

# BCG

THE BOSTON CONSULTING GROUP

## *Northern Sights: The future of tourism in Iceland*



*A perspective from The Boston Consulting Group*

September 2013



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This is an independent report by The Boston Consulting Group (BCG). It was commissioned by a consortium of private companies, including Icelandair Group, Isavia, Blue Lagoon, and Europcar. Input and guidance was provided by a Steering Committee comprised of representatives of these firms. Additional input was provided via interview with several tourism industry stakeholders and finally by over 200 survey respondents from the sector. All recommendations remain the independent view of BCG.

## **Foreword by Prime Minister Sigmundur Davíð Gunnlaugsson**

Iceland is an extraordinary country, with distinctive nature, a unique culture, and an authentic and warm-hearted people.

We have much to offer the hundreds of thousands of visitors who travel to our shores every year. Our hotels, guest houses, transport companies, tour operators, restaurateurs, shop-keepers, and site managers work hard to make visiting Iceland something to remember and give tourists a world-class holiday or business experience.



I strongly believe that these visitors have much to offer to Iceland too. Tourism makes our country stronger, more prosperous, more open, and more prominent on the world stage. It challenges us to think bigger and more globally - a mindset that rewards us across every sector of our economy.

It is in this light that I welcome this important contribution from The Boston Consulting Group to the debate over the future of tourism in our country. It provides a clear view on some of the key questions we need to answer as a nation: What should our aspirations for tourism be? How do we achieve these goals? How should we fund much-needed future investments? And what is the potential economic opportunity if we execute on our strategy in the right way?

Based on the calculations of the authors, tourism could be one of the largest growth engines of the Icelandic economy over the coming decade – not only in Reykjavik, but across every region of the country. With close attention to the management of our environment and the sustainability of our natural assets, we can address the challenges that tourism presents, and grasp the benefits that it confers.

Tourism is one way that we give the world a glimpse into the magic of Iceland. I want to give many more visitors the opportunity to experience that over the next decade, and help make Iceland stronger and more prosperous in the process.

In recent years, the successful growth of tourism has done much to aid the Icelandic economy and has helped to put Iceland firmly on the map as one of the most exciting places in the world to visit. I believe that with clear strategy, the right measures and combined effort of public and private actors, tourism will flourish in the coming years.

**Sigmundur Davíð Gunnlaugsson**  
Prime Minister of Iceland

## **Foreword by Minister Ragnheiður Elín Árnadóttir**

When I took office as Iceland's Minister of Tourism Affairs in May, I was faced with a number of challenges.

Iceland's tourism sector is at a turning point. Foreign visitor numbers are growing exponentially. Smoothing out seasonal cyclicalities is important, and fortunately we are making progress towards realising Iceland's potential as a year-round destination. Tourism-generated foreign exchange revenues are mushrooming, an ever-increasing variety of jobs are being created, and firms in tourism, retail, and services are growing by leaps and bounds. The tourism industry is today the most robust sector in the Icelandic economy. Nonetheless, untapped opportunities are abundant. Authorities and tourism operators must work together to make Iceland a better year-round destination than ever before.



The mainstays of the tourism sector are Iceland's culture and natural beauty. But with recent growth and developments, there are increasing signs that our natural resources – particularly our delicate wilderness areas – will not be able to tolerate continued growth and unrestricted visitor access. We must formulate a comprehensive strategy for conservation, utilisation, funding, and fee collection that accounts for this. Some of Iceland's most popular and sought-out destinations cannot afford to wait. We must take immediate action if we are to prevent irreparable damage.

Stakeholders have already shared many ideas on funding and fee collection, which should help with access management and distribution of strain. Some landowners and firms are already charging for access to certain areas, but we have yet to formulate a comprehensive strategy for Iceland as a destination. The formulation of such a strategy and the protection and development of tourist destinations are the most critical joint tasks facing the authorities and the tourism sector, but it will take time to consolidate differing points of view on such a complex issue.

In view of all this, I am delighted that Icelandic tourism operators should join forces and embark on a project as ambitious as that described in this report. The proposals presented here are based on interviews with a broad group of stakeholders large and small and, as such, are extremely important for the authorities. But even though we have critical work ahead of us, we must never lose sight of the satisfaction that tourism brings to those who work in the field – not to mention the enjoyment it brings to customers. We must remember this and allow it to guide all of our work!

**Ragnheiður Elín Árnadóttir**

Minister of Industry and Commerce, Iceland

## Executive summary

**T**ourism is a vital part of the Icelandic economy. This year, it is likely to become the country's largest export sector, overtaking fishing for the first time ever. Iceland has been remarkably successful over the past ten years at attracting new visitors, who consistently leave with a smile on their faces, inspired by Iceland's distinctive nature, unique culture, and warm-hearted welcome. The next ten years could see Iceland move to a new phase of development, with visitors generating substantial new revenues to fund products, environmental conservation programmes, and infrastructure – creating more and better jobs, tax income, and economic growth as a result. But achieving this will require a concerted effort from a host of individuals and organisations across Iceland's tourism sector.

The scale of tourism's contribution to Iceland today is already impressive. In 2013 we estimate tourists will pay around ISK 17 billion in direct taxes (ISK 27 billion including indirect contributions), equal to ISK 120,000 contribution to every household in the country. These are taxes that would otherwise need to be levied directly on Icelanders. Tourism provided around 7,000 Icelanders with a wide range of jobs. The real value of tourism exports grew 136% in the first decade of the century, from ISK 33 billion to ISK 78 billion.<sup>1</sup> Tourism's share of total Gross Value Added in the economy rose from 4.6% in 2004 to around 6% in 2012.

This growth is likely to continue at pace over the next ten years. We project tourist numbers could rise from nearly 700 thousand in 2012 to nearly 1.5 million in 2023. This growth could more than double tourism's direct contribution to Iceland's economy – to ISK 215 billion in 2023 (and an indirect contribution of ISK 400 billion).<sup>2</sup> While increasing tourism will bring significant benefits, it will also create significant challenges for the country: Conserving nature, engaging visitors to spend more during their stay, reducing the seasonality of tourism, and spreading visitors further around the country.

Balancing the opportunities of growth with the need to address its challenges, we believe that the future vision for Icelandic tourism should be to "maximise tourism's contribution to the whole of Iceland with managed and sustainable growth of visitors inspired by Iceland's distinctive nature, unique culture and warm-hearted welcome."

This more managed and sustainable approach should be achieved by targeting a set of tourist segments which are attractive to Iceland because of their size and spend patterns, the seasons they travel in, and the regions they might travel to, and for whom Iceland has a strong intrinsic appeal.

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<sup>1</sup> "Charting a Growth Path for Iceland" (McKinsey & Co., 2012)

<sup>2</sup> Monetary values discussed in this report are at 2012 prices. That is any increase in values is real and negates the effects of inflation.

We have defined the target visitor groups that we believe meet these criteria as Affluent Adventurers, Older Relaxers, Emerging Market Explorers, City Breakers and those travelling for business meetings and conferences ("MICE<sup>3</sup> visitors").

To attract these target visitors while at the same time ensuring the sustainability of Iceland's natural assets, Iceland's tourism sector will need to work together across three broad categories of activity: Building the destination; Funding the vision; and Organising for success. These will need to be underpinned by strong leadership that takes ownership for delivering the vision and corrals the varied actors in the sector to drive towards the same goals.

**Building the destination.** Icelandic tourism has developed rapidly in the past few years, but stakeholders will need to push four elements even further to accommodate the expected rise in visitors in the future: Conserving sites, by putting in place a "watch list" for areas in need of improvement and taking action to manage visitor numbers at those locations to enhance the tourist experience; developing new products that appeal to target visitors, such as expanded cultural facilities for Older Relaxers; building complementary infrastructure, both to transport tourists and to preserve the visitor experience as numbers increase; and to refocus promotional activities, using selective channels to maximise appeal to a much narrower target audience.

**Funding the vision.** Building the destination will require new investments – in conservation, product, infrastructure, and marketing. Since tax revenues will neither be sufficient nor appropriate to finance these, there will need to be a new mechanism to raise revenues. The ongoing, lively debate on this topic has focused on a range of options. We believe that an Environment Card, providing access to most key nature sites in the country for a fee, delivers the optimum balance between feasibility, fairness, efficiency, and capacity to raise significant funds. In addition to this, individual sites and service providers should develop value-added services to further engage those visitors who are willing to pay more. These could be subject to additional charges, in the same way that many museums around the world charge for special exhibits. This is a well established method to maximise both experience and willingness to pay.

Funds raised by the Environment Card would be channelled into a Nature Fund and used for four major purposes: First, they should pay for the operating costs of the card itself (estimated at around 10% of the forecast revenues). Second, around 40% of the funds should be distributed directly back to tourist sites, parent municipalities and land owners based on the visitor volumes they attract. This incentivises sites and local authorities to join the scheme and it provides them with direct benefits from growing their visitor base. The remaining revenues should be split between two investment funds: A grant-based fund, focused on environmental conservation,

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<sup>3</sup> MICE = Meetings, Incentives, Conferences and Events

training, and tourism development in less-visited regions; and a loan-based fund that invests in commercially-viable projects, providing longer or more flexible terms than banks would be willing to offer. Section 5.3 shows a worked example of how this distribution of funds might work for the benefit of Gullfoss and its municipal authority.

**Organising for success.** Today, governance of tourism in Iceland is complex, with many entities with overlapping responsibilities and a lack of central accountability. Experience from other countries, such as Finland and Australia, shows that simplicity, along with a central driving force with public and private sector participation, is essential to ensure a coordinated effort across the tourism sector. Alongside a range of measures to reduce today's complex structures, we recommend the establishment of a public-private Tourism Task Force, whose responsibility will be to own the long-term strategy, set targets, measure progress, coordinate activity, and drive change. Only a body such as this could set the pace required to execute the extraordinary breadth of activity needed to achieve Iceland's ambitious goals.

With the measures described above, we believe the tourism economy could grow at 7% per year, significantly faster than the 2.6% projected for the rest of the economy. One side effect of this growth will be higher direct receipts. By 2023 we predict annual tourism tax receipts of ISK 33 billion (ISK 52 billion including indirect contributions), a rise of ISK 17 billion in ten years, equivalent to an increase of nearly two points in Value Added Tax ("VAT") or ISK 90,000 in taxes per Icelandic household.

Since the identified target visitors travel more in the winter, Iceland would see a reduction in the steepness of its summer peak, while developing new products in the regions would focus new growth comparatively more in the East, West, Westfjords, and North. Of the 5,200 new jobs that tourism will directly create in the next decade, 1,400 of these will be generated outside the capital and South. This is greater than the roughly 1,200 people registered as unemployed in those regions, implying a significant positive impact on their local labour markets.

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Over the past ten years, the successful growth of tourism has done much to aid the Icelandic economic, while giving the country a far greater degree of international exposure. Looking to the next ten years, the future still looks bright for Icelandic tourism. There's much to do to make it reality.



## **Introduction and methodology**

Last winter The Boston Consulting Group (BCG) was commissioned to write an independent report on the future of tourism in Iceland. The project was a private initiative by a broad set of companies with a strong stake in Iceland's future success as an attractive, growing and sustainable tourist destination. These included Icelandair Group, Blue Lagoon, Holdur / Europcar, and Isavia. Our report is intended not to be the definitive answer, but rather to add new ideas, evidence, and analysis to the active and vibrant debate ongoing in Iceland.

The primary research and development of the report was conducted in two phases, from December 2012 to February 2013 and then from May to July 2013, by a team of BCG consultants based in Reykjavik. In developing the report, we made use of a wide variety of primary and secondary data sources, including: One-on-one interviews with 15 Icelandic tourism stakeholders; an additional series of stakeholder interviews and focus groups conducted by Capacent, supplemented by a web survey, which altogether captured more than 200 responses; publicly available data from Statistics Iceland, the Icelandic Tourist Board, Promote Iceland, and other Icelandic data sources; data from the Icelandic Tourist Board's most recent summer and winter visitor surveys; and a very wide range of international benchmarks and data drawn from BCG's tourism database, international data-gathering institutions, press reports, and company websites.

We used the data available to draw a range of conclusions that we tested with our Steering Committee (compromised of representatives of the sponsoring organisations), as well as with a wide range of public officials and other tourism stakeholders. This allowed us to refine our thinking, as well as explore areas that we had not previously considered. Our findings are, however, our own and reflect BCG's independent view of the right course of action for Icelandic tourism over the next decade.

