

The growth of tourists in Vietnam over the last five and a half years has come almost exclusively from other Asian countries and the Vietnamese themselves.

In the last year, nearly 75% of the growth in international arrivals came from China and Russia.

Our forecast for Vietnam inbound tourism is very aggressive; 33 million international arrivals by 2022. However, 80% of them will be from China. We do not see any reason to believe a significant rise in growth rates from the traditional markets is on the horizon.

Tourists from these Asian countries (and Russia) have considerably different purchase considerations than those coming from Western Europe, North America, and Australia. Investors in Vietnam's tourism industry need to be aware of this paradigm shift and position themselves accordingly.

Vietnam's Paradigm Shift in Tourism

THE VIETNAM RESORT REPORT

September, 2013

MGT Management Consulting Quantify Your Strategy

The Vietnam Resort Report is a paid monthly newsletter for stakeholders and potential investors in Vietnam's coastal tourism industry. Subscriptions are \$100 USD for a year. To subscribe, send an email to info@mgtmanagement.com

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“Think of a Paradigm Shift as a change from one way of thinking to another. It's a revolution, a transformation, a sort of metamorphosis. It just does not happen, but rather it is driven by agents of change”¹

Introduction

My wife and I were recently having dinner in Nha Trang with a friend -a European lawyer- who has been working on M&A deals in Saigon for many years. He has been hearing a lot of concern about low occupancy rates in hotels. This surprised my wife, who is Director of Sales at a large resort in Nha Trang. She complained that all the work she's put into developing promotions and value-added programs for her resort have not been approved; the reason being that there is no longer any low-season.

This strange phenomenon is also apparent when reading news compilation websites in Vietnam. On the same day, different industry employees and experts give completely different answers about the health of the industry. Some see over-supply and no growth in demand; a very pessimistic outlook. Others say that certain locations are in need of many more rooms to meet high demand. The year-over-year growth rate in 2013 is a steady but unspectacular 8%² which would seem to make both these extreme reactions to the market, curious.

When looking deeper into the numbers, it is apparent that Vietnam's tourism industry is going through a paradigm shift. Locations and businesses not positioned for the new reality are seeing decreasing demand, while those positioned correctly are doing very well and will continue to do well. Over 58% of the growth in international arrivals this year came from China. Chart #1 below shows that traditional markets such as the USA, Australia, and Western Europe (represented by France in the chart) have not grown at all in the last five and half years. In fact, in June 2009 the USA and China had the same number of arrivals to Vietnam. By June 2013, Chinese arrivals were almost four times the number from the USA.

The second largest growth market (although still just barely reaching the top ten in size) in 2013 is Russia¹. Nearly 14% of Vietnam's growth this year has been from the Russian market. With political discontent in Egypt and Turkey³ and Phuket's airport reaching maximum capacity, we expect this market segment to increase substantially during the fourth quarter and future years.

The rest of the growth comes from regional neighbors like South Korea and Japan. Both South Korea and Japan have surpassed the USA recently in the number of total visitors to Vietnam.

¹ <http://www.taketheleap.com/define.html>

² All Vietnam tourism statistics in this report are from the Vietnam National Administration of Tourism website unless noted otherwise. Their website is: <http://www.vietnamtourism.gov.vn/english/index.php?cat=012042&itemid=7114>

³ <http://vietmaz.com/2013/09/more-russian-tourists-expected-in-vietnam-in-peak-season/>

