McKinsey & Company

Travel, Logistics & Infrastructure Practice

Reimagining tourism: How Vietnam can accelerate travel recovery

While domestic travel has kept the Vietnamese travel sector afloat, the industry needs to reinvent itself until international tourism resumes.

by Margaux Constantin, Matthieu Francois, and Thao Le

March 2021

For most players in the travel industry, the idea of vacationers lounging on a beach thousands of miles from home or sailing the high seas seems like a distant memory. Globally, countries experienced a decline of 35 to 48 percent in tourism expenditures last year compared with 2019. Vietnam, with its ten-month international border closure, has not been exempted.

Tourism contributes a significant share to Vietnam's GDP, and the economy has relied on domestic travel to buoy the sector. Local tourism resumed shortly after the country ended its relatively brief lockdown—just in time for 2020's summer holiday season. Our analysis shows that demand for domestic travel in Vietnam will continue to grow and will recover relatively fast because of growing domestic spending: vacationers who cannot yet travel abroad are redirecting their money locally, at a higher level than in 2019.

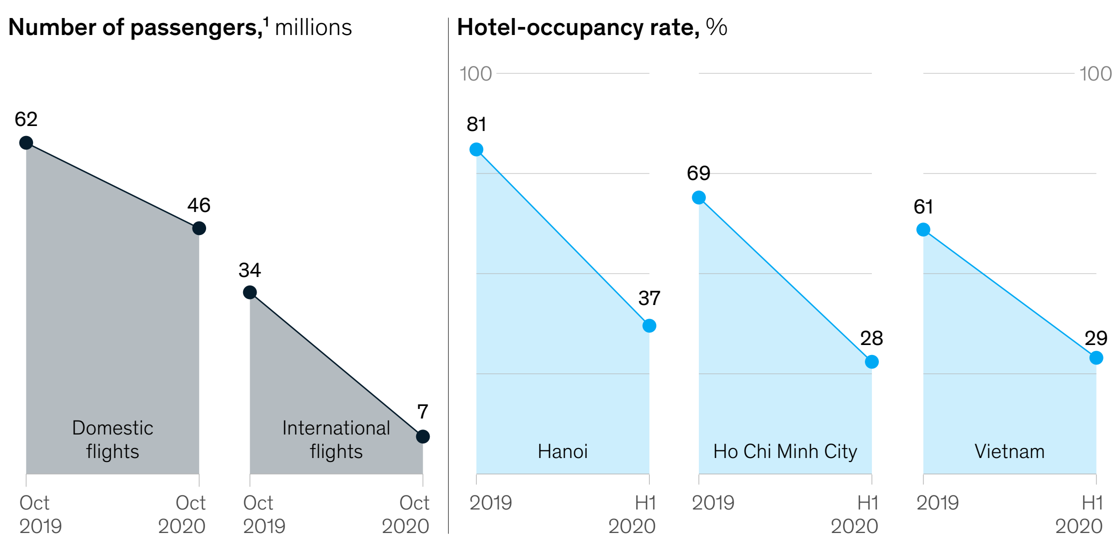
As Vietnam's travel sector continues to evolve and as prospects of international travel become increasingly feasible with vaccination rollouts, travel and tourism players have to adapt to survive. This article gives an overview of the state of Vietnam's tourism sector, looks ahead at how the industry is likely to recover, and maps out a way forward for the country's travel and tourism companies.

The state of travel in Vietnam today: Staying afloat

Vietnam's tourism sector relies heavily on international travel, which plunged last year. International flights dropped 80 percent in October 2020 from the same time period a year earlier (Exhibit 1). Hotels, in turn, filled only 30 percent of their rooms.

Exhibit 1

COVID-19 had an outsize impact on Vietnam's tourism sector.