# 1. Context: Icelandic tourism today

## 1. Context: Icelandic tourism today

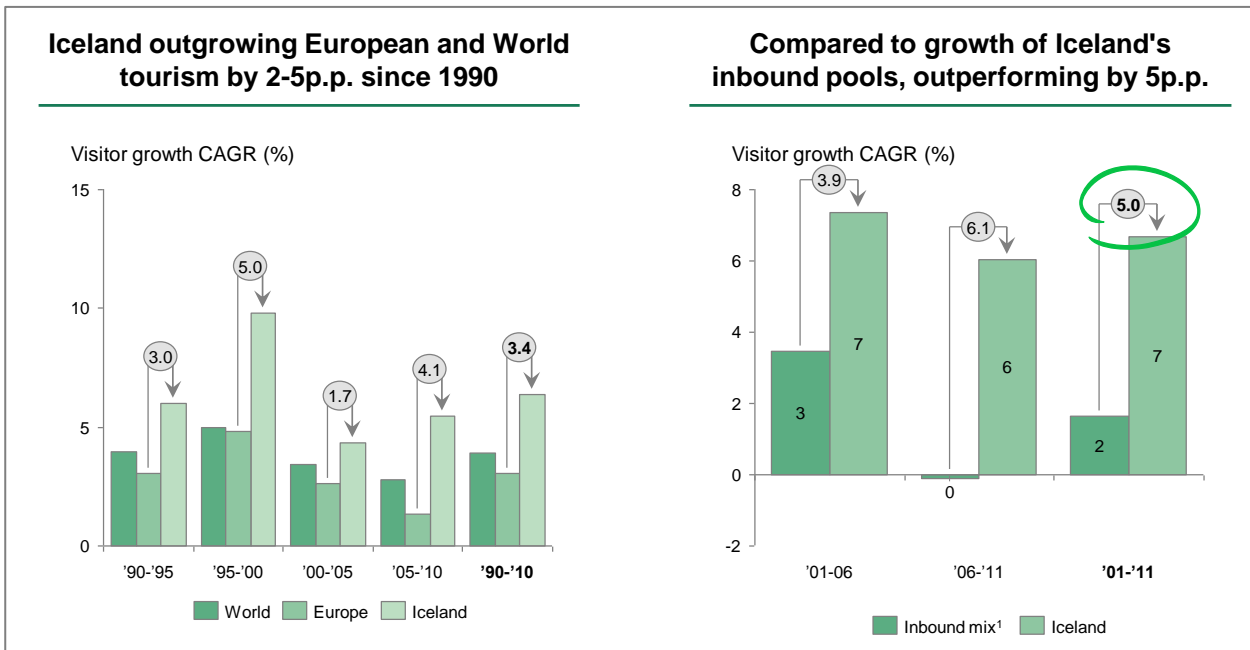
Over the past 10 years, Iceland has more than doubled the number of visitors that arrive through its four international airports, the Smyril Line sea route, and cruises. From around 249,000 in 2002, international visitor numbers through Keflavik, capturing the vast bulk of arrivals, exceeded 649,000 last year. Current indications show this trend continuing at pace, with 10 – 30% year on year growth in each month of 2013.

This growth has been driven by five key factors:

- Growth in tourism globally
- The eruption of Eyjafjallajökull volcano, driving awareness of Iceland as a destination
- Airline route development, led traditionally by Icelandair but, more recently, by a range of international airlines opening up routes into Keflavik
- Promotion of Iceland as a tourism destination, notably since 2010 through the "Inspired by Iceland" and "Ísland allt árið" campaigns and a general increase in marketing efforts abroad
- Devaluation of the Icelandic Krona in 2008, leading to a perception change of Iceland as an affordable location for a holiday

Exhibit 1 shows the extent to which Iceland has outpaced European and world tourism growth over an extended period of time. It is not only that Iceland attracts visitors from particularly high-growth countries. The right hand chart shows that, even considering Iceland's inbound market mix, i.e. the set of countries that send visitors to Iceland today, Iceland has grown as much as five percentage points faster per year than the total growth of outbound tourists from those countries. In business terminology, Iceland is winning market share from competing destinations.

Exhibit 1. Icelandic tourism has grown significantly faster than world tourism over two decades



1. Weighted average growth rates for outbound growth of top 12 inbound country flows to Iceland; assumes constant mix over time based off of 2011-12 survey (weighted avg. summer/winter)

Source: Icelandic Tourist Board, "Visitor Survey Winter 2011/2012", UNWTO Barometer 2030, Euromonitor departures by country

This growth in visitor numbers has generated major economic gains, taking tourism from what was sometimes described as a "hobby" for Icelanders to become the country's second largest export industry. In 2013, tourism may even overtake fishing in this respect for the first time. The real value of tourism exports grew 136% in the first decade of the century, from ISK 33Bn to ISK 78Bn.<sup>4</sup> Tourism's share of total Gross Value Added in the economy rose from 4.6% in 2004 to around 6% in 2012, meaning that more than one in ISK 20 in Iceland is spent in the tourism sector.

However, as tourism takes off, there is a growing sense that Iceland could do more to both manage this growth and ensure it is as sustainable, efficient and beneficial as possible. We have identified four challenges for the future development of Icelandic tourism:

- **Conserving natural attractions** and preserving the visitor experience at them
- **Enabling higher visitor spend** by delivering greater value to visitors
- **Reducing seasonality** to mitigate pressure on capacity during peak summer months
- **Improving distribution of tourism** to reduce pressure on the South-West and spread the benefits of tourism throughout the country

<sup>4</sup> "Charting a Growth Path for Iceland" (McKinsey & Co., 2012)

### ***1.1 Conserving natural attractions***

Visitor growth has created two risks for the future sustainability of Iceland's most important natural attractions. Firstly, over-use of sites risks causing temporary or permanent damage to the soil, vegetation, or landscape. Secondly, increased visitors, especially when concentrated at peak periods, can cause congestion, reducing the experience at sites. Comments from our survey of Icelandic tourism stakeholders echoed this concern, as did an academic report from the University of Iceland, which noted that "The very fast growth of tourism to [Iceland] and into the wilderness raises concerns regarding the difficulties of maintaining the qualities of the resource and the experience of visitors."<sup>5</sup>

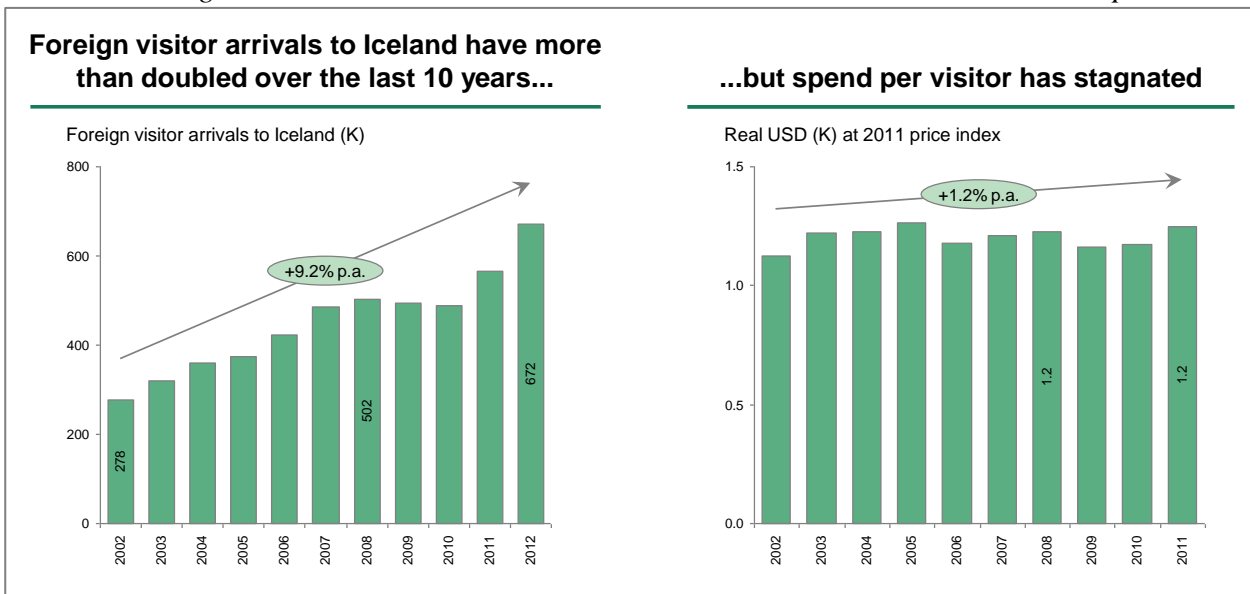
### ***1.2 Enabling visitors to spend more***

As the tourism industry develops to accommodate higher visitor numbers, it would be expected to create more opportunities for visitors to buy goods and services that improve their experience of, and engagement with, the country and its nature. However, the growth in visitor spend has not kept pace with the expansion in numbers (see Exhibit 2). While spend has increased 1.2% per year for the past decade, this is lower than the GDP growth of most of Iceland's inbound markets (even counting the financial crash), indicating that Iceland is capturing a smaller share of its customers' wallets than at the start of the millennium. This trend is, to a degree, a global phenomenon. Additionally, part of the explanation lies in a growing "black" market and the expansion of the winter and shoulder seasons, which attract lower-spend visitors. These are only partial explanations, however, and there remains a significant opportunity to grow visitor spend.

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<sup>5</sup> "Managing popularity: Changes in tourist attitudes in a wilderness destination", Anna Dóra Sæþórsdóttir, *Tourism Management Perspectives* 7 (2013) 47–58

Exhibit 2. A large rise in visitor numbers has not been met with an increase in visitor spend



Note: Tourism spend is international tourism receipts, excluding purchases with Icelandic airlines by foreigners; spend data for '00-'08 from Statistics Iceland, data for '09-'10 from UNTWO

Source: Icelandic Tourist Board, Statistics Iceland, Oanda, EIU, UNWTO World Tourism Barometer

### 1.3 Reducing seasonality

Tourism in Iceland has been highly seasonal, with around half of all visitors arriving in just three months of the year (June-August). This places strain on the ability of Icelandic infrastructure and tourist attractions to bear peak loads without wasteful investment in capacity that sits idle through the rest of the year.

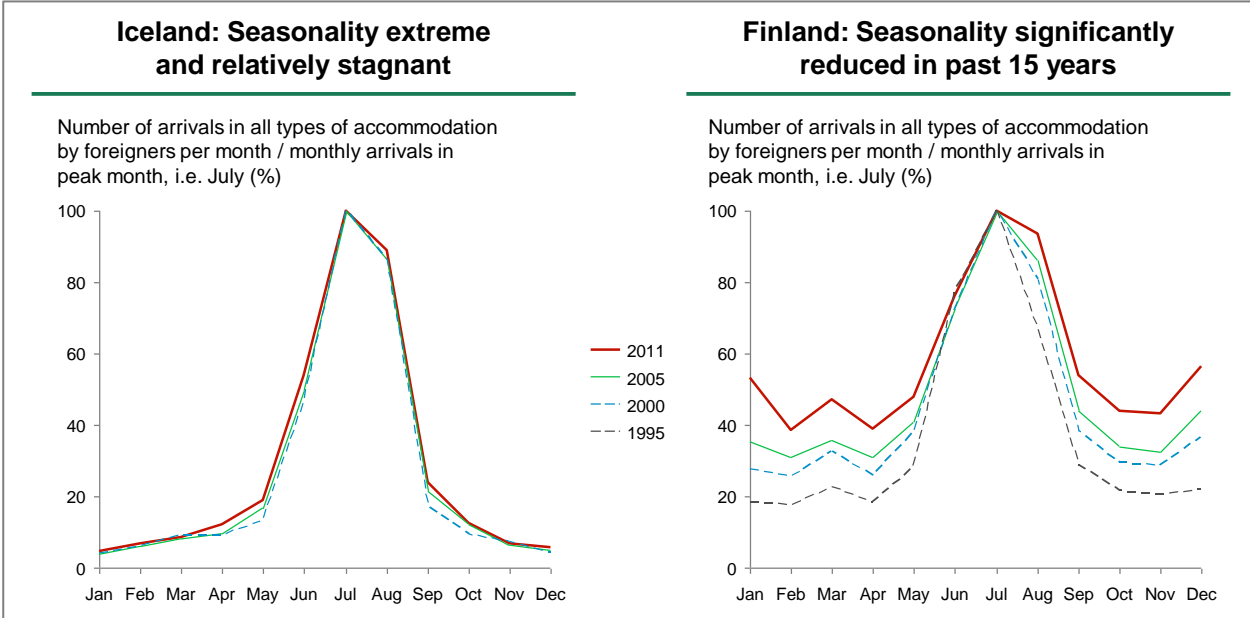
Comparing Iceland to benchmark countries, such as Finland, it is clear that this is not an inevitable consequence of climate, hours of sunlight, or the centrality of nature to its attractiveness as a destination (see Exhibit 3). Finland has created a major winter tourism cluster around Lapland, which now attracts almost a quarter of its winter visitors, despite similar weather patterns to Iceland's northern resort, Akureyri. Whilst this may not be the ideal strategy for Iceland, the example serves as an illustration of how focused marketing and product development can reduce seasonality in a highly effective way.