Chart #1: Visitors to Vietnam by Country for Past 68 Months

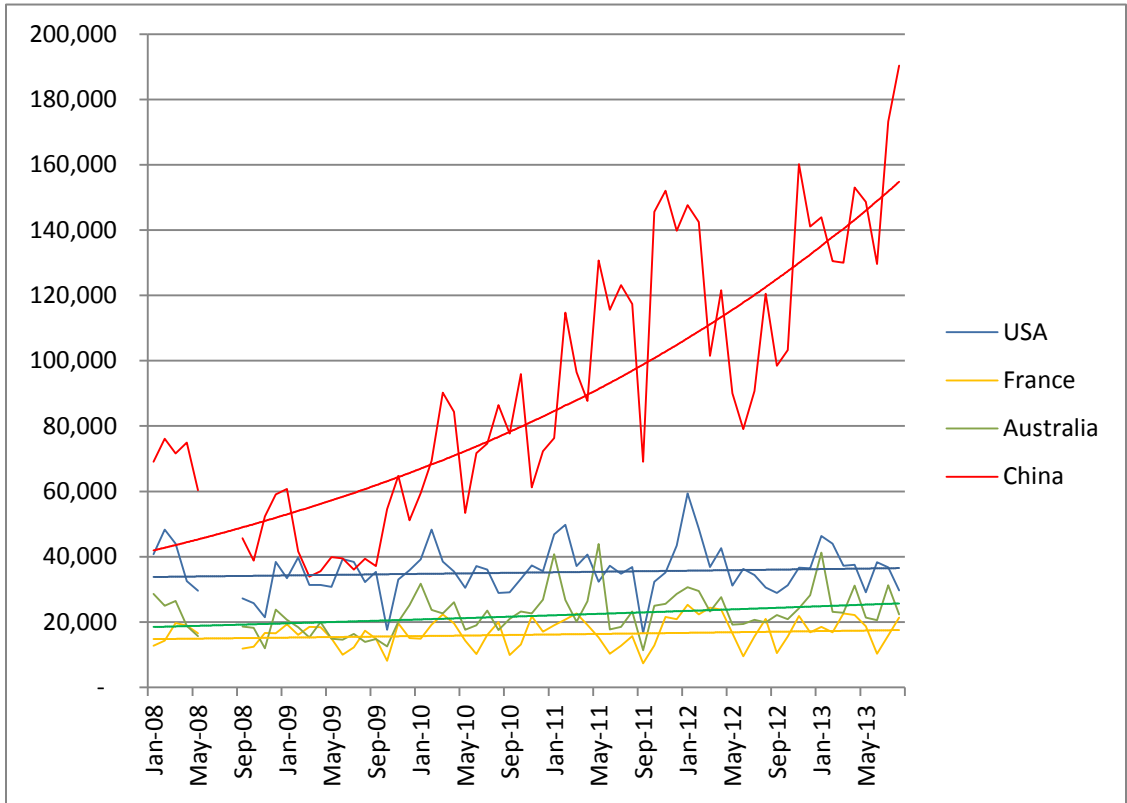
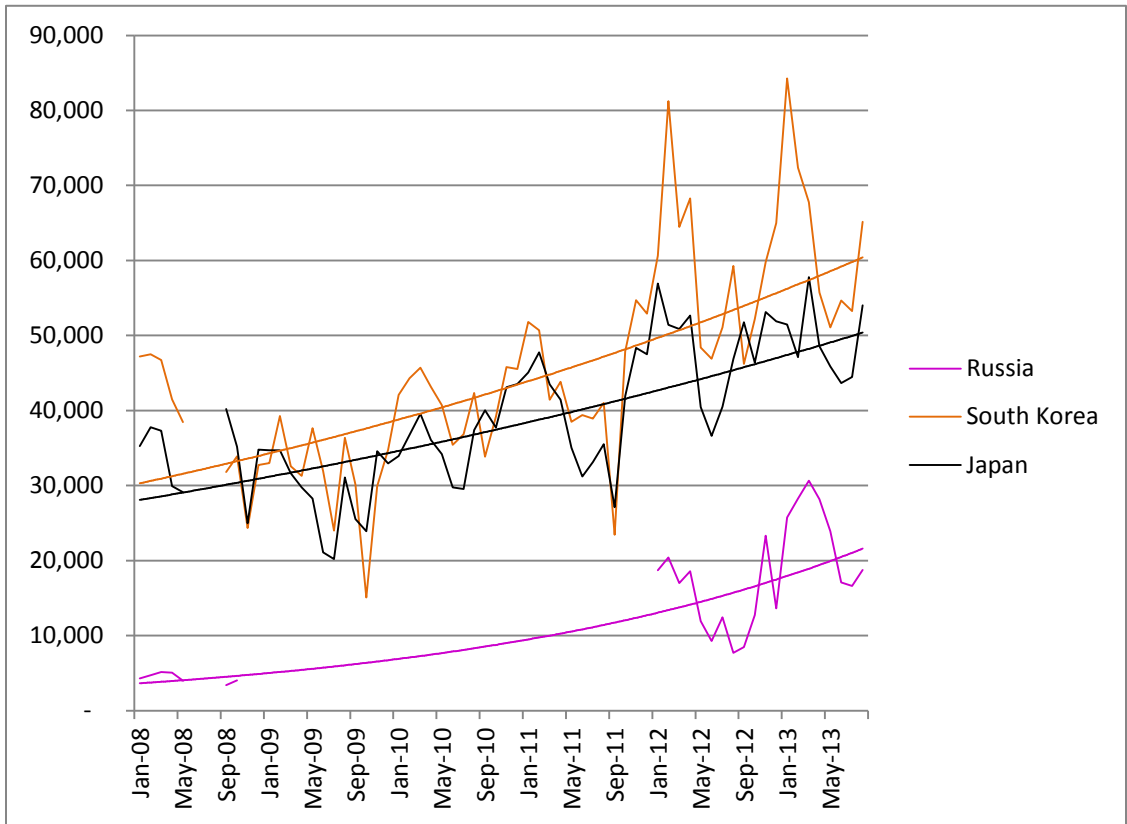


