

The Industry Responds

“Making Sense of a Turbulent World for the Travel Retail Industry”

Keynote Session Panel Discussion with Linda Hopkins, Bill Emmott, Masato Takamatsu, Victor Gubareff and John Koldowski

Hopkins: Thank you Bill, your review of the world's recovery in the last six months and your optimism for recovery in Japan has left us with a degree of comfort but certainly with a sense of cautious optimism knowing that those dogs lay restless just outside the door. Let us take this discussion forward now and try to draw out of this excellent overview of geo-politics and geo-economics, some meaning for our particular industry. I would like to invite to the stage now, two very distinguished gentlemen who are with us in Singapore. Doctor Victor Gubareff is from the United States organisation, called STRATFOR which stands for Strategic Forecasting and he is going to be joining us on stage. He is the Director of Intelligence from STRATFOR. Also, I would like to invite to the stage, Mr. John Koldowski who is the Managing Director for the Pacific Asia Travel Association's Strategic Information Centre. Please welcome them. While they are sitting down, I would like to invite back to the stage, Mr Masato Takamatsu from Japan Tourism Marketing Co.

Bill, this question, I hope, does not come out of left field for you, but I remember in your March 23rd issue, you dealt quite a bit with the luxury goods sector--and for all of you who have not read that, please get down to the

Economist's website and have a look at that. You dealt with the luxury goods sector but in today's discussion, you did not mention too much about long-term versus short-term growth of this particular sector. You talked about democratization of luxury which is an interesting trend to see the broadening market for luxury goods, but can you put a spin on that a little bit for our industry so we can understand; is this a long term trend in luxury goods? Is it just short term growth we are seeing right now? Do you have a sense or is there any way we can look at tracking this trend? Are there indicators we can look at?

Emmott: It is always very intimidating to talk about a specialist subject in front of hundreds of experts. I think this audience is really the expert on that issue. All I can say is I think the general forces behind this luxury goods industry are strong. As I said in my presentation, I do see a continued spread of affluence. But I do see a continued problem of information overload; and brands are extremely important to help you to distinguish between different bits of information, different forces upon you. I do see the spread for desire for using luxury goods to differentiate yourself from others to a wider group of people, that democratisation of luxury that you mentioned. I think this is going to mean for the luxury goods companies increased pressure to keep up the flow of new products to feed this growing market. In particular, to keep discipline over the costs and execution, as we said in the article, of how luxury brands are sold through specialists and general retail outlets. And the division between the successes and the failures would probably lie in that ability to have a sort of pipeline of new products and the ability to execute very well to

have the right items on sale at the right times in the right stores; as we saw from the Japanese bar.

Hopkins: As you rightly pointed out in that particular article, it is very labour, it is very capital intensive to develop new products for the luxury goods sector. You made a particular point about the consolidation of the luxury goods sector. That would be one of the things that would probably drive consolidation: an intense need for capital to produce new products all the time and that is where I am driving at. Will this be a long term growth for the luxury goods sector or short term growth? Because it is capital intensive to continue to build new brands and market new brands at that level.

Emmott: I think it will be long term growth. Think of the rewards from this market: it is so promising that you are going to continue to have companies trying to capture these rewards. I think it is a long term trend.

Emmott: Excellent, that's good news for us. I am going to ask a general question to our three other panelists here. Maybe you can provide an insight into this. You heard Bill's excellent overview of the geo-political, geo-economic scene. You each come from different disciplines, from slightly different industries. From where you sit, what do you see as the biggest challenges that our industry will face in the next two years? Maybe, Victor, we can start with you.

Gubareff: Thank you, Linda. I think first the biggest challenge is really to learn from our industry. How to do business and be successful in these two years to come when international global environment will continue to be volatile, very turbulent and very uncertain. Risks are still high and to know how to do successful business is a biggest challenge.

Hopkins: That is one of the reasons why we made “traveling through change” our theme this year. We recognized we are experiencing such a rapid change of pace and adapting to that on a continuing basis is a challenge. Thank you. Takamatsu-san?

