are the most lucrative and eliminate those that are not. This could continue to impact destinations whose flight segments are not as profitable as others.

## Lodging - still rough waters ahead

Lodging demand in 2009 was down from year prior. According to Smith Travel occupancy through October was 56.8% down from 62.7% year prior and down from 65% in 2007<sup>2</sup>.

Selected Occupancy Rates  
October YTD

Cities	2009 Occupancy*	2008 Occupancy	2007 Occupancy
Los Angeles	65.6	73.8	76.8
San Diego	65.5	72.9	75.0
San Francisco	73.3	77.7	76.5
CA	61.7	68.5	71.0
U.S.	56.9	62.7	65.0

Source: Smith Travel

This reduction in demand has also resulted in a decrease in Average Daily Rate (ADR) of 9% in 2009 vs. 2008.

## Looking ahead

Looking ahead to 2010 overall demand is still projected to be soft. According to Price Waterhouse occupancy is projected to be up just slightly by 1.1%<sup>3</sup>.

## What consumers are saying

As one might expect consumers have not only cut back spending, but are actually wary of spending. There are a couple of bright spots. According to Trip Advisor in a recently released survey U.S. residents

are expected to travel more in 2010<sup>4</sup>. Survey findings included the following bright spots:

- 41% of U.S. survey respondents indicated they plan to **spend more on leisure travel in 2010 than they did in 2009**
- 92% of travelers are **planning two or more leisure trips in 2010 up from 89% in 2009.**
- 66% said the economy **will not affect their travel plans for the New Year.**

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## The SMG Take

*"Go out yonder, peace in the valley  
Come downtown, have to rumble in the alley  
Oh, you don't know the shape I'm in"*

*The Band*

## State of California- It's still broken

Last year in this space I wrote 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. No question about it, we are living in interesting times. The ongoing fallout from the economic recession, the state budget and the impact it will have on the state of California and its impact on consume discretionary spending is still disconcerting.

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

## The New Normal – now a reality

The second thing that is really worrying is the changing consumer buying behavior. Consumer spending accounts for 70% of the Gross National Product (GNP). Consumer spending has carried this economy for a good long while and given that personal income growth rates are declining and as we have shown people's personal level of debt has increased, one has to ask where does the spending

<sup>2</sup> Smith Travel

<sup>3</sup> E Hospitality.com



<sup>4</sup> Trip Advisor

come from? The new framework for consumers is *do I need it or do I want it?* As such, destinations are going to have to create real value to entice consumers to visit. This **new normal** is a significant shift from the pre-recession habits of wild consumption. And it's not likely to shift anytime soon.

### **Tourism funding - Is your destination's BID in place?**

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

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### **What you need to consider**

The fundamental question we now face is how do you sell a vacation with a dramatically changed environment?

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

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

### **Focus on the core**

Now is the time to focus on the core market that has an interest in your destination. Look at the activities that your destination has and reach out to those niches. Road bikes, mountain bikers, surfers, foodie

etc. Now is not the time to sell a soft vacation. You need to give people specific reason to visit, either through activities or special events.

### **More technology - with a balance**

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

### **Get efficient**

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

### **Look for efficiencies within the budget -**

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

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

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

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



## Final thoughts

On the upside, consumers are resilient and they seem to always find the money for fun. Nowadays they are assessing that fun through the prism of whether they **need** it or simply **want** it. They may not ski twenty days but they will find a way to ski ten days this year. They may not take six trips a year but they can find a way to take two or three. But it has to make sense from an ROI perspective.

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

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

Have a great new year.



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