Indeed, in the past year Iceland has demonstrated its potential to "sell the winter". Arrivals to Keflavik rose 21% between January and May 2013 compared to the previous year, while initial evidence from the summer season shows growth of only 10% (see Exhibit 4)<sup>6</sup>. There is significant opportunity for Iceland to attract more year-round visitors (see Section 3) and for the

<sup>6</sup> Isavia: Summer season increase is based on data to August 15th

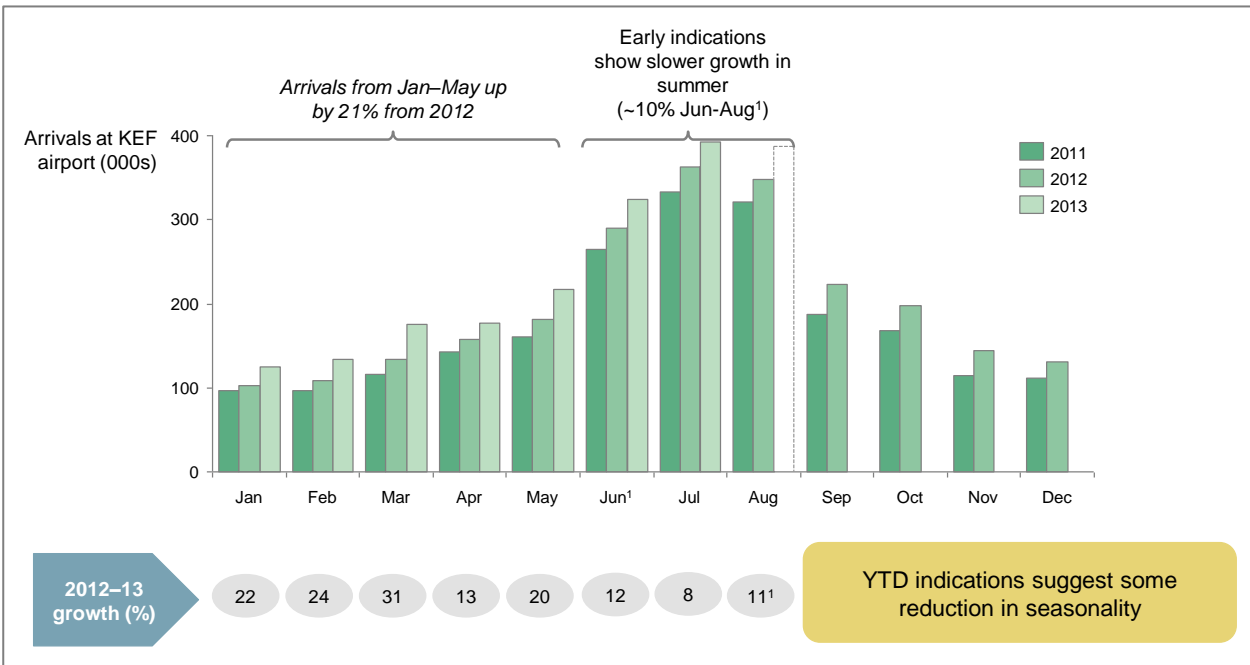
country to develop new attractions that build on Iceland's winter assets, such as the Northern Lights, adventure skiing and other winter-related activities (see Section 4).

Exhibit 3. Icelandic tourism has been highly seasonal in contrast to that of Finland



Source: Statistics Finland, Statistics Iceland

Exhibit 4. Indications from 2013 show possible reduction in seasonality



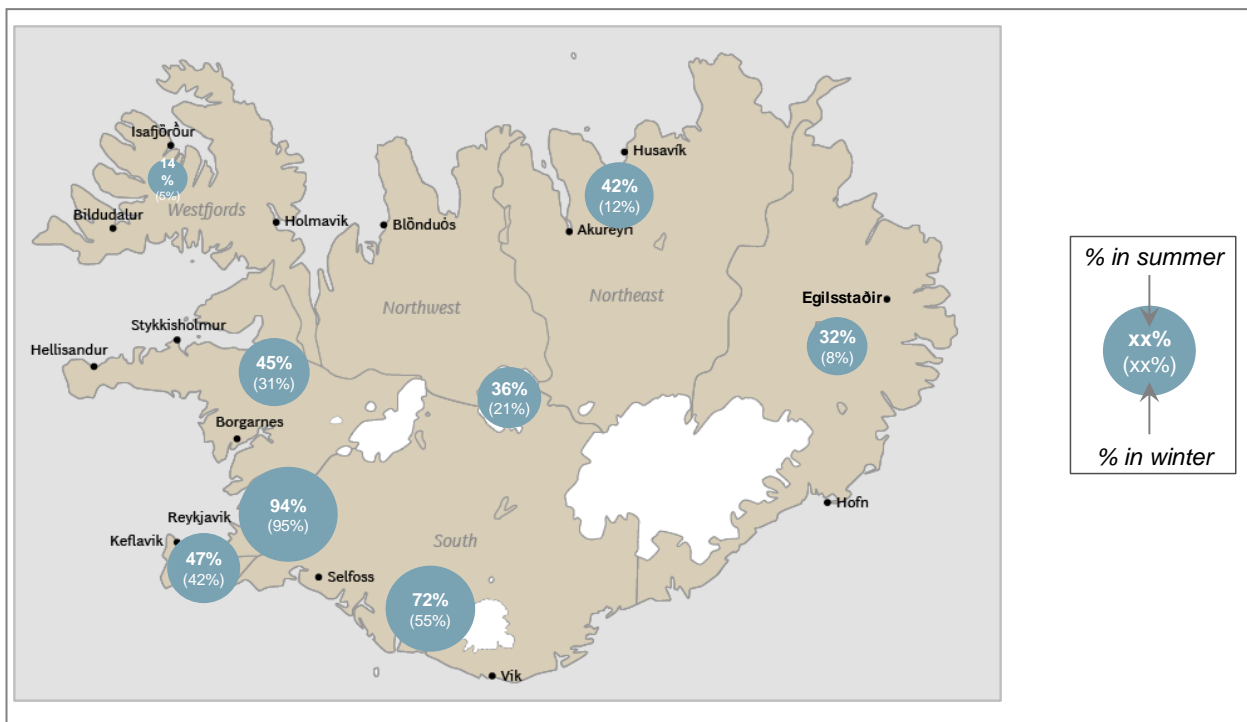
1.2013 projection based on data to August 15th 2013

Source: Isavia

### 1.4 Improving regional distribution

Icelandic tourism is strongly focused around Reykjavik and the South-West. Recent visitor surveys show that, while around 95% of visitors to Iceland spend time in Reykjavik, less than half visit the North, and only around a third make it to the East (see Exhibit 5). This is largely driven by the presence of Keflavik International airport in the region and the concentration of accessible, high-quality attractions in the "Golden Circle" of the South-West, the home to world-famous Geysir, Gullfoss and Þingvellir National Park.

Exhibit 5. Most visitors only experience southern and western regions of Iceland



Source: Icelandic Tourist Board: "Visitor Surveys Summer & Winter 2011/2012"

However, in the long term, avoiding an over-reliance on infrastructure in one part of the country, and driving a balanced growth of tourism across the country, can be achieved by: Identifying the visitors that are more likely to spend time outside the South-West; improving access to the regions (especially in winter); and developing new products in other regions. As with seasonality, Iceland has shown the potential to improve regional distribution. In 2012 the year on year increase in sold hotel nights outside the south-west was 44-51% while it was 8% in Reykjavik though it should be noted that the former is from a much smaller base.

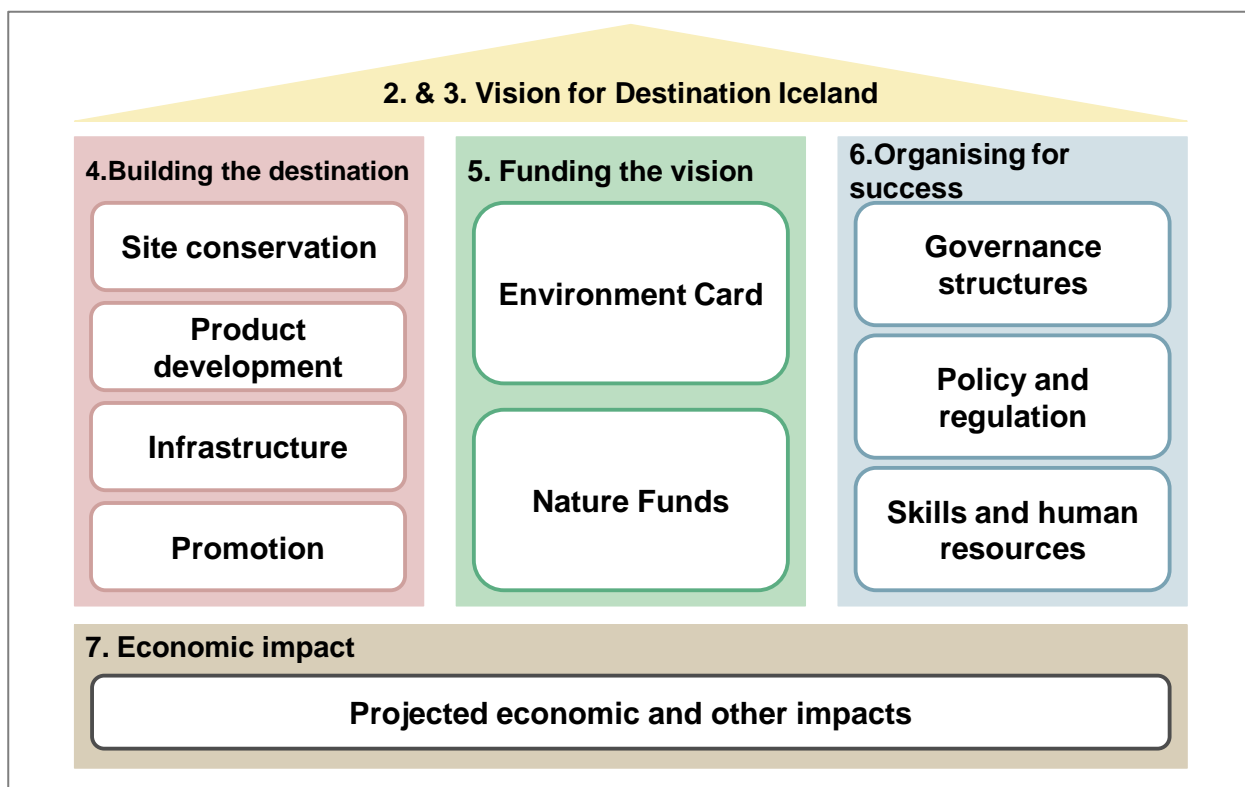


### 1.5 A contribution to the forward-looking strategy for Icelandic tourism

With the backdrop of growing visitor numbers, the challenges described above will only become more pressing. We are at a critical juncture in the evolution of Iceland as a tourism destination, requiring a well-considered long-term strategy that reconciles the goals of the Icelandic people with the evidence from international and local experience, and provides a feasible way forward that can achieve broad support.

This report attempts to lay out some ideas and evidence to support a new strategy for Icelandic tourism, focused on growing its contribution to the Icelandic economy in an environmentally manageable, socially beneficial way (Chapter 2). It identifies a narrow set of high-potential target segments that Iceland should pursue (Chapter 3). In order to achieve this vision, we have outlined a co-ordinated programme of activity based on three pillars (see Exhibit 6). In chapter 4 we explore the first pillar, "Building the Destination", defining a series of measures that should be put in place to attract target tourists to visit, to capture more value from them during their stay, and to minimise the impact of their visit on the nature they enjoy. Chapter 5 focuses on how to fund the necessary investments on a sustainable basis whilst Chapter 6 sets out a model for the public and private sectors to govern the growth of tourism and to coordinate the actions required to maximise its benefits. Chapter 7 delivers an evaluation of the potential economic impact that these measures could deliver. Finally, three annexes provide additional detail on methodology.

Exhibit 6. Key elements of an Icelandic tourism roadmap



Source: BCG analysis

As tourism numbers grow, the debate on Iceland's future tourism strategy will become ever livelier, with different groups calling for actions along common themes. As such, we do not pretend to hold the definitive solution. Rather, we seek to build on the existing canon of work.<sup>7</sup> We hope our contribution is useful and timely, that it brings new ideas and international experience to the table, and that it helps strengthen the resolve of public and private players to take decisive action in favour of managed, sustainable growth.