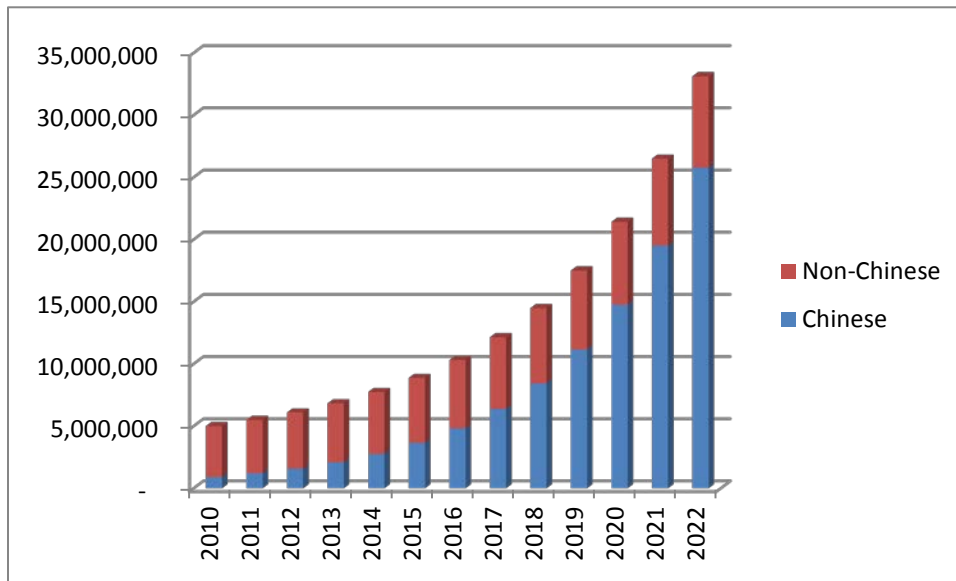
Chart #2: Visitors to Vietnam by Country for Past 68 Months



Future Growth

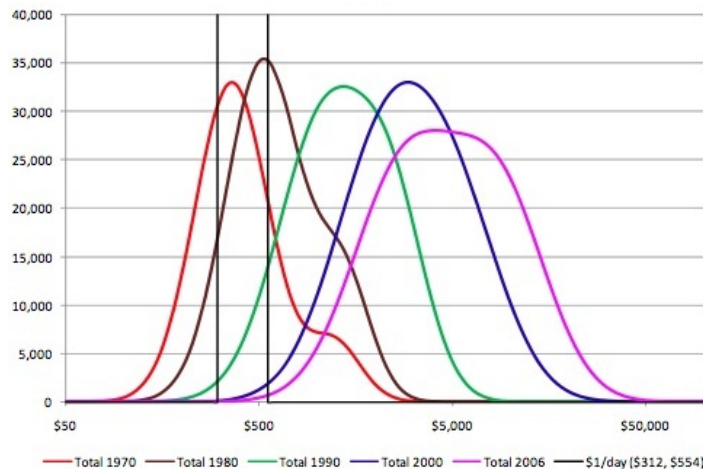
MGT Management has developed its own demand forecast model for the next ten years. We looked at Mexico’s tourism growth during the 1960’s through the early 1990’s when the United States was experiencing an unprecedented growth in the middle class due to the baby boom and increasing income. (For details, click [here](#)). Our forecast is much more aggressive than most. We see arrival numbers increasing exponentially in the next decade; to nearly 33 million. Of these, nearly 80% will be Chinese.