[1]Includes both inbound and outbound flights. International visitors accounted for 18.5 million in 2019 and 3.7 million in 2020.
Source: CBRE; CAA of Vietnam; Vietnam's Ministry of Culture, Sports and Tourism

The sharp drop in foreign travelers has had an outsize impact on tourism expenditures—and Vietnam's overall economy—because they spend significantly more than their local counterparts. In 2019, a year in which the tourism industry accounted for 12 percent of the country's GDP,[1] international travelers made up only 17 percent of overall tourists in Vietnam, yet accounted for more than half of all tourism spending—averaging $673 per traveler compared with $61 spent on average by domestic travelers (Exhibit 2). The tourism sector created 660,000 jobs between 2014 and 2019,[2] and this sharp expenditure dive has also stunted the country's food and beverage and retail industries.

As a return to pre-COVID-19 levels of international tourism may be far off, the travel sector's short-term revival could depend on local tourism. In 2019, Vietnamese tourists spent $15.5 billion, of which $5.9 billion flowed overseas. The majority of tourists are unable to leave the country, so they are looking domestically to scratch their travel itch. Travel companies should therefore rise to the occasion and capture value from this opportunity.

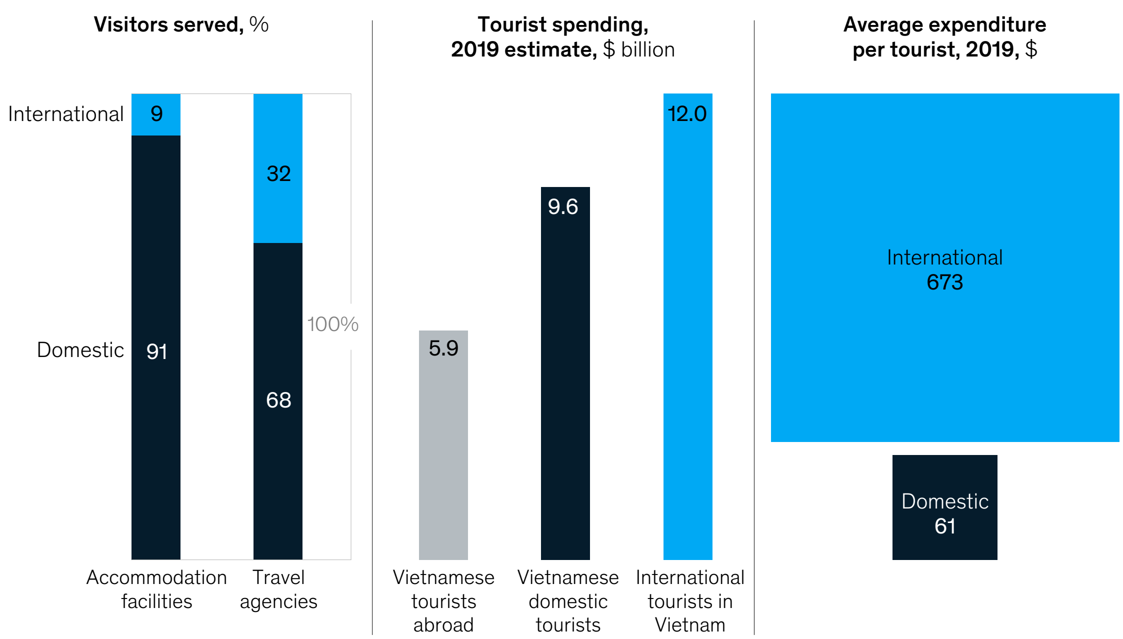
Looking ahead: Vietnam's tourism industry can recover by 2024 if it implements a zero-case-first approach

Even with favorable tailwinds driven by domestic tourism, Vietnam will be dependent on international markets, which represent around $12 billion in spending. The majority of Vietnam's international tourists come from Asian countries, with those from China, Japan, South Korea, and Taiwan accounting for around 80 percent of Vietnam's foreign tourism spending. Vietnam's strong economic ties with these countries could lead to a relatively fast tourism-industry recovery compared with other key tourist destinations in Europe and North America (Exhibit 3).

Exhibit 2

International tourists comprise a small percentage of tourists in Vietnam but generate the most spending.