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<sup>7</sup> Including PKF's report in Feb 2013, "Long-term strategy for the Icelandic tourism industry" and the ten year strategy of the Icelandic Tourist Board

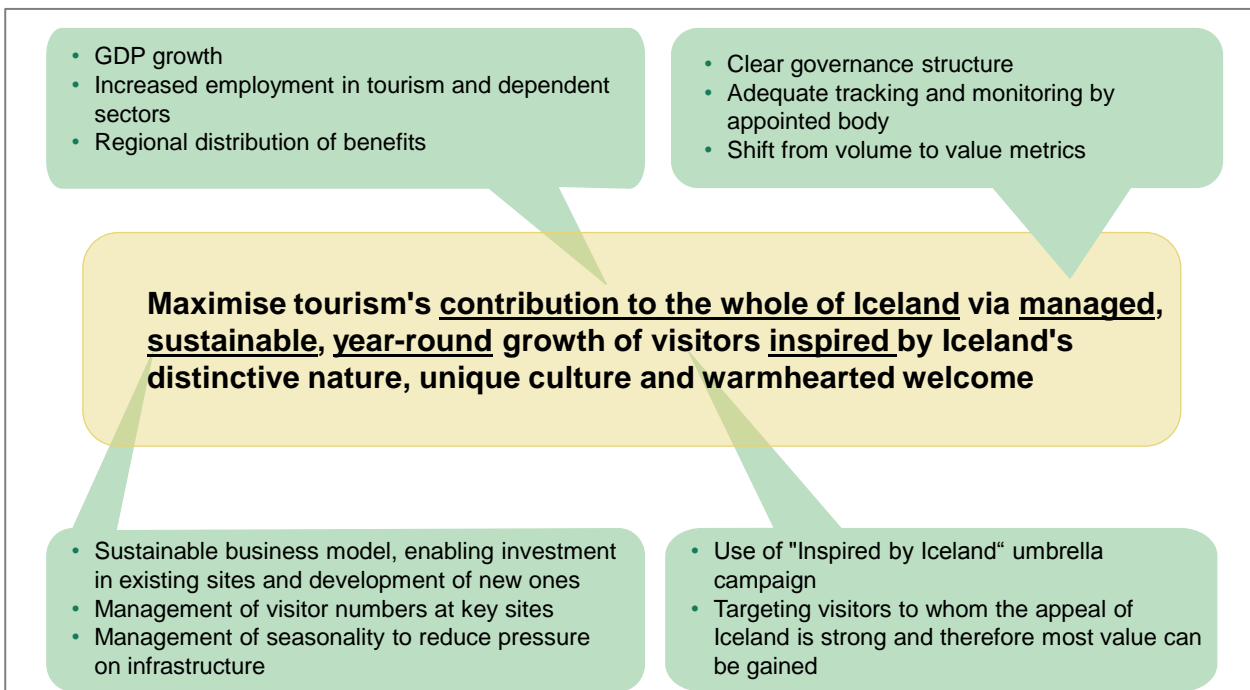
## 2. Aspirations for Destination Iceland

## 2. Aspirations for Destination Iceland

The first step to developing an effective strategy is to form a clear view of Iceland's aspirations for tourism over the next 10 years. Should it aim for volume or value? Should it aim to maximise total economic impact, an effective distribution across regions, or the long-term preservation of its natural environment? What kind of visitors should it seek to attract?

In the recent past, the implicit and explicit focus of tourism promotion authorities has been to drive growth in visitor numbers. For example, a key objective of the "Inspired by Iceland" campaign was initially to "rapidly increase visitor figures above forecast". In addition, the data published by Statistics Iceland and the Icelandic Tourist Board since 2009 has primarily focused on arrivals and overnight stays, rather than economic contribution. On volume growth, Iceland has been overwhelmingly successful, with arrivals growing by 9% year on year since 2002, more than doubling in a decade. This has transformed Iceland as a tourism destination and provided significant economic benefits during a difficult period for the country. At the same time, projections of continued rapid visitor growth have highlighted the challenges of welcoming large numbers of tourists: Preserving the natural environment; ensuring visitors contribute to Iceland; reducing seasonality; and improving the distribution of tourists around the country. We have, therefore, proposed vision focused on maximising value (see Exhibit 7).

*Exhibit 7. Proposed vision for the future of tourism in Iceland*



Source: Interviews with Icelandic tourist industry stakeholders, BCG analysis

Vision statements can be useful tools to rally a large number of disparate stakeholders around a set of common goals. In this way, our goal is for this vision, or a variation of it, to be adopted by

the full range of Icelandic tourism players, with one entity responsible for "owning" it and driving the translation of high level aspirations into tangible actions.

As part of this process, the words of the vision statement need to be translated into specific objectives with measurable targets, so that the entity with overall responsibility for delivering it can drive action and assess progress against defined milestones. The remainder of this section outlines a proposal for how this vision can be given tangible meaning in these ways.

### ***2.1 Translation of vision into objectives and targets***

We have defined the vision so that each component has a direct bearing on the Icelandic tourism industry's future actions:

#### **1. "Maximise tourism's contribution to the whole of Iceland..."**

This part of the vision shifts the focus from volume of visitors to their contribution to Iceland's economy, society and culture. It also highlights the inclusion of the country as a whole, rather than just Reykjavik and the South West, as beneficiaries of the strategy. Some potential objectives and Key Performance Indicators (KPIs) would be:

<b>Objectives</b>	<b>Key Performance Indicators</b>
Maximise benefits of tourism to Iceland's economy	<ul style="list-style-type: none"> <li>• Gross Value Add (GVA) of tourism sector</li> <li>• Employment in tourism Sector</li> <li>• Tourism contribution to tax receipts</li> </ul>
Improve tourism's regional distribution	<ul style="list-style-type: none"> <li>• % of Tourism GVA outside of Capital region and South West</li> </ul>

The targets in all cases would be set by a public-private Tourism Task Force (see Section 6), which would be responsible for embedding the objectives and establishing regular progress reporting against targets.

#### **2. "...with managed and sustainable growth of visitors..."**

The second component of the vision statement focuses on managing growth to reduce pressure on key sites and infrastructure and ensure the sustainability of Iceland's natural attractions.

Objectives	Key Performance Indicators
Reduce seasonality of tourist arrivals	<ul style="list-style-type: none"> <li>• % arrivals in Shoulder season (April-June and September-October)</li> <li>• % of arrivals in Winter season (November- March)</li> </ul>
Maintain or improve visitor experience at key tourist sites	<ul style="list-style-type: none"> <li>• Perceived congestion at key sites (measured via surveys)</li> <li>• Visitor satisfaction at key sites (measured via surveys)</li> </ul>
Ensure environmental sustainability of natural attractions	<ul style="list-style-type: none"> <li>• Results of regular third party reports on site sustainability</li> </ul>
Raise revenues to fund conservation and investment in new products	<ul style="list-style-type: none"> <li>• Revenues raised through visitor charging</li> </ul>

### 3. "...inspired by Iceland's distinctive nature, unique culture, and warm-hearted welcome"

The final part of the vision statement articulates the appeal of Iceland, and is intended to reflect a new emphasis on promoting Iceland to a more targeted set of tourist segments. These are the visitors who are most likely to contribute to Iceland, as well as those for whom the country has the greatest intrinsic appeal.

Objectives	Key Performance Indicators
Grow share of target segments in total visitor population	<ul style="list-style-type: none"> <li>• % visitors from target segments</li> </ul>
Improve mix of visitors towards those that contribute most	<ul style="list-style-type: none"> <li>• Average spend per visitor in target segments vs. non-target segments</li> <li>• Average stay length per visitor in target segments vs. non-target segments</li> </ul>
Develop Iceland's tourism product	<ul style="list-style-type: none"> <li>• Average visitor satisfaction with trip to Iceland (comparison of target and non-target segments)</li> </ul>

## ***2.2 Ownership of vision statement, objectives and targets***

For this vision to become meaningful, it will need to be owned and adopted by an entity with broad authority and widespread influence in the tourism sector. It will then need to be developed to the next level with specific numeric targets, which will be measured and published in a progress report on a regular (e.g., quarterly or half-yearly) basis.

We recommend that a Tourism Task Force, with participation from the public and private sectors, be set up to take on this task, as well as several other key coordinating functions. Our full recommendations for ensuring that the organisation and governance of Icelandic tourism are fit for purpose can be found in Section 6.

### 3. Iceland's target visitors

### 3. Iceland's target visitors

To achieve the aspirations in Section 2, Iceland will need to take action across three key areas: Development of tourism products; improvement of tourism infrastructure; and refinement of Iceland's destination marketing.

These actions will be led, financed, and executed by a very wide range of actors, including the government, large private companies, industry associations, banks, and a constellation of small and medium-sized tourism businesses, such as guest houses and tour operators.

Many of these organisations will need to make significant investments, which will only pay off if they are coordinated with the investment decisions of others in the sector. For example, a hotel firm developing new accommodation targeted at older tourists will rely on municipalities and private entrepreneurs developing cultural attractions that fit those visitors' needs. Both the hotel firm and the entrepreneur will, in turn, need support from the tourism promotion authority to market the destination to their target clients. With limited national marketing budget (see Section 4), it is important to focus efforts to maximise the impact of each dollar spent.

Conversely, without a clear focus on a small number of clearly-defined target visitor segments, the impact of Iceland's tourism investments could be significantly diluted. This risks improving Iceland's appeal by a small amount for many tourist types, but not enough to make a real difference on their travel intentions or their spend behaviours in the country. Indeed, the net result might actually bias growth towards less demanding budget-oriented travellers, who are unlikely to help Iceland achieve its goal of maximising tourism's contribution with the least environmental impact.

Instead, for Iceland's tourism strategy to succeed, it will need a clear consensus on a few key visitor types that it will most actively seek to attract.

#### 3.1 *What is a target visitor?*

We believe there are two characteristics that mark out Iceland's ideal tourists from others: First, how attractive these tourists are to Iceland; and second, the extent to which Iceland appeals to them.

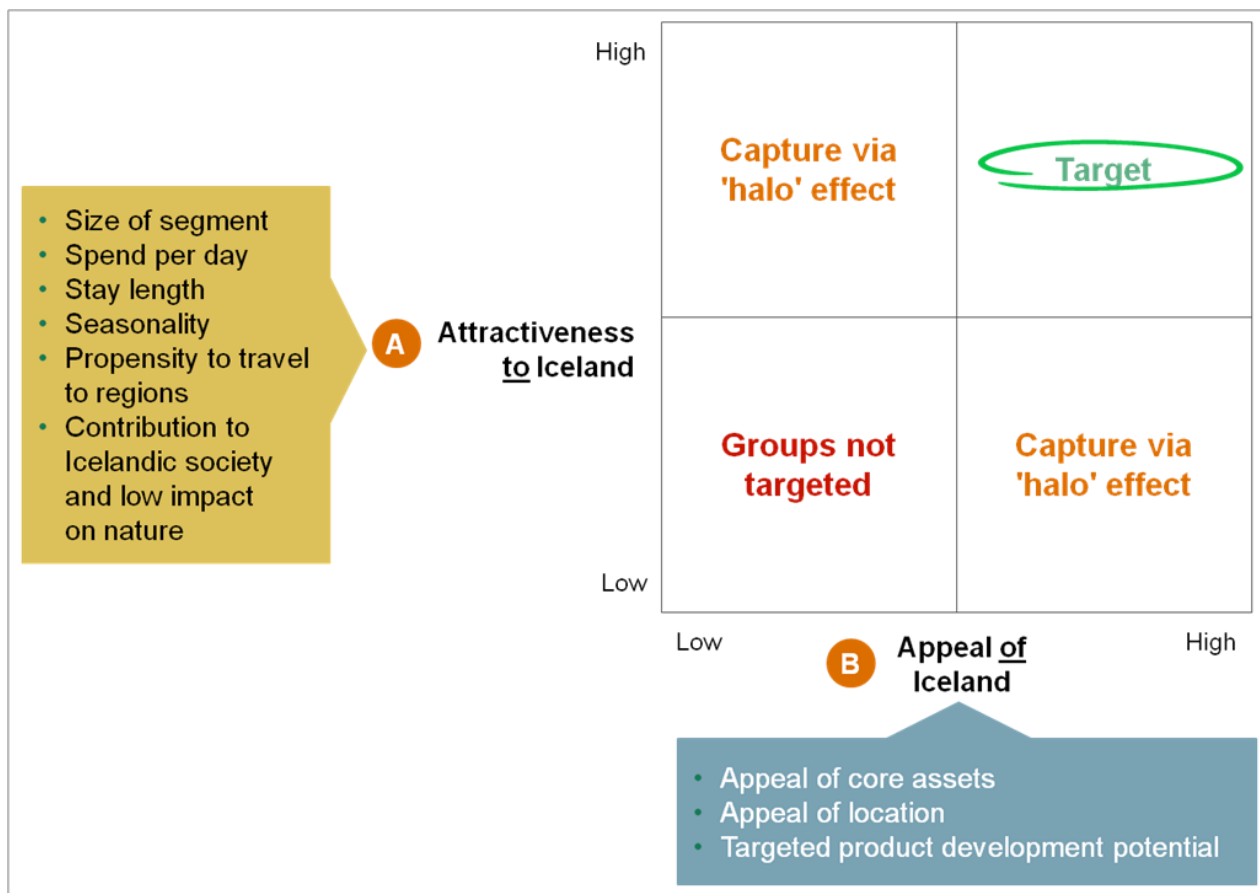
The attractiveness of a tourist segment is linked to the size and growth of that segment globally; their spend per day on Icelandic products and services; how long they typically stay; the regions that they visit (outside the capital area); and whether they travel to Iceland in summer or winter, with winter visitors more attractive than those who visit in peak months.



On the other hand, the appeal of Iceland is typically greatest to travellers motivated by discovering distinctive nature; experiencing Iceland's unique culture; and enjoying its authentic, warm-hearted welcome. Targeting visitors for whom Iceland has a strong intrinsic appeal requires much less marketing investment. It also leads to much better results when the visitor arrives, both in terms of the visitor's satisfaction with their trip, but also their willingness to stay longer, spend more, explore more of the country, and travel at different times of year.

Combining these two dimensions allows us to map different tourist segments on to a matrix (see Exhibit 8) with different actions to be taken for segments in different areas of the chart.

Exhibit 8. Segmentation of tourists by attractiveness to Iceland and appeal of Iceland



Source: BCG analysis

Segments that are both attractive to Iceland and for whom Iceland is appealing fit in the top right box and should be targeted by the tourism sector. Segments that fall into the other boxes are unlikely to contribute to the same extent as the target segments, so should not be a focus for product development or destination marketing. However, some of them will be inspired to visit Iceland anyway through the "halo" effect of the efforts that were intended for target segments.