Chart #3: Projected International Arrivals to Vietnam



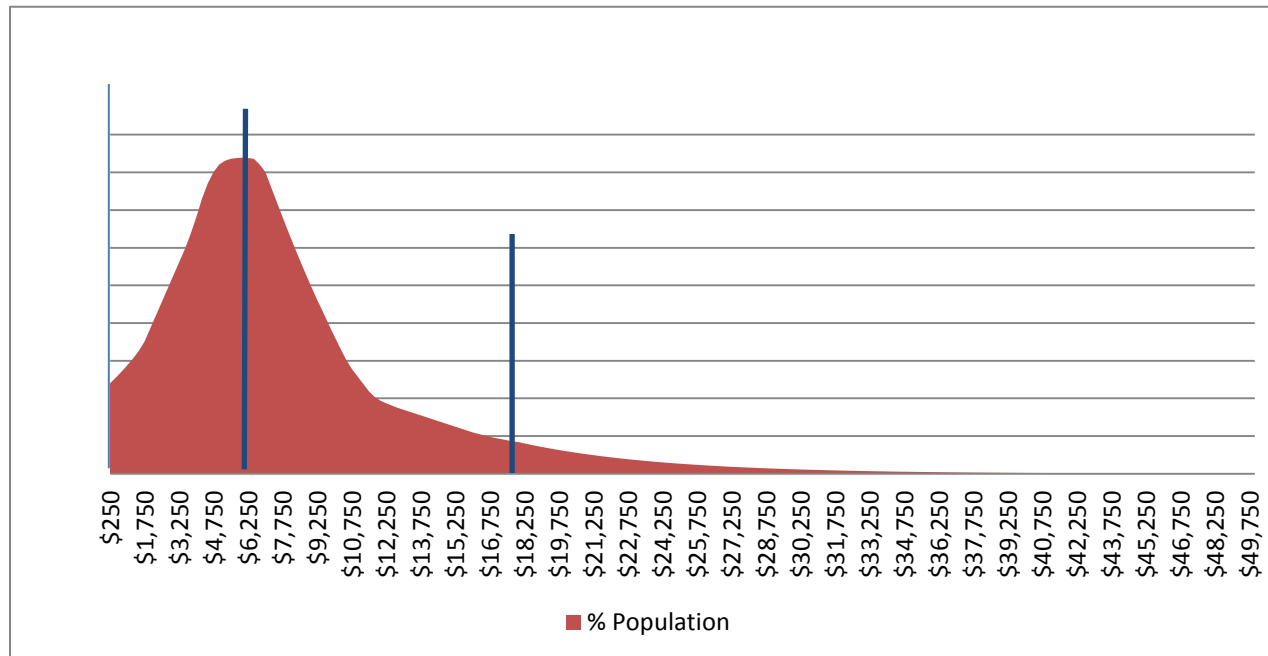
We believe Vietnam is seeing only the beginning of the growth in the Chinese market. The average income for Chinese households is still around \$5,500/year. McKinsey and Company has determined international travel expenditures begin around \$18,000. When looking at the Chinese income distribution curve (Chart #4), it is very apparent that only the far right “tail” has the financial means to travel now. That curve is moving about 8% per year to the right, and soon that large “bump” will be traveling overseas.

Chart #4: Chinese Income Distribution Curve 1970-2006 (Logarithmic Scale)



Looking at income distribution on a linear scale shows that those Chinese who are already traveling internationally have a very diverse range of incomes. We think Vietnam will attract lower income Chinese travelers because of the country's competitive advantages (for our report on Vietnam's competitive advantages, see [here](#)). If that happens, Vietnam would see an increase in market share along with the tremendous market growth.

Chart #5: China Income Distribution Curve (Estimated / Linear Scale)



Y-Axis is the percentage of the Chinese population. The X-Axis continues for a very long distance, where some very small percentage of the Chinese population earns tens of millions of dollars per year.

Local Tourism

It has been under-reported, but in the last ten years, the fastest growing tourism market segment in Vietnam is Vietnamese tourists. Since 2002, the local market has grown at an average compounded growth rate of 10%⁴. Despite the sluggish economy, that has increased to about 12% in 2013. The locals are increasingly going to the beach (Nha Trang has seen a 20% increase in locals the first half of 2013).⁵

Obviously the majority locals look for low cost hospitality options, but as the country's GDP rises, the local market will become more stratified.