Domestic vs international tourism in Vietnam



Source: Euromonitor; GlobalData; GSO

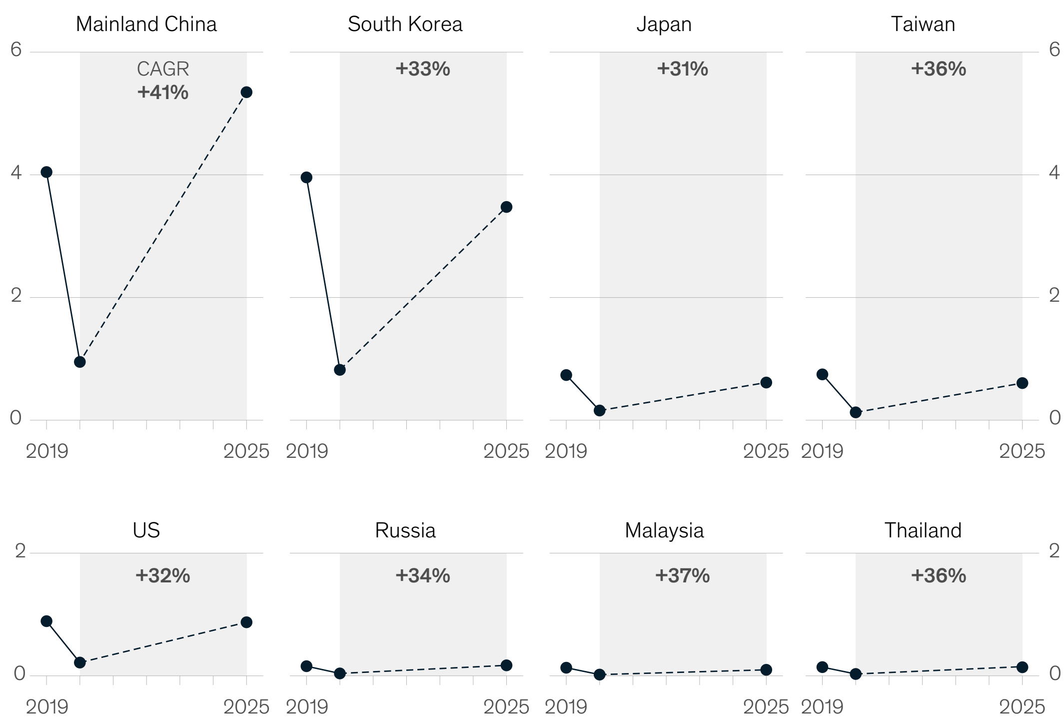
[1] "Total revenue from tourists in the period of 2008–2019," Vietnam's Ministry of Culture, Sports and Tourism, May 29, 2020, vietnamtourism.gov.vn.
[2] *Global Economic Impact & Trends 2020*, World Travel and Tourism Council (WTTC), June 2020, wttc.org.

Exhibit 3

Vietnam can expect to see international tourism rebound first with travelers from other Asian economies.

Number of inbound arrivals to Vietnam by top source markets, 2019, millions

Inbound tourism expenditures, A1 recovery scenario, $ billion



Source: GSO; McKinsey tourism recovery model

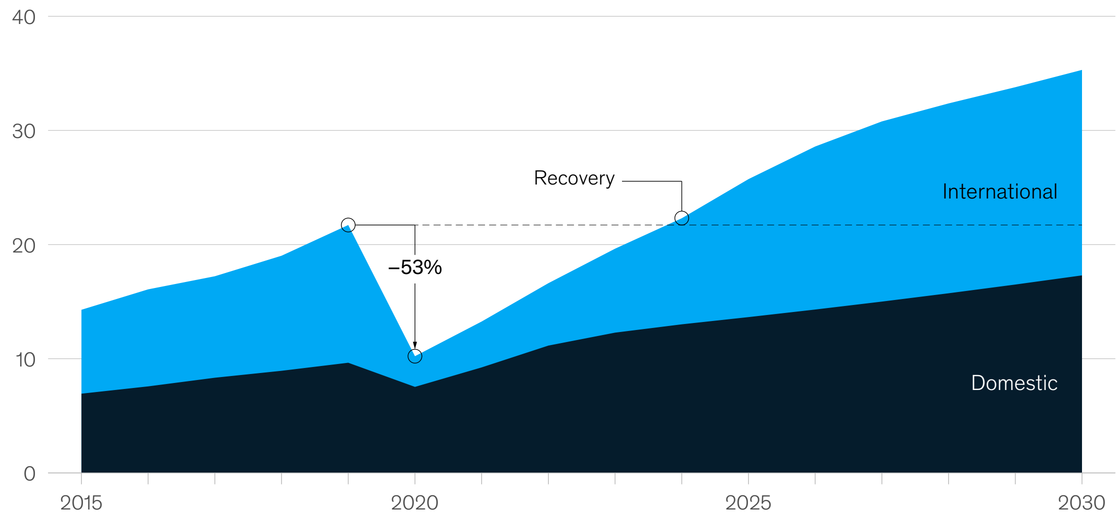
To make the most of these ties, Vietnam has been pursuing a zero-case-first strategy since the start of the pandemic. This strategy is associated with markets in which COVID-19 transmission rates are low and—as a result—traveler confidence, at least on a domestic level, is relatively high.