### 3.2 Visitor segment analysis

We applied the logic described above to analyse 11 potential visitor segments, as well as a number of niche segments. All these segments visit Iceland today, though they vary widely in terms of numbers of visitors and behaviour. We have broadly defined the segments by four characteristics: What they are seeking from their trip, their age range, income level, and inbound market (where they come from). The 11 segments are described in the table below.

Exhibit 9. 11 potential visitor segments for Iceland

	Seeking	Age	Income	Inbound market
1 Older Relaxers	Culture/relaxation	50+	M+	Mature markets
2 Affluent Adventurers	Adventure	18-59	M+	Mature markets
3 Emerging Market Explorers	All types	All ages	All	Emerging markets
4 MICE	MICE	25+	M+	Mature markets
5 City Breakers	Culture/relaxing	25-49	M+	Mature markets
6 Health Tourists	Health/medical	35+	M+	Mature markets
7 Super Premium	All types	25+	H	All markets
8 Backpackers	Adventure	18-34	L	Mature markets
9 Budget Travellers	All types	All ages	L	All markets
10 Families	Mild adventure/culture	(lead adults) 25+	All	All markets
11 Cruise	Culture/relaxing	35+	M+	Mature markets

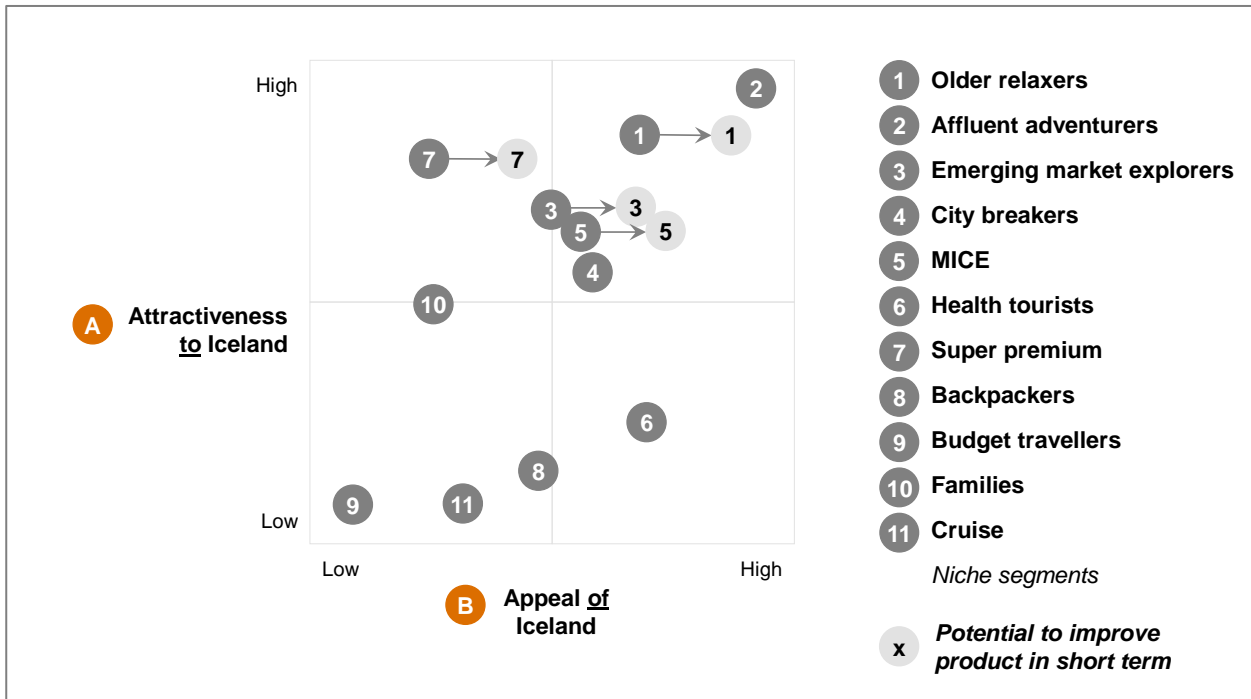
Note: MICE = Meetings, Incentives, Conferences, Events

Source: BCG analysis

To assess the attractiveness of these groups to Iceland, as well as the appeal of Iceland to them, we needed to understand both their current importance to Iceland (number of visitors and key behaviours), but also their *potential* if Iceland developed appropriate products for them to enjoy. We, therefore, conducted a full assessment of all 11 segments based on the available data on tourism in Iceland today, as well as extensive international benchmarks on the size, growth, behaviour, and preferences of these groups globally. The full results of our assessment can be found in Annex A.

To summarise our findings, we mapped the segments on to the matrix described above (see Exhibit 10). This shows not only where they sit today, but also how Iceland might become more appealing to them if it develops relevant products in the near term.

Exhibit 10. Map of visitor segments on to assessment matrix



Source: BCG analysis, Icelandic Tourist Board Visitor Survey Summer & Winter 2011/12, international databases (see Annex A)

Our assessment has highlighted five target visitor segments for Iceland in the next ten years:

- **Older Relaxers**
- **Affluent Adventurers**
- **Emerging Market Explorers**
- **City Breakers**
- **MICE**

**Older Relaxers** are a key segment globally and indeed are the largest of the defined segments in Iceland today. This age group, which runs from middle age to seniors, is a large and growing part of the population in Iceland's core markets of Western Europe and the US. They currently represent around 30% of the population in these markets and are expected to grow by between 20 and 25% by 2020, despite flat population growth overall in Western Europe and just 12% overall growth in the US.<sup>8</sup> Additionally, they spend above average amounts per day whilst in Iceland.

While Older Relaxers are very attractive visitors, Iceland is not currently focusing its marketing efforts on the segment. While this segment tends to prefer cultural activities to adventure tours,

<sup>8</sup> Forecast from Prognos

Iceland's advertisements abroad heavily emphasise the latter. Equally, the lack of indoor activities may deter some older travellers, especially in winter. The result is that Older Relaxers in Iceland today stay for less time than average in the country. For this reason, we have placed Older Relaxers firmly in the top right box of our matrix, yet with an arrow to the right to highlight the potential to improve Iceland's appeal to this important segment.

**Affluent Adventurers** are a clear target segment for Iceland and are the second largest of the defined segments today, according to our analysis of the Icelandic Tourism Board's Summer and Winter surveys 2011-12. These are the tourists who want to explore Iceland's distinctive nature, yet are also able to pay to add extra value to their visit. For example, instead of exploring a national park alone, they may hire a guide; instead of just viewing a glacier, they may pay to experience ice climbing or ice walking.

Affluent Adventure visitors stay in Iceland for longer than the average visitor. They tend to spend more, with soft adventurers spending around 40% more than mass tourists, according to international data sources. Finally, they are a fast-growing segment. Around 20-25% of travellers from developed markets are already "hard" or "soft" adventurers, and this looks set to rise to 30% in the near term.

At the same time, Iceland has a very strong appeal to this segment. It is consistently ranked in the top five adventure destinations of the Adventure Tourism Development Index, coming top in the latest report for the sub-category on "adventure activity resources". Iceland's mix of distinctive nature, expanses of untouched wilderness, and adventure sports are a powerful draw for visitor seeking an adventure holiday. The combination of Iceland's strong appeal with the attractiveness of adventure tourists makes this segment a key target for Iceland's tourism industry.

**Emerging Market Explorers** are currently a small segment in Iceland, driven by the distance of the largest emerging markets (China, India) from the country and the lack of direct air routes. However, emerging market tourism is also one of the key "mega-trends" in travel, with the leisure market from China expected to increase by a factor of five in the current decade. This growth is expected to comprise around 60% of all visitor growth into the EU. Iceland has recently seen evidence of this growth, with Chinese arrivals at Keflavik increasing by 69% in 2010/11 and 60% in 2011/12, albeit from a low base.<sup>9</sup> Equally, the opening of an Icelandair direct route to St Petersburg in June 2013 can be expected to have a rapid impact on visitor arrivals from Russia in the coming months.

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<sup>9</sup> "Tourism in Iceland in Figures" (Icelandic Tourist Board, April 2013)

Aside from growth, Emerging Market Explorers are attractive because of their high spend per day in Iceland. Today in Iceland, they spend around 50% more per person per day than the average tourist. However, the segment's stay length is typically shorter than average, reflecting in part the tendency of Chinese tourists (a significant portion of this segment) to visit several countries during a single trip. This characteristic highlights the opportunity for Iceland to join forces with other Nordic countries and/or Greenland to promote multi-country trips including Iceland.

In terms of Iceland's appeal, there is a moderate fit today with the Emerging Market Explorers segment. In particular, the "experienced" emerging market traveller, looking to visit new places and enjoy both sightseeing and relaxed entertaining, has a reasonable match with Iceland's offer. Additionally, Chinese travellers are less likely to travel with children, which fits with Iceland's current positioning, and with the positioning advocated by tourism stakeholders in our Capacent survey. We believe, however, that there is potential to improve Iceland's appeal to this segment through targeted product development. For example expanding the shopping proposition could appeal to Chinese visitors who have a strong gift-buying culture and seek unfamiliar brands, allocating a much larger proportion of travel spend to shopping than average.

Our Capacent survey of Icelandic tourism stakeholders showed a striking polarisation of views on the importance of emerging market travellers. Nearly a third of respondents believed that Asia should be Iceland's top or second top focus for future visitors, whereas another third believe Asia is the least important market for Iceland to tap into. This polarisation suggests Emerging Market Explorers are unlikely to be Iceland's top targets in the coming years. Nonetheless their high growth rates both in Iceland and globally, as well as their attractive spending characteristics, make them an important part of Iceland's future visitor mix.

**City Breakers** represent ~10% of all overseas trips and are growing at approximately 3% per year, according to data on short breaks from the UK, Iceland's strongest market. Their most attractive characteristic is their reduced seasonality, since they are both less dependent on weather conditions and more likely to be driven by the timing of national holidays (rather than the long summer break). Additionally, they spend about 50% more per day in Iceland currently compared to the average visitor.

Reykjavik is a relatively appealing city break destination, given its cultural heritage, lively restaurant scene, calendar of events, and proximity to key attractions in the Golden Circle. However, it is also a relatively expensive location, higher even than London according to one source.<sup>10</sup>

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<sup>10</sup> Post Office 2013 City Costs Barometer

**MICE travellers** are those visiting Iceland for business purposes (Meetings, Incentives, Conferences and Events). The segment is comprised of business travellers, typically on higher incomes, and generally from mature markets.

The MICE segment is attractive to Iceland given their much higher spend per person than other visitors. Although MICE travellers are unlikely to spend time outside the South-West, events are held year-round. Therefore, attracting more MICE travellers could be an important driver of reduced seasonality. Whilst this segment is still in its infancy in Iceland, several recent developments have improved Iceland's appeal, such as the building of Harpa Conference centre in 2011 and the foundation of "Meet in Reykjavik" in 2012.

In addition to the five target segments described above, two other groups will be important for particular parts of Iceland's tourism sector. The first is domestic visitors (Icelanders travelling in Iceland), who can contribute significantly to reducing the regional and seasonal concentration of tourism. The second is a series of niche segments that could be attractive to, and interested in, Iceland, but are too small to be considered as targets for the entire tourism sector. These include educational tour groups, music festival enthusiasts, Gays and Lesbians, amongst others. Specialist events and festivals have already been established in Iceland targeting these groups, providing a solid base for further product development.

Concentrating the efforts of the tourism sector on the target groups identified in this section represents, in our view, the best way to serve the goal of "maximising the contribution of tourism to the whole of Iceland". The next section of the report, *Building the Destination*, is focused on the actions required to attract these visitors to the country, engaging them once they arrive, and minimising their impact on the natural environment.

## 4. Building the destination

## 4. Building the destination

As stated above, achieving Iceland's aspirations for tourism rests on three pillars: Building an attractive, sustainable destination; funding the vision; and organising for success. This section focuses on the first of these pillars.

There are four key elements to building up a tourist destination:

- **Promotion** of the destination to target visitors, primarily in their home countries
- **Product development** to engage them once they arrive in the country
- **Infrastructure** to enable them to access and enjoy the country's attractions
- **Site conservation** to mitigate any damage caused by tourists to the sites they visit

### 4.1 Promotion

International promotion is critical to the development of tourism. Our survey of tourism stakeholders in Iceland showed 96% of respondents rate tourism marketing and distribution as "important" or higher. This percentage is larger than any other factor bar a coherent government policy and regulatory framework.

Since 2010, Icelandic tourism promotion has been led by Promote Iceland. Its "Inspired by Iceland" campaign, launched in 2010, has successfully cut through the mass of tourism marketing messages internationally, despite a relatively low budget, to win some prestigious advertising awards, including at Cannes Lions.

The campaign, originally designed as a response to Eyjafjallajökull's eruption, had three objectives; to increase visitor numbers; to reverse negative opinion around Iceland; and to drive consideration and show Iceland is a safe place to visit. All three goals have clearly been met, given the dramatic rise in tourism in the recent past. In the process, it has also shown some positive results on reducing seasonality, with significantly higher growth in winter 2012/13 than is anticipated for this summer.