⁴ <http://www.wordhcmc.com/features/item/3627-high-season-blues>
⁵ <http://vietnamcolors.net/2013/07/danang-nha-trang-popular-among-tourists/>

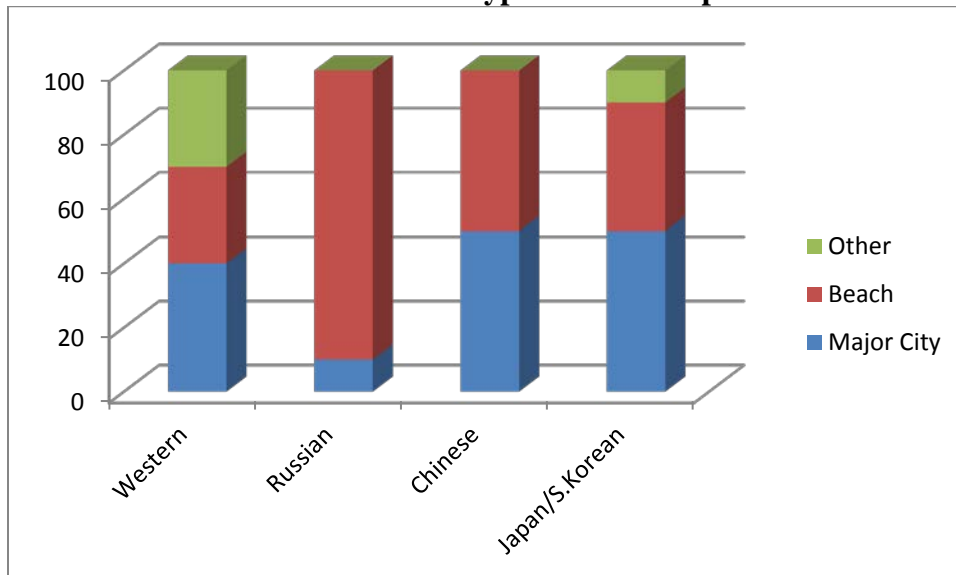
Purchase Considerations of the New Marketsⁱⁱ

If travelers from the new, growing markets have the same purchase considerations as those from Western Europe, North America, and Australia, then no paradigm shift occurs. That is not the case. The following example is the easiest way to explain what is happening:

Tourists from Eastern Russia are by far the fastest growing market segment to Vietnam in 2013. If you live in Eastern Russia, you go on vacation during the winter to wear your smallest swimsuit, get cooked to a crisp in the sun, and eat as much fresh seafood and fruit as you can. These visitors are not interested in seeing rice fields, climbing in the Cu Chi Tunnels, or touring the War Remnants Museum. Many North Americans have these same purchase considerations, but they are better served by flying to Mexican beaches rather than half-way around the world. Russians fly into Cam Ranh Airport, stay about two weeks and never leave the beaches between Nha Trang and Phan Thiet. If you find a Russian wandering around Sapa in the winter, he is more likely to be a Soviet military advisor who got lost during the war than a tourist. On the other hand, Western Europeans, North Americans, and Australians come to Vietnam for a once in a lifetime experience and try to soak up as much culture and activities as they can fit into their trip.

Chinese purchase considerations are a little more difficult to interpret, but they are still obviously different than Western tourists. From our analysis of Mexico/USA tourism, we believe more and more Chinese will be repeat visitors to Vietnam's beaches. Add some casino gamblers, shoppers looking for cheaper prices, and first time international travelers who want to travel somewhere cheap, familiar, and close by, and you have a very similar situation as in North America. Already, the Chinese represent 50% of international tourists arriving to Danang. Southern Vietnam has considerably warmer winter weather than that of China, Japan, and South Korea. If the infrastructure is developed, it is very likely that Vietnam will become the winter destination for Asians looking for warm-weather activities such as golf.

Chart #6: Estimate of Where the Typical Tourist Spends Time in Vietnamⁱⁱⁱ



Major cities are HCMC & Hanoi. Beach includes Danang and Nha Trang

The Western Markets

Is it possible we will see significant growth in the number of Western Europeans, North Americans, and Australians? It is possible, but unlikely. The fact is that Vietnam is considered a “once in a lifetime” trip for these markets. When people don’t return, their numbers have to be replaced by new tourists^{iv}. To see significant growth in new tourists, the status quo has to change somehow. This could happen in several ways, each is rather unlikely.

1. *Increase in the total population* – Population growth is stagnant in these markets.
2. *Increase in disposable income* – In the USA, the middle class is shrinking and college tuitions are crippling the finances of the younger generation. Southern Europe is seeing youth unemployment above 40%. An increase in affluent travelers is unlikely.
3. *Increase in awareness* – Most Westerners are already aware of Vietnam as a tourist destination. An effective advertising campaign could increase growth, but probably not by more than a few percent.
4. *New attractions* – The discovery of the Phong Nha caves could entice more tourists to come to Vietnam and explore.
5. *Infrastructure development* – Another possibility. If, for example, Vietnam upgrades its decrepit train system and makes traveling within the country easier, more tourists may come and others may return. Also, linking the interior to the coast by the re-opening of the Phan Rang to Dalat railroad and adding new routes (as planned⁶) could make previously inaccessible areas much easier to reach.
6. *Changing the visa regulations* – The most likely and most effective change that could happen would be either the elimination of the tourist visa, or partnering with Thailand and Cambodia for a one-visa region. This seems to have some traction in the government. Giving the 20 million tourists arriving in Thailand easy access to Vietnam will sure to increase the number of Westerners arriving.