By implementing the zero-case-first approach, and taking into account Vietnam's currently resilient local economy and proactive government campaigns, Vietnam's tourism sector could recover to precrisis levels in 2024 (Exhibit 4).

Exhibit 4

If Vietnam can maintain a low infection rate, its tourism sector can recover as soon as 2024, driven by the return of domestic travel.

Tourism expenditures in Vietnam, $ billion



Source: McKinsey tourism recovery model

Under this scenario, three paradigms are changing the way travel companies plan for Vietnam's recovery:

— *Shifts in tourism behavior could result in high-end domestic trips.* With borders remaining closed for outbound travel, an increase in domestic luxury trips could occur as travelers reallocate their budgets. Of course, as noted above, the spending power of domestic tourists is weaker than that of foreign tourists, so this type of travel cannot completely fill the gap created by the lack of international travelers.

— *Price cuts could be used to stimulate demand but aren't sustainable for the long term.* Many travel companies offered discounts in the immediate aftermath of the crisis in order to compete for business and stimulate demand. This may result in price dilution, especially for hotels across the country, and thus may not be a sustainable strategy for the long term.

— *International travel bubbles have to be explored with caution.* Currently, Vietnam has strict travel restrictions in place and allows only a select number of weekly international flights for travel by experts and diplomats, who are subject to mandatory quarantine on arrival. Vietnam needs to protect the status quo of having near-zero rates of COVID-19 cases and cannot risk opening its borders freely until herd immunity is reached, most likely through mass vaccinations. Thus, it could take some time before inbound foreign tourism returns at scale. In the meantime, there might be some opportunity to pursue more gradual and less risky measures. For instance, there have been discussions about establishing travel bubbles to allow travel between other countries with zero or near-zero transmissions, such as Australia, China, and Singapore. Travel companies should be prepared for two scenarios: one in which travel bubbles open up for inflows of international tourists, and the other in which domestic tourism remains the main driver of value.

Six actions to jump-start Vietnam's tourism recovery

As travel companies reimagine their pathways to recovery, it is important to address the risks and anxieties related to COVID-19, while also solving for the pain points and trends that existed before the crisis. Below are six steps that Vietnam, and other countries operating in a zero-case-first market approach, can take as they embark on this road to recovery.

Focus on domestic travelers

Local demand can be revitalized by focusing on emerging destinations with the joint cooperation of local governments, online travel agencies, attractions, hotels, and airlines. Outdoor tourism that involves sunshine, beaches, mountains, and nature were among the top choices for Vietnamese travelers after the lockdown was lifted in mid-May last year, and airports at the two big travel hubs of Ho Chi Minh City and Hanoi were busy. To further tap into the domestic opportunity, operators will have to focus on affordability while striving to maintain high-quality products and experience.