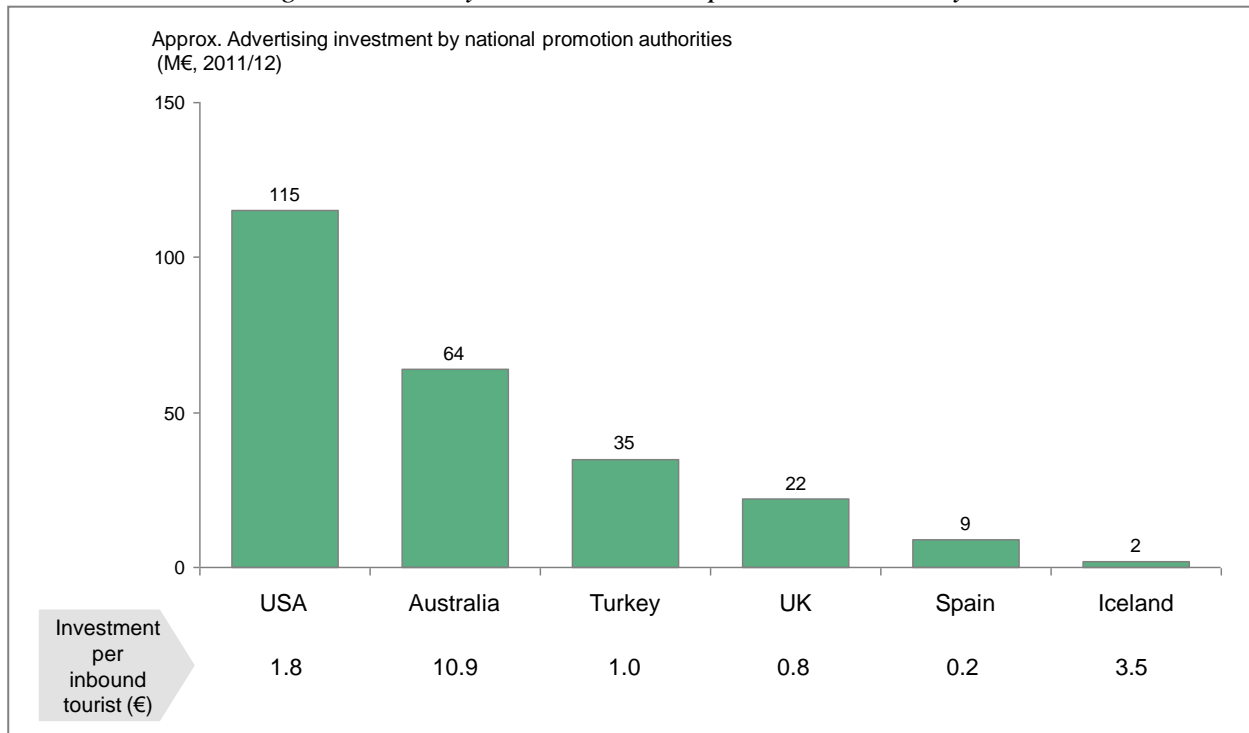
Given the shift in ambition from volume to overall contribution, Iceland's tourism promotional activities will need to more clearly focus on a narrow group of target segments that are both attractive to Iceland and for whom Iceland has an intrinsic appeal. These were identified in the previous section as Older Relaxers, Affluent Adventurers, Emerging Market Explorers, City Breakers and MICE.

The need to prioritise marketing spend is one of the major reasons why a segmented approach to target visitors is so critical. This is especially the case for Iceland, whose limited advertising



budget has to compete with the giant national promotion authorities of the US, Australia and even Turkey for poster space in the London Tube or a page in the New York Times travel section. Exhibit 11 shows the gap between Iceland's tourism advertising investment and that of some other major promotion authorities.

*Exhibit 11. Advertising investment by national tourism promotion authority*



Source: Tourism Review, CreativeBrief.com, CampaignLive.com, Australia Sunday Morning Herald Business Day (2012), World Bank International arrivals data (2011)

As shown in the current "Inspired by Iceland" campaign, one approach to maximising the impact of limited spend is to use selective, high-engagement channels, such as social media. Social media is increasingly effective even among the Older Relaxer segment. One survey showed use of social media by over 65s grew 150% between 2009 and 2011, albeit from a relatively low base.<sup>11</sup> Social media is particularly effective in cases where users have a high emotional attachment to the product, as many former and potential tourists have with Iceland, and where the Internet is a key medium of choice for consumers, which is more likely to be the case for travel products.

Aside from international promotion, one other important role for tourism promotion is to advocate for tourism internally in the receiving country. An especially strong example of this is Singapore's "4 million smiles" campaign. This campaign had the dual purpose of highlighting the beneficial impact of tourism on Singapore's economy and society, while also encouraging the local population to offer a more positive welcome to its visitors. Alongside a traditional advertising

<sup>11</sup> "Older Adults and Internet Use" (Pew Internet, 2012)

blitz, the campaign included a competition for Singaporeans, involving submitting an image of their smile to a website, and a guide book plus training for taxi drivers.

Building on the "Inspired by Iceland" campaign with targeted promotion, both externally to target visitors and also internally, is a key tool for Iceland to achieve its future tourism vision.

#### **4.2 Product development**

Iceland has a range of world-class attractions for visitors to enjoy, from the Golden Circle and Blue Lagoon in the South-West, hiking and stunning scenery in the West and Westjords, whale watching and world-class waterfalls in the North, the Lagarfljót Wyrm and reindeer of the East, and the National Parks of the South, as well as the Northern Lights island-wide.

This is an exceptional base of assets for Iceland to build on in developing an attractive offer for its future target visitors. However, there are opportunities to better manage and develop existing assets, while also building up new attractions for visitors to enjoy.

**Developing existing attractions.** There are two key areas where Iceland could improve its use of existing assets. Firstly, it could better manage the flow of visitors to and around popular sites, reducing possible congestion at peak times and enhancing the visitor's experience. The second area for improvement is in developing a more comprehensive, engaging offer for visitors.

Currently, some of Iceland's most popular tourist sites hold visitors' attention for no more than 30 minutes to an hour. For example, a typical visit to Gullfoss might consist of a walk down the path from the car park to the lower viewing areas (20 minutes with photos); a walk to the higher viewing areas (20 minutes with photos); and a potential visit to the shop and cafe (0 – 30 minutes). Of course, it is possible to spend more time at the site if the visitor is willing to linger at the viewing points or in the cafe. However, the average tourist may wish that there was more opportunity to engage in activity while admiring the extraordinary falls.

#### **HOW THE DEAD SEA ENGAGES VISITORS**

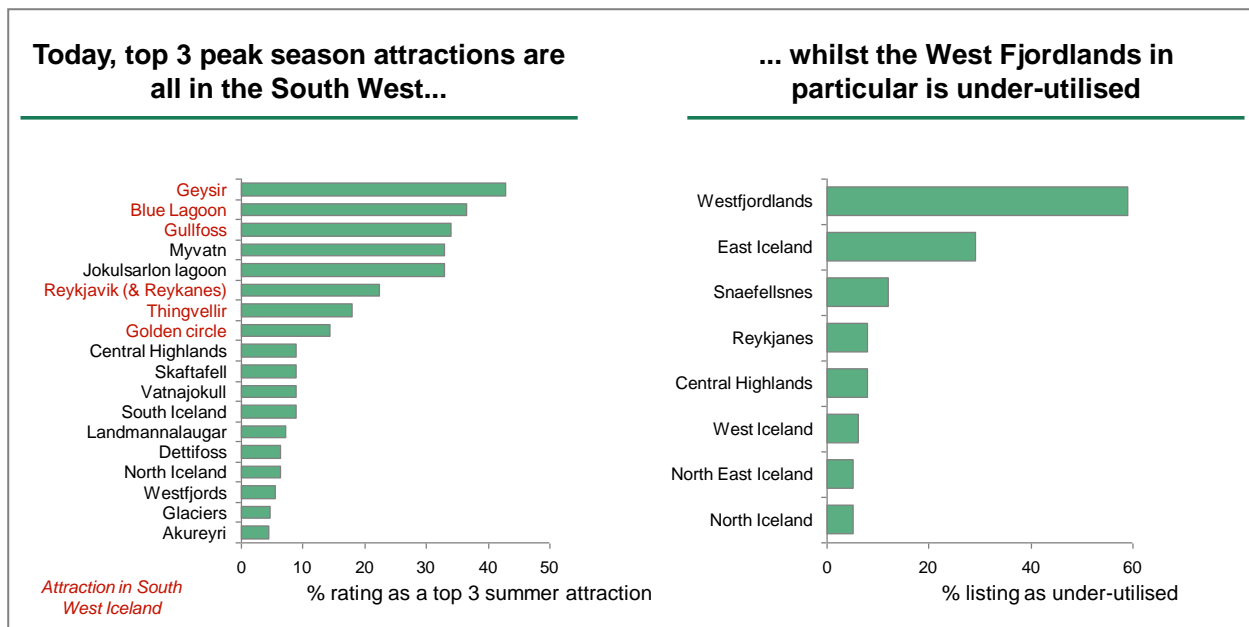
The Dead Sea provides an interesting contrast to Iceland's major natural attractions. On the one hand, the Dead Sea has a fairly limited natural offer. Without peripheral services, the core focus is the activity of floating in the water, which has the dual appeal of being a unique physical experience while also offering wellness benefits because of the sea's mineral content. With temperatures regularly climbing above 40 degrees Celsius, however, the recommended maximum floating time is just 10 minutes. Even adding time to purchase and cover yourself in the famous Dead Sea mud, the whole experience lasts barely an afternoon.

Despite this, the average stay at the Jordanian side of Dead Sea is 2.7 days, as compared with just

1.9 days at Petra, Jordan's most famous tourist attraction. This results from a major development of the area by tourism companies, building up hotel resorts that offer both private access to the Sea, but also a full range of complementary activities, including sports, spas, food options, and evening entertainment. As a result, instead of being a stopping point on a day trip, the Dead Sea is a key part of some visitors' holidays, generating significant revenues and supporting a sizeable tourism industry. Developing a set of activities *around* a tourist attraction can, therefore, be as important as the quality of the attraction itself in determining an area's ability to generate value from its assets.

**Building up new attractions.** All regions in Iceland are endowed with inspiring natural assets. However, most visitors experience only those that are located in the capital region and South-West of the country. The responses from our Capacent survey showed that most of the top attractions are in the South-West, whereas the most under-utilised areas of the country are the Westfjords and East Iceland (see Exhibit 12). Of course this is a function of both distance from Reykjavik and Keflavik International Airport and also the challenge of travelling. Despite this, developing new clusters, like the Golden Circle/Reykjavik group of attractions accompanied by improved access, in other regions will encourage greater distribution of tourists to less-visited parts of the country.

Exhibit 12. Icelandic stakeholder survey shows concentration of attractions in the South-West



Note: Does not included 'other' category, or Northern lights since Northern lights are not location specific  
 Source: Capacent survey of Icelandic tourism industry stakeholders, May 2013

Aside from these benefits, more products enable the country to welcome increased numbers of visitors without damaging the environment or tourists' experience of natural sites.

Iceland is full of ideas, big and small, and many of them are being developed into attractions in different parts of the country. There are numerous ways to evaluate this progress and we propose a structured, three-step approach to both generating ideas for new attractions and then prioritising the ones that should be funded and built:

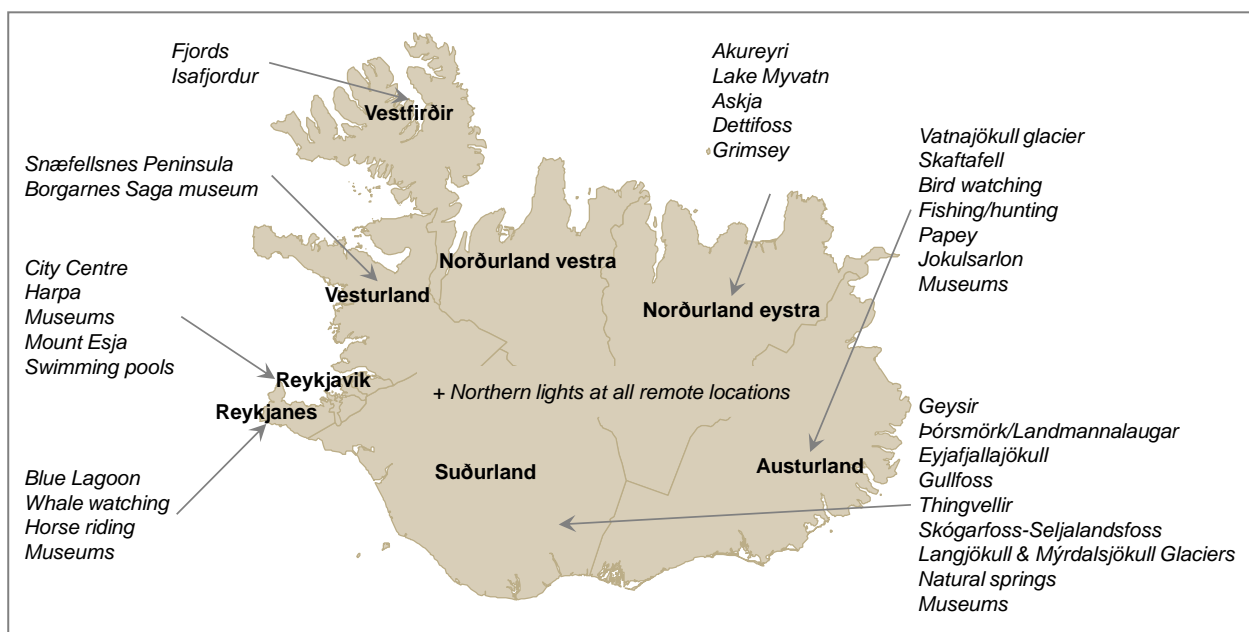
1. Identify assets/sites with potential to draw more visitors
2. Brainstorm ideas for new attractions
3. Test ideas through seven filters to select projects for funding, including the project's appeal to our identified target visitors, the site's accessibility, its potential to attract visitors in winter, and its fit with the broader Icelandic tourism vision and brand.