On the other hand, if our forecast is correct about the growth in Chinese, Russians, and other Asians coming to Vietnam in the next ten years, there is sure to be a negative reaction by tourists from Western Europe, North America, and Australia. Western travelers to SE Asia are looking for unique, once in a lifetime experiences, and going to beaches filled with Russians and Chinese does not meet that criteria. These tourists may choose Laos, Cambodia, and Myanmar to explore instead.

Conclusion

Our opinion is that Vietnam’s coastal locations are, in general, undervalued. Vietnam is perfectly positioned geographically to be the number one international destination of the largest and fastest growing market in the world. Locations such as Phuket and Bali have seen real estate prices double in the last year, while prices of coastal assets in Vietnam have dropped or remained the same. We also strongly feel this is an excellent time to enter the market, as non-market factors are affecting the cost of capital inside Vietnam (see our report [here](#)) which should increase returns for new investors.

⁶ <http://vietmaz.com/2013/07/six-more-railway-routes-planned-for-central-highland-tourism-hub/>

Some businesses and locations are much better positioned than others to take advantage of this coming wave of visitors. In general, high-end hotels in Hanoi and HCMC and other businesses that focus on affluent western visitors are not going to see the same growth as south central coastal locations in the three to four star price range.

In The News This Month

Vietnam Government zones northern Binh Thuan Province for titanium mining.⁷

As we predicted in our Ten Year Outlook ([here](#)) back in March, the Vietnamese government has now zoned the area between Phan Thiet and CaNa^v for titanium mining. This effectively cuts off resort development northward from Saigon - at Phan Thiet. It creates two distinct coastal development areas;

1. The southern region of Phan Thiet, Mui Ne, La Gi, Ho Tram, and Vung Tau. This area will be closest to the HCMC airport (and later, Long Thanh).
2. The south central region of Nha Trang, Cam Ranh, northern Ninh Thuan, and Ninh Chu Bay. This area will depend on the Cam Ranh airport for international arrivals.

An interesting comparable is in Southern California, where the Camp Pendleton Marine Base and the San Onofre nuclear power plant effectively separate San Diego from Orange County/Los Angeles.

Phu Quoc is still not seeing new development of international resorts⁸.

It seems that Phu Quoc is not going to see a significant amount of new supply of four and five star rooms that meet international standards until at least 2015. It is ridiculous how the island's potential has been badly squandered by the provincial government. The island was made its own administrative area recently, but nothing seems to have changed. Five important points that should make investors scramble to develop on the island;

1. Phuket's airport is at maximum capacity for landings.
2. Bangkok is the most visited city on earth.
3. Phu Quoc Island is actually closer to Bangkok than Phuket is.
4. Phu Quoc has an international airport.
5. Vietnam is seriously considering joining Thailand and Cambodia for a one-visa system.

If good lodging options existed on the island, I would guess the Thailand airlines would begin direct flights from Bangkok.

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⁷ <http://vietmaz.com/category/vietnam/ninh-thuan/>

⁸ <http://vietmaz.com/2013/09/big-tourism-projects-on-phu-quoc-island-still-unmoved/#.UifElzZgcmM>

ⁱ In quantity, not growth rate. Russia ranks #1 in growth rate.

ⁱⁱ Obviously we are generalizing here. Not everyone is the same. We think of it as a steep normal distribution curve where our generalizations are the mean, but there are always some people who behave differently.

ⁱⁱⁱ We have no empirical evidence to back this up. It is simply our observations and experience from being in Vietnam for eleven years. Also, see the first endnote above.

^{iv} With Russians and Chinese, there is likely to be a much higher return rate. If the return rate is 20%, then only 4 out of every 5 tourists have to be replaced.

^v If our specialty was consulting for warehousing and logistics companies, we would be telling them to take a close look at CaNa. The small city has a great deep-water bay, it sits right on Highway 1A and the north/south train tracks, and it is going to be in the center of Vietnam's mining and energy development.