Takamatsu: Looking at your customers and the traveler, your challenges come from other retail channels. As I discussed this morning, customers and travelers have so many different retail channels to choose from, not only duty-free shops. They can even research their favourite product over the internet. I heard this story in one of the Japanese-based duty-free shops in Narita: they have their own website where the customers/travelers can make a pre-order before they travel and pick up the product they have purchased over the internet at the airport before departure. This trend will go on, I mean, this will be bigger in the future. Also, there are many other retailers who have not yet come into this industry, maybe seeking their way into it. We do not know yet who they are but it can be Microsoft or some other electronics giant. As long as they have some contact relationship with the customers, they do. The customers are interested in new products and that is what we are dealing with.

Hopkins: An important trend to spot. I take up your first point. I think you reiterated what Bill said a few minutes ago about information overload. The customer is out there, receiving a lot of messages and he is out there trying to sieve through all the messages to find what is of value to him, to her. John?

Koldowski: Thanks Linda. The way we see it is that we have market forces pushing forward on one hand but we have regulatory pressures on the other trying to cap some of those areas. We have, for example, the general agreement on try-and-services and what that might do to try to open up competition, affect your yields but we have these other regulatory pressures. We heard about one on tobacco, I believe which will severely dictate, if you will, the direction we can go to actually capitalize on these market demands. I still think the regulatory area is a big one.

Hopkins: Ok, I know during the China workshop a little bit later on, you will touch on some of the regulations that are affecting the travel industry which will be interesting. Ladies and Gentlemen, we would like to have you involved in our discussions and our hostesses have mics. If they could, please, take these throughout the aisles here. Raise your hands if you would like to ask a question. Or you can write a question down on a piece of paper if you are shy to stand up with a microphone. Let us move on. Victor, you talked about adapting to change and certainly the last few years have shown us just how flexible companies need to be and the importance of learning to adapt quickly. The global economic downturn really began in earnest in 2000 and

since that time, companies have really struggled to different degrees. But what would you note as a real success story? I mean your clients are Fortune 500 companies as well as governments. You deal with companies on a daily basis who want to understand risks, who want to understand all of these factors that are affecting their operations. So tell us a success story, a company that maybe did not have a silver bullet but really helped the company turn the corner in a negative climate.

Gubareff: All right, I think I would like first of all to complement local regional companies. I am talking about tour operators and travel agents from Malaysia and South Korea. I believe just nearly after the events of 11 September in the United States, happened, the world was waiting to see what would happen next. South Korean and Malaysian companies immediately assessed the situation and realized that they should really not expect a big flow of western tourists in the region. So what we did we increased marketing to Chinese outbound tourist markets and we deployed our little secrets for South Korean companies which was successful and really great use of the internet. We created special websites in Chinese, mostly Mandarin but we use all these local specifics to target a Chinese tourist specifically and we do these successfully. We can see an increase in Chinese tourist in Korea where the same goes for Malaysian companies. We realize for Chinese tourists to come to another country and see only Chinatown or places which were seen in China are probably not enough. We decided to categorise the diversities that Malaysia has. At tourist hotel booths, we started to promote Malaysia as

a country which has very diversified range of places to go, goods to buy and we did enjoy success.

Hopkins: Excellent, you were talking about the tourism bodies in those particular countries, and concentrated efforts to offset the loss in Western tourism by focusing on the Chinese outbound.

Gubareff: I would have the local tour operators join international tourism boards as well and local travel retailers also benefited from it.

Hopkins: Bill, do you have any specific success stories? You deal with companies on a day-to-day basis, you know what their struggles are...

Emmott: You know, the thing with journalists is that we always get more interested in failures, not success. It is a terrible fact. It is hard to single them out. I will mention only two companies that maybe I think are noteworthy. One is outside this particular industry but pretty much goes to what I was saying about the internet. I think Amazon.com actually is a pretty impressive success story. It ruled the whole boom-and-bust period. In having stuck to what it is good at in continuing to focus on the customer and investing in the quality of the customer experience, and then sharing how through the internet through a rivaled distribution out there, you could produce, I think in the end, what would be a profitable business delivering quality goods and services over the internet. I think it is sobering for any of us in the non-virtual world (which *The Economist* is one). To see the internet boom-and-bust does not mean the

internet is over. I think Amazon is well worth looking at. The second one I will just briefly mentioned was mentioned in the article in *The Economist*--which you kindly published a moment ago--on luxury brands, which was Gucci. We particularly focused on Gucci in the article because of the ability of Gucci to really bring about a great big flow of brands and products coming through its development process and organizing to keep them coming rather as a big pharmaceutical company has to keep investing in new product development. We try to watch Gucci for the future because of how promising that approach looks like it could be like in that sector.