We recommend that it be incorporated into the investment criteria by the government, entrepreneurs, companies and investment funds alike for any future tourism investment funds (see Section 5). The box below shows an example of how this approach could be applied in the case of a generic Icelandic glacier.

### **APPLYING THE PRODUCT DEVELOPMENT APPROACH TO AN ICELANDIC GLACIER**

**Step 1.** As a starter for step one, we have identified, with the help of Iceland Travel and others, a number of sites across the country that could be used as a basis for further tourism attractions (see Exhibit 13).

*Exhibit 13. Examples of key sites across Iceland with potential to draw more visitors*



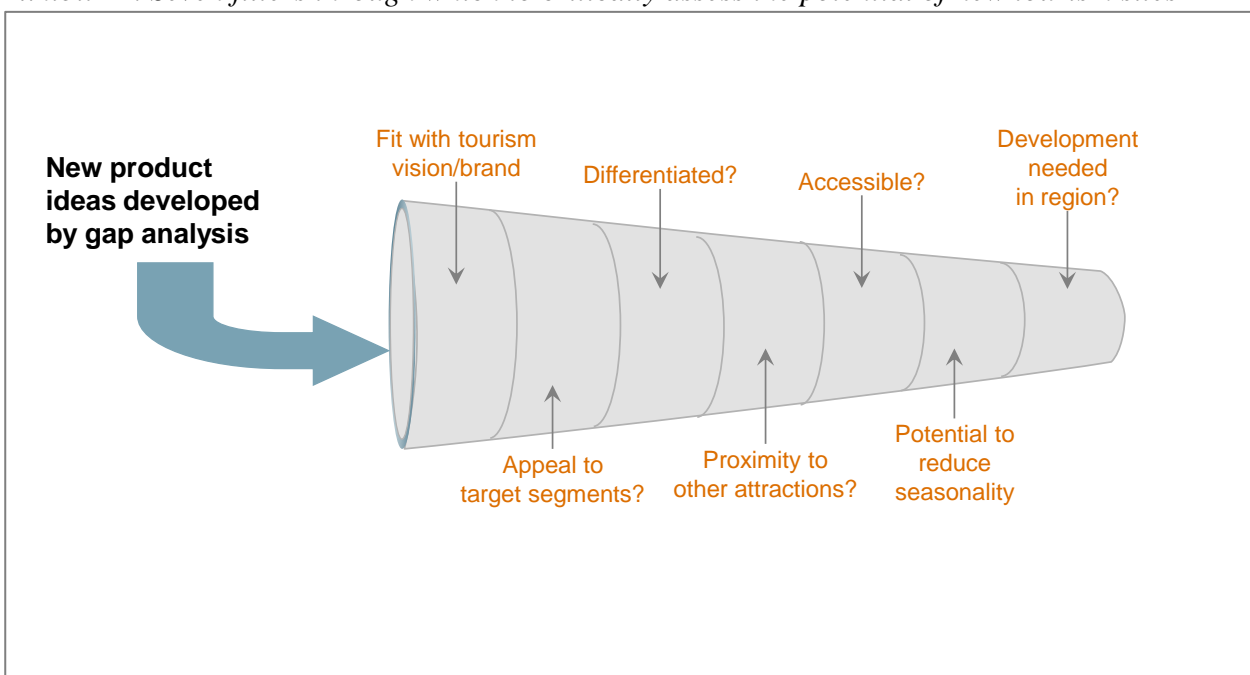
Source: Iceland Travel, interviews with Icelandic industry players

**Step 2.** As an example, we conducted a brainstorming exercise to generate ideas for product development at Langjökul glacier located around 3-4 hours outside of Reykjavik. Drawing from international examples of glacier-related activities, as well as a creative brainstorm, we identified eight ideas for potential products at the glacier:

1. Mass market ice cave
2. Exclusive ice cave
3. Mid-market ice cave
4. Ice climbing
5. Ice walking
6. Viewing platform
7. Glacier museum
8. Snowmobiling

**Step 3.** We then tested each of these ideas against seven filters (see Exhibit 14).

*Exhibit 14. Seven filters through which to critically assess the potential of new tourism sites*



Source: BCG analysis

For example, applying the first filter to idea 3 (mid-market ice cave) would suggest the product would be a good development to explore further. The fit with the vision for Icelandic tourism is strong since the ice cave adds value to a visitors' experience of an asset. The appeal is expected to be strong for Affluent Adventurers and MICE visitors, both of whom seek new experiences. Meanwhile supplementing visits with opportunities to learn about ice cave formation, for example, could be expected to appeal to Older Relaxers. Whilst the glacier is more than 3 hours

from Reykjavik, it is easily accessible by road and its proximity to other attractions would add to the appeal for City Breakers and Emerging Market Explorers. Finally a large ice cave is differentiated and the South remains under-developed versus the South West.

By contrast, creating a viewing platform alone, without other activities on offer, would meet an immediate challenge. It would not appeal to Affluent Adventurers, since it lacks an active component, but it also does not sufficiently fit with the Older Relaxer preference, since this segment prefers a cultural or educational experience. The strongest fit may be with Emerging Market Explorers, who are keen to pack in as many sites as possible into their trip. However, the distance from Reykjavik reduces the appeal to this segment, as is the case for City Breakers. Based on our assessment, therefore, the idea falls at the second filter.

Of course this example is a thought-exercise. However, in a real example, we would recommend the use of targeted consumer research for all high potential ideas.

This example highlights again the importance of focusing new products on a narrow group where there is a strong fit, rather than a broad set of segments for whom the product has relatively weak appeal.

### 4.3 Infrastructure

A common concern around the growth of Iceland's tourism sector is the pressure that these visitors are placing on the country's infrastructure. There are four types of infrastructure that will be most affected:

- **Hotels** and other accommodation
- **Airports**, in particular Keflavik, the point of arrival for most visitors to Iceland
- **Site facilities**, such as signage, toilets and parking
- **Basic social services and infrastructure**

In almost all cases, the main driver of infrastructure demand in future will be either visitor numbers (relevant for the airport and sites), or overnight stays (which is more important for hotels and basic social services). However, the seasonality of tourism will also be a key factor, since infrastructure, from airports to paths around tourist attractions to social services like the police, is most stressed at peak periods. On any given day in July 2012, there were up to 35,000 international visitors in Iceland. This represents an increase in the country's population of around 6%, putting significant pressure on infrastructure at this time of year.

**Hotels.** Most of the hotel and guesthouse accommodation in Iceland is in the capital region and the Southwest of the country, with approximately 4.4 thousand rooms in 2012, just over 40% of rooms across the country. Despite this, the Capital and Southwest also benefit from the highest

occupancy rates and the lowest seasonal volatility. In 2012, room occupancy in July in the Capital region reached 91%, compared with peak month occupancy of 78% in the South and 56% in the Northwest. In the critical shoulder season, from March to May and September to November, the Capital region maintained occupancy rates above 60% in each month versus occupancy as low as 7% in the Northwest in March and 20% in the Northeast in the same month.

Based on our forecasts on visitor numbers, regional distribution, and seasonality, we have projected the number of hotel rooms that will need to be built by region over the next decade. We estimate that around 5,700 new rooms will need to be built, half as much again as exist today, of which around 60% will be needed in the Capital and Southwest. While this increase is lower than a simple projection of visitors numbers would suggest, based on reduced seasonality and increased regional dispersion, it will nonetheless require significant investment in the next 10 years.

**Airport.** Keflavik airport has, at most times of day and for much of the year, sufficient spare capacity to handle a large increase in visitor numbers to Iceland. However, as a result of Iceland's geographic position and Keflavik's use as a hub, it experiences a set of two very sharp intra-day peaks, from around 6.45am to 7.45am and then again from 4pm to 5.30pm. These "banks" represent the times that most airlines prefer to land or take off, based on convenient take-off and landing times at their origins and destinations in Europe and North America. For example, an Icelandair flight taking off at 20h40 from Dulles airport, Washington, D.C., will land in Keflavik at 6h20, in time to take off again during the morning "bank".

Maintaining these banks is essential to be able to offer short connection times to passengers. A side effect, however, is that Keflavik is becoming increasingly congested at specific times of day during the summer months. This, and other factors, implies Isavia will need to invest in expansion over the next 10 years.

**Site facilities.** Infrastructure at sites was highlighted by tourism stakeholders through our Capacent survey as a key priority for future investment. 65% of respondents rated infrastructure at tourist sites to be the key priority for improvement, above roads, airports, and ports.

As discussed in the previous section on product development, there is an opportunity to develop existing sites with more engaging attractions and activities. However, at a more basic level, there is also a need to invest in facilities such as parking, signage, and toilets. The cost of these facilities is typically not very high. The greater challenge is ensuring they are staffed and maintained on an ongoing basis. While we discuss potential solutions fully in section 5, we recommend that facilities are, wherever possible, linked to the development of a new revenue stream. For example, investment in improved parking could be linked to parking charges. Construction of a visitor

centre could be linked to attracting more visitors and encouraging them to pay for value-added services at sites.

The main exceptions to this approach would be where facilities are required primarily for conservation purposes or for the development of tourism in a less-visited part of the country. In the latter cases, there may be a gap of several years between the timing of the investment and any future opportunities to generate revenues. The rationale for investing would therefore hinge on a broader social benefit argument. For example, if a regional tourism authority outside the South-West were to develop a 5-year plan for site and infrastructure development that required a subsidy to be financially viable, this would be a strong candidate for funding. All investments must meet a test of achieving long-term sustainability. Otherwise, the up-front funding risks being wasted as newly-built facilities decay over time.

**Basic social services and infrastructure.** As seen above, Iceland's population is up to 10% higher on any given day in July as a result of tourism. All these people will need service from the police, care from hospitals, access to roads, collection of waste, and all the other services provided in a well-functioning society. As tourism numbers grow over the next ten years, the growth in the temporary population will need to be explicitly provided-for by national authorities responsible for services and infrastructure.

As an example, Iceland's network of roads is cleared in the snowy winter months by the ICERA, or Roads Administration. The Administration services approximately 80% of the country's road network in winter to a greater or lesser extent, leaving only rarely-used highland roads completely inaccessible. However, of the roughly 10,500km of road that is serviced, much of this network, including some key roads along the South of the country, remains challenging to use, especially for tourists without very large, powerful vehicles. As tourist numbers rise, and new sites in different parts of the country promote themselves as winter attractions, the Roads Administration will need to expand its service levels to enable access.

As will be discussed in Section 6 (Organising for success), we recommend that a Tourism Ministers Council takes responsibility for coordinating the development of basic infrastructure to meet the needs of future visitors, as well as those of the Icelandic population.

#### ***4.4 Site conservation***

The final component to building tourism in Iceland is environmental conservation of natural sites. This serves two goals: First, it ensures that the Icelandic tourism sector remains a responsible user of the country's important natural resources - an important goal in its own right; second, it ensures the long-term sustainability of the tourism economy. This is particularly important for a destination such as Iceland, whose appeal is rooted in its natural beauty.



There are two main approaches that have worked effectively at sites internationally to mitigate these against congestion and damage to the natural environment:

- **Manage visitor flow to and around sites**
- **Restrict visitor numbers** either directly, limiting the number that can enter a site, or indirectly, by restricting nearby accommodation or tour operator traffic

**Manage visitor flow to and around sites.** Managing visitor flows can mitigate against environmental damage and congestion. International experience shows that a range of often low-cost measures can make a dramatic impact on the ability of sites to sustain much larger traffic, some of which could be applicable within Iceland. A summary of these measures is provided in Exhibit 15.