Consider new pricing models to rebuild demand

Rebuilding demand and propelling volume, through discounts and presales, are key tactics during the early stages of recovery, especially for high-end operators that will not be able to tap into international demand for some time. However, the crisis has also forced operators to set aside their existing commercial playbooks. Historical booking patterns and trends normally used as key reference points for price optimization and yield management may no longer be as relevant. In this context of depleted demand, the paradox is that while price cuts are necessary, they could also be dangerous. In this light, companies can also explore opportunities to bundle products—which can offer upselling and cross-selling opportunities—as well as diversify their revenue stream and enhance premium product and pricing.

Five-star hotels in Hanoi and Ho Chi Minh City, for example, can provide full "staycation" packages for families, complete with home pickup by luxury car, a suite, and discounts on food and drinks. Tourism companies and hotels could work together to provide end-to-end travel packages that include flights, train tickets, limousine and bus services, and accommodations. Other companies could capitalize on booming demand for luxury and outdoor activities, such as yacht tours or farm stays.

As demand grows and confidence increases, operators will naturally be inclined to revert to a more dynamic pricing model, based on indicators such as hotel occupancy and domestic-air-travel passenger numbers—and how they grow toward achieving prepandemic levels. That will then give companies an opportunity to refine optimal pricing mechanisms, especially around key domestic holidays such as Tet (the Vietnamese New Year). This is not something that all countries are getting right. Many hotels in Germany, for example, missed pricing or revenue-management opportunities when demand for summer travel reemerged last year.

In the future, dynamic pricing models and the revenue-management function will need to be revisited, based on three new axioms: traveler segments will not be the same for a long period of time and will be a stronger and more diverse domestic mix; demand elasticities will be different, with health concerns playing a more influential role in decision making; and demand will remain very volatile, as observed in Vietnam during the Tet holiday this year, when a small spike in COVID-19 cases led to a big drop in bookings and travel demand throughout the country.

The time for digital (really) is now

Even before the pandemic, consumer reliance on digital for travel-related bookings had been growing. In 2018, online travel activity made up 19 percent of the total tours and activity market size. The pandemic has made the adoption of mobile and digital tools even more essential. Strategic collaborations—such as online travel agencies providing ticket-booking services via instant messaging and social-media platforms—could offer an opportunity for increased market penetration.

At the same time, travel companies should revamp their online touchpoints and experiences to improve customer experience. This is already starting to happen: the website of the Vietnam National Administration of Tourism (VNAT) has virtual tours for its most popular destinations, and some tour guides have organized real-time online tours for international customers. In addition, a commercial titled, “Why not Vietnam” aired on CNN in October 2020 to drive international traffic to the website, and on the domestic level, a reality show with the same name offered up weekly online travel photo contests to engage viewers.

Furthermore, companies could also think about placing digital tools in new places within the customer journey. They must recognize that factors promoting customer loyalty may have changed; near-term uncertainty may mean, for example, that the ability to cancel a reservation matters more than brand choice or price. Taking this into account, companies could empower customers to build their own itineraries using connected digital tools that make it easier for them to modify or cancel their plans. Solutions and policies that provide choice and control will help build the long-term trust and confidence necessary to get travelers back on the road and in the air.

Lay the groundwork for inbound demand

To capture early outbound demand, travel players could benefit from tracking the development of travel bubbles. This is especially relevant for Vietnam, as the majority of tourists to Vietnam are from nearby regions with strong economic ties and relatively low transmission rates. As stated earlier in this article, our analysis finds that nearby countries such as China, Malaysia, and Thailand could provide inbound expenditure growth of at least the CAGR between 2020 and 2025 (Exhibit 3).

In this context, travel companies will need to be flexible and nimble to capture early international-travel demand—and should be prepared to implement strict health and safety protocols that fulfill the stipulations of both domestic and destination security policies. That said, betting on travel bubbles cannot in itself be a strategy in the short term, as international arrivals are expected to remain low in 2021, and foreign demand will not return to 2019 levels before 2025.

Reinvent the traveler’s experience beyond accommodation—and ‘redistribute’ tourism investments toward unconventional and more diverse destinations

Globally, travelers are personalizing their trips through destination adventures. Tourism spending is shifting away from accommodation to activities—a trend that holds true for Vietnam. According to a report released by the General Statistics Office of Vietnam, Vietnamese travelers have allocated smaller budgets for accommodation in the past few years, accounting for approximately 15 percent of travel expenditures in 2019, down from 23 percent in 2011.