Hopkins: Excellent, thank you. John, do you have a success story that you like to share?

Koldowski: Yes. We obviously do not deal with company to company, however, there have been two remarkable success stories I believe in the region. Bear in mind that the troubles here started well before 2000. I think 1997 was the start of things for destinations within Asia and to look at how the Republic of Korea positioned itself, began to understand how the whole travel and tourism sector was an essential element in keeping people employed, in keeping money moving. How the private sector joined hands with the public sector and did a whole load of things which in the middle of crisis time saw a record number of not only arrivals to South Korea but also a record in the amount of revenues that was actually generated from tourism. The second one is that, I believe, of Malaysia. This is where it becomes a little bit innovative because at that time, Malaysia was moving to almost a closed

economy and everybody was saying, “Do not do that, it will not work; you are doomed”. Well, they were not doomed. It did in fact work. So, keep that mind open to try different things. We have seen two classic examples I believe at the country level.

Takamatsu: I am not an expert in the travel retail industry so I will talk about the travel industry. Most of the travel companies in Japan are trading with the low prices of tour operators. There are some companies that are doing very well in the very difficult situation after September 11th. They are the ones who are after the senior market. I think of a couple of companies. They have built very good customer relationships with their senior customers. Amazingly, they are so close to their customers that they do not miss a word of the customers from their surveys or comments. As soon as they get the report or comments from the customers, they reflect them on a travel plan and after a month or two, they are now selling the new tour based on their comments. The customers really like the way they do it and when they offer such tours based on the customers’ needs, then the customers will not question the prices. They enjoy very high profitability compared to the other travel companies in Japan. The key word is customer relation.

Hopkins: Absolutely. With the growth of the internet, we tend to want to look at the younger generations of consumers today and get our messages out to them. It is easy to dismiss the Japanese seniors but they are so key right now to the survival of our industry. Is there a question, we will get the microphone to you and I am going to ask one more question to our panel. I have asked

about success stories but what about some of the biggest mistakes you have seen companies make in the current climate? Bill? You do not have to say the company's name but specifically if you can talk about a mistake that was made.

Emmott: Well, I guess I think the key mistake companies typically make in recessions is to steal from the product in the way they cut cost. The thing we are all pressured to do is to cut our costs right down and to control investments and I think that is clearly the right response to recessions but if you do that by degrading the product, basically you are stealing from the future. And I think that is the thing that is going to distinguish, in the difficult period, which companies prosper in the future and which do not. Have they degraded the product or have they maintained the quality of the product and service to the customer and just tried to keep on delivering it at a lower cost. That I think is the differentiating factor.

Gubareff: Speaking about biggest mistakes, from our point of view as strategists, I would say the first mistake is that companies nowadays continue ignoring their world and what is going outside their industry. What is the biggest lesson from September 11th? I would say the biggest lesson is to learn in advance how such crises and economic recession will influence your business. I still see where too many companies in the industry still ignore it. Beyond the forecast for recovery there are no guarantees at all that new attacks won't occur. Therefore, if you do not learn from it, you will suffer from it. The second mistake is when some companies go to emerging markets to

start a new business. They try to build a hotel in China, for example, or they try to open travel retail operations in S.E. Asia. We usually grossly underestimate the importance of getting to know and learning the local negotiations culture, how local businesses operate and how the companies should adjust themselves to a business climate, national culture and government. So, they go there and they start negotiating with foreign officials and then realize there is no success in negotiations. Only after using an international negotiation style and strategy do they realise what should be learnt in advance before you go and really start doing business abroad.

Hopkins: Ok, information. I have a question for Bill Emmott and it comes from the audience. Could you please comment on the positive information or hype about China and its future economy? How much of the hype we are hearing is actually reality? You touched quite a bit on China today and that is a key issue for our industry right now with a large number of outbound Chinese travelers.

Emmott: Ok, I will answer that by first of all using a rather sober analogy and then trying to be a bit more cheerful. The sober analogy is that, in 1900, if you asked a proper forecaster whether Germany is going to become a rich country, one of the great economies of the world; the answer would correctly have been yes. But quite a lot of things had happened between 1900 and when that happened; politics does not happen in a smooth way. Now, I think the same is true of China. China's national position, economically and politically, is a much richer and bigger power than it is now. The potential for

economic regeneration is huge and I am very optimistic for the longer term but clearly, political change has got to take place in China, accommodating the economic change, dealing with the shift of balances of power within the country, new winners, new power centers. This is always very difficult for domestic politics to deal with and I think it is going to be especially difficult for a dictatorship to deal with, for a communist party-run country to deal with. Well, I would say there will be bound to be political stability in China over the next ten to twenty years as the country comes to terms with the fantastic economic changes that are taking place. These changes will take place but they will not happen smoothly in political terms.

Audience: Question for Bill. You commented on the possible threat in China, you gave a rating on the stability in the world with a potential change of leadership in China. How is that going to affect us?

Emmott: First of all, I think much depends on whether it is a domestic crisis or an international crisis. In a country as large as China, admittedly, any domestic crisis is going to have a repercussion on the region. But really the question on whether the repercussions are major depends on whether Taiwan gets involved or whether there is a conflict of any sort over the future status of Taiwan. I think there is a risk, there will be because I think in a power struggle in China, the status of Taiwan is bound to be one of the cards that factions will want to play within the competition to gain power in China. But I do not think it is a certainty. I just think it is a high risk so really there are two kinds of effects on you. A domestic crisis that produces economic volatility in China just

means the market potential, that is China for the industry, is going to be bumpy and uncertain even if the long trend is up. But if it becomes an international crisis involving Taiwan, therefore involving the United States, I think that would have a big economic impact on the short to medium term in the whole Asia Pacific region. Because it would be a very unsettling factor. So it depends on whether it really becomes an international crisis or not.

Hopkins: We are not going to spend too much time on China, so if you have a question on China, let us hold that for the workshop that will be taking place a little bit later when we will be dealing with the Chinese market in specifics.

Audience: We have been hearing about the crazy pressures on prices and margins and the increasing price sensitivity of consumers. Yet we are also hearing about the long term growth of luxury goods and brands. How do you see these two trends co-existing over the medium to long term?

Emmott: I think it is going to be different in different sectors, that is the thing. I think we have moved generally out of the inflationary period and towards a period in which competition is much more intense and therefore pricing power for companies is much more limited than it used to be. That is going to be quite wide-spread. But the ability to use advertising and quality to maintain premium products will still be there and I think the heart of competition, the heart of business strategy, is going to be guided in this period in trying to maintain premium values in pricing. I am not of a kind of school of thought which thinks every market is going to move towards a commodity market with

low prices. I think that is wrong. But it is going to take a lot of effort and strategy to defend high premiums.

Koldowski: It is a very significant point and a very good question. It really comes back to something known as relative value. But to understand relative value, you have to get inside the head of an individual consumer and getting back to this one-on-one marketing; this relationship marketing. In fact over the last two days, I have been watching with fascination an advertisement where a gentleman and his lady friend are looking to buy a car. The salesman was saying, "What would you like?" The robot hand goes out and begins to spray the car red. Have you seen the ad? He is basically buying a model but having the color virtually on delivery. The point of interest is the tagline because the tagline says "one degree of separation." And to me, that says it all. When you get so close to each individual customer that there is only one degree of separation between you, your product and the needs and wants of the customer. And that is the way, I believe, it has to go, relative value.

Hopkins: Ladies and Gentlemen, I am afraid we are going to have to end our discussion here. I would like to thank Godiva who is graciously hosting our coffee break which is waiting for us outside these doors. We are running a bit late, I thank you for your patience. The workshops will begin at 12.10 if you could please be prompt by showing up at the right room. Please join me in thanking our panelists.