Instead of spending on luxury accommodations, travelers are saving money for destination experiences. Many tourists are booking activities before they travel, which suggests the in-destination experience has a bigger impact in the overall tourist decision-making process. Many adventure activities, such as cave discovery, highland hiking, isolated island stays, water sports, and food festivals have become the main reason for travelers to visit a destination in the first place.

In Vietnam, examples of efforts aimed at developing a distinct experience—rather than specific infrastructures—have emerged recently, such as the development of Ho Chi Minh City’s “night economy,” and diversified marketing from the Binh Duong province to spotlight its festivals as main attractions. VNAT is also participating in this effort, specifically making farm stays in mountainous areas an axis for the development of more indigenous experiences. Meanwhile, other regions are also marketing unique experiences: Dalat is promoting its hiking and camping attractions, Mui Ne its golf and water sports, and Ninh Binh and Phong Nha-Ke Bang their nature activities.

Local operators, who often lag behind big travel companies in terms of resources but are more agile in organizing personalized activities, can leverage increasingly popular online players to connect directly with customers and provide these options. International online travel agencies such as TripAdvisor, as well as closer-to-home players such as Traveloka and Triip.me, have been building dedicated "experience" platforms to inspire users and allow them to choose the most suitable tours by providing a range of attractive options for destination adventures. Tourism companies could shift their efforts away from building resorts and selling sightseeing tickets to design exceptional activities, and leverage these platforms to take advantage of travel-experience trends.

Reimagine government's role in tourism

In most countries, reinventing the tourism industry will involve industry professionals working in concert with industry groups and governments. Vietnamese tourism administrators have an exciting opportunity to reimagine their roles and lead the sector through recovery and beyond—first, by boosting domestic demand to make up for lost income from international travelers, and second, by promoting Vietnam's image as a country that has managed the pandemic fairly well. To do this, three things should occur:

— In the short term, government and industry associations need to ensure the survival of operators. The government can experiment with new and sustainable financing options such as hotel revenue pooling, in which a subset of hotels operating at higher occupancy rates share revenue with others. This would allow hotels to optimize variable costs and reduce the need for government stimulus plans.

— In the midterm, government-backed digital and analytic transformation is necessary, especially to level the playing field for small and medium-sized enterprises, which made up more than 50 percent of travel suppliers in 2018. Encouraging and helping local operators adjust to the demand for online travel services is critical to help them stay competitive. Government can play a vital role as a matchmaker, connecting suppliers to distributors and intermediaries to create packages attractive to a specific segment of tourists, and then use tourist engagement to provide further analytical insights to travel intermediaries. This ability allows online travel agents to diversify their offerings by providing more experiences off the beaten track. The Singapore Tourism Analytics Network (STAN) and the Tourism Exchange Australia (TXA) platforms are examples of how this mechanism can work at scale.

— Finally, Vietnam has a solid opportunity to boost its stature as an adventure destination. Governments and industry associations can leverage the overall momentum of the country, as well as the expected return of international travel, to boost demand. Our analysis finds that in the Asia–Pacific region, adventure remains the leading travel trend searched by travelers, so Vietnam is well positioned to leverage this trend. Similarly, investments are also expected to shift away from mega development projects, such as Phu Quoc and Nha Trang, toward small- and medium-scale projects and cities that offer specialized offerings like sports tourism, medical tourism, and even agricultural tourism.

Travel players in Vietnam can seek to accelerate the industry's recovery by capturing emerging growth opportunities domestically as they gradually rebuild international travelers' confidence. Our six steps should set the stakeholders in Vietnam's travel industry in the right direction and help them thrive in the tourism economy of the future.

Margaux Constantin is a partner in McKinsey's Dubai office; **Matthieu Francois** is an associate partner in the Ho Chi Minh City office, where **Thao Le** is a consultant.

The authors wish to thank Celine Birkl, Bruce Delteil, and Alex Le for their contributions to the article.

Designed by McKinsey Global Publishing