*Exhibit 15. Measures to manage visitor flow to and around sites*

	Measure	International Examples	Measure details	Potential application to Icelandic sites
Manage visitor flow <u>to</u> site	a Advance tickets with controlled time slots	<ul style="list-style-type: none"> <li>• Last Supper, Milan</li> <li>• FastPass, Disney</li> </ul>	<ul style="list-style-type: none"> <li>• 15 mins max viewing time</li> <li>• Pass to get specific slot for rides with long queues</li> </ul>	<ul style="list-style-type: none"> <li>• Geysir</li> <li>• Jökulsárlón</li> </ul>
	b Developing wider area (incl. visitors centre)	<ul style="list-style-type: none"> <li>• i-SITES, NZ</li> <li>• Acropolis, Greece</li> <li>• Stonehenge, UK</li> </ul>	<ul style="list-style-type: none"> <li>• Films, lectures, info boards</li> <li>• New museum</li> <li>• Wider neolithic landscape marketed to visitors</li> </ul>	<ul style="list-style-type: none"> <li>• Þingvellir</li> <li>• Skaftafell</li> <li>• Lake Mývatn</li> </ul>
Manage visitor flow <u>through</u> site	c Increasing perimeter of visit	<ul style="list-style-type: none"> <li>• Stonehenge, UK</li> </ul>	<ul style="list-style-type: none"> <li>• Ropes added to increase capacity of site, protect stones</li> </ul>	<ul style="list-style-type: none"> <li>• Gulfoss</li> </ul>
	d One-directional flow	<ul style="list-style-type: none"> <li>• Milford Track, NZ</li> </ul>	<ul style="list-style-type: none"> <li>• Limited no. walkers in same direction</li> </ul>	<ul style="list-style-type: none"> <li>• Laugavegurinn trail</li> </ul>
	e Site design (e.g., signage, boardwalks)	<ul style="list-style-type: none"> <li>• US National Parks</li> </ul>	<ul style="list-style-type: none"> <li>• Boardwalks and signposts to stop meandering</li> <li>• Trees and creeks to maintain sense of isolation</li> </ul>	<ul style="list-style-type: none"> <li>• Skógar trails</li> <li>• Hveragerði springs</li> </ul>
<b>Which of these are most relevant for Icelandic sites?</b>				

Source: Web search of tourism examples, BCG analysis

**Restrict visitor numbers.** This more intrusive approach is primarily used in circumstances where the natural site is at high risk of damage. For example, the Rwandan government operates a permit system for visitors looking to see their famous mountain gorillas. Only 30 permits are distributed per day, with the cost per permit set at \$750. Similarly, at Machu Picchu, only 400 people are allowed each day to climb the Huayna Picchu peak, with entry restricted to two time slots.

A less directive approach has so far been taken by the authorities around Ayers Rock in Australia, who have attempted to reduce the number of tourists choosing to climb the sacred site. Educational materials have been created and distributed so that visitors understand the cultural, safety, and environmental rationale to resist the temptation to climb. The impact has been a marked reduction in the proportion choosing to ascend to the peak, from around 74% in 1990 to around 20% in 2012.

This approach is applicable at sites in Iceland such as snorkelling and diving in Silfra fissure or entering the Thrihnukagigur volcano.

This section, Building the Destination, has highlighted a wide range of actions that will be required to attract Iceland's target visitors and achieve its ambitious tourism aspirations over the next decade: Targeted promotion; focused product development; expanded infrastructure; and improved site conservation.

Each of these areas of activity will require significant investment over an extended period of time. In the next section, we focus on identifying a funding source for this investment that is sufficient, stable and sustainable over the next decade or more.

## 5. Funding the vision

## 5. Funding the vision

Building up Destination Iceland will require a large amount of capital investment each year for the next ten years. We estimate that around ISK 13Bn of public and private investment will be needed this year, rising to ISK 21Bn in 2023.<sup>12</sup> Much of this will be funded by private companies, either from their existing reserves or from privately-raised bank or equity finance – for example for hotel and airport investments. However, a significant proportion, which could amount to more than ISK 7Bn in 2023, would need to be funded either by taxation or through a new revenue source. In this section, we review the options to meet this gap, with a particular focus on the idea of an Environment Card paid for by visitors to gain access to Iceland's top 30 natural sites.

Of course, tourism already makes a major contribution towards government revenues through direct and indirect taxation. We estimate that tourists will pay around ISK 17 Bn in direct taxes in 2013 (ISK 27 Bn including indirect contributions), which is equal to ISK 120,000 contribution by every household in the country. This is a major revenue source, comparable to the roughly ISK 35 Bn raised each year by taxes on corporations and legal entities.

Nevertheless, during our time in Iceland, no single point came out more strongly from our discussions with tourism stakeholders, our review of the data, and the survey that Capacent conducted on our behalf, than the need for new revenues to fund investments in the tourism sector. One focus group participant said: "I think that every cent we spend to strengthen the infrastructure at sites will be well spent". Capacent reported that the need for new revenues was almost universally accepted within the industry.

At the same time, there is a strong view that these new revenues should not be provided from general Icelandic tax income. If taxes were raised on Icelanders, this would create an additional burden for Icelandic citizens. If it relied on taxes raised from tourism, it would make Iceland dependent on a relatively unstable and uncertain revenue stream, varying according to economic conditions and political imperatives. Funding investments directly from taxation would encourage rent-seeking behaviour by tourism sector players, whose incentive would be to play to a political audience rather than build up an effective case for their projects. Finally, taxation offers no link at all between payment and enjoyment (inconsistent with the "user pays" principle) or between the performance of visitor attractions and their income, providing no incentive for sites to generate results on their investments or even to undertake major projects at all.)

Therefore, future revenues will need to be raised using a new mechanism. We recognise that the form of this mechanism is a source of much debate in Iceland today. We have, therefore, aimed to follow a structured, logical, evidence-based approach to reach our conclusions.

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<sup>12</sup> Around 80% of this will be spent on hotel developments – both new builds and refurbishments - and investments in new and existing visitor sites. Around ISK 1.5Bn per year will be needed to invest in capacity at Keflavik airport. Finally, capital investment will be required in basic services such as sewerage and telecommunications to serve higher numbers of tourists.

## 5.1 A new mechanism to raise revenues for tourism investments

We believe there are broadly three types of mechanism to raise new revenues:

- **Flat charge on all visitors**, typically levied on arrival or departure
- **Multi-site access charge**, often referred to as the "Environment Card" model
- **Single-site access charges**, where individual sites charge at point of entry

Within each of these, there are a wide range of specific solutions, from airport taxes and cruise charges on the first type to any number of varieties of "Environment Card" for the second type. Even charging at individual sites can take a number of formats. To simplify, we assessed the high level mechanisms as a first step, and then determined the best operational format as a second step.

To assess these options, we identified four criteria that reflect the key objectives of raising new revenues:

- **Maximise revenues** raised to fund investments in existing and new site development
- Minimise **impact on visitor demand**, except to deliberately manage flow of visitors at peak times
- Ensure **efficient distribution** of resources across existing and new sites, while providing an incentive for site operators / owners to invest in high-quality product development
- Ensure charging mechanism is **feasible** and can be **implemented at low cost**

These criteria were tested and refined with a range of public and private sector tourism stakeholders. Our summary assessment of the revenue mechanism options against the criteria can be found in Exhibit 16 below.

Exhibit 16. High level assessment of revenue mechanisms against decision criteria



Source: BCG analysis

As the above assessment shows, we believe that a multi-site access charge achieves more of the objectives than the alternatives. The evidence that informed this evaluation is provided below.

**Flat charge on all visitors.** A flat charge, such as an arrivals or departures tax, has several attractive features. Most importantly, it is a simple charge to levy, since the point of entry or exit is very well-defined (Keflavik Airport in most cases, or a small number of cruise liners), and it can raise significant revenues efficiently.

However, it also suffers from some critical challenges that strongly undermine its likely effectiveness. First, the charge would, in any feasible form, need to be levied on all travellers to and from the country. This would include international tourists, but also Icelanders travelling abroad and business travellers with no intention to visit Iceland's nature sites. This is both contrary to the user pays principle, but also may have an unintentional impact on the demand for outbound travel by Icelanders and for business travel to Iceland.

Secondly, the empirical evidence on arrivals charges (typically in the form of a duty on airline passengers) shows that demand for air travel is relatively elastic. One study showed that demand falls by 0.7% for every 1% rise in air fare costs<sup>13</sup>. The impact on leisure travel is particularly

<sup>13</sup>1998 Deloitte & Touche study on Manchester-Milan route ( $R^2 = 0.96$ ), quoted in "The Price Sensitivity of Tourism to Britain" (The British Tourist Authority, 2001)

strong, suggesting that an arrivals charge could dampen visitor demand, reducing the economic benefits from the growth in tourism.

The impact on demand in some international examples was strong enough to cause some air routes to become unprofitable, leading to withdrawal by the airline. For example, FlyBe recently withdrew its Inverness-Gatwick route, citing the rise in UK Air Passenger Duty in April 2013.<sup>14</sup>

Another recent example is the case of the Ticket Tax in the Netherlands, introduced in 2008. Flights in the EU were subject to a €11.25 fee, rising to €45 for long-haul flights. This led to an estimated 9% loss in total passengers to alternative airports and a reduction in the number of low-cost airlines flying to the country. The tax was scrapped just a year later.<sup>15</sup>

Finally, the revenues raised by a flat visitor charge would most likely be collected directly by the Icelandic government as part of its standard tax collection procedures. This would fundamentally separate the revenues raised from any incremental investment in the tourism industry, creating a risk that the charge is used to fund alternative government projects outside of tourism.

Given that some tourist sites are already starting or considering charging for entry, the levy of an arrivals or departures tax is unlikely to persuade them to stop. By implication, implementing such a tax could lead to a situation where visitors paid a tourism fee on arrival or departure and then were also required to pay entry fees at sites. This would significantly increase the cost of a trip to Iceland, while also reducing the visitor experience at sites. This highlights a critical success factor for any revenue raising scheme: It must have the buy-in of the owners of major sites. Otherwise, it runs the very strong risk that major sites will start charging visitors anyway, representing an additional cost to visitors on top of the state-sponsored charging scheme.

**Multi-site access charge.** This type of charge typically involves visitors buying a tourist card, sometimes called an Environment Card, which allows them to enter a range of sites without any additional payment. The key advantage for this mechanism is that it allows tourism authorities to bundle the most popular sites with less well-visited attractions under one charging scheme. Participation in the scheme would be optional to land owners, but by offering significant benefits, including centralised administration, revenue sharing, marketing, access to data and the opportunity to up-sell, we believe membership of the scheme would be sufficiently attractive.

Bundling is a standard approach used in many product categories, from software to entertainment to natural attractions, to boost demand for secondary products within a group. For example, customers get most of their value in the Microsoft Office suite from Microsoft Word, Excel, and

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<sup>14</sup> <http://www.e-tid.com/loss-of-flybe-route-a-hammer-blow-for-highlands/79381/>

<sup>15</sup> [www.greenaironline.com/news.php?viewStory=412](http://www.greenaironline.com/news.php?viewStory=412); [www.dutchamsterdam.nl/684-schiphol-amsterdam-airport-ticket-tax](http://www.dutchamsterdam.nl/684-schiphol-amsterdam-airport-ticket-tax)

Outlook. However, the Office suite deliberately includes the much less used OneNote, Access, and Publisher. While these products would not have enough demand on their own, they serve to make the overall package more appealing for consumers, allowing Microsoft to generate more revenues overall, while encouraging trial and uptake of less-well-known products.

In the same way, bundling natural attractions in Iceland would create a zero marginal cost for consumers to try out sites outside of the Golden Circle. This would both increase the value of the overall bundle for them, while sharing the load of visitors around a greater number of sites.

The Card could also become a very interesting selling product for tourism service providers through commissions, or other incentives.

A multi-site access charge also obviates the need for expensive enforcement infrastructure. While there are certainly some challenges to ensure that visitors purchase cards before they visit sites, for example preventing visitors passing the same card from one person to the next, enforcement would still be significantly cheaper and less intrusive than in a model that required visitors to pay for entry at each site. While we would not be expect to achieve 100% compliance, we believe a combination of spot checks and visitor education on the need for investment should drive sufficient numbers to purchase the Card before making their visits.

Another advantage of the card model is its ability to balance the need for a link between usage of sites and revenues with the requirement to be able to use some of the funds for investments in new or less-developed attractions. On the one hand, the card is only bought by tourists and Icelanders looking to visit Iceland's natural sites, in line with the user pays principle. On the other, the card model pools revenues from across different sites, enabling redistribution between new and existing attractions.

The card also allows popular destinations to supplement their incomes with value-added attractions, or "exhibits". While the card would provide free entry, sites would be able to develop new and engaging products for which visitors would be willing to pay extra. Many museums operate this way, with entrance to all standard exhibits either covered through a charge, a "museums card", or by government funding (as in the UK), and then special temporary exhibitions added on, often with high price tags. The current main exhibition at the British Museum, "Life and death in Pompeii and Herculaneum" has drawn together one of the finest collection of artefacts from the devastated cities ever displayed in one location. The standard ticket cost of £15 (ISK 2,800) reflects the high quality of product on offer.

The card model has been successfully implemented by tourism authorities in both city and nature contexts, for example in Oslo, Rome, Granada, London, and in the national parks of South Africa and the USA.



**Single-site access charges.** The final revenue mechanism is charging at individual sites. The key advantage of this approach is that it requires limited coordination and has the potential to raise significant revenues, since visitors pay at the point of greatest value to them. Indeed, some sites are already starting to apply individual charges.

There are three important challenges with this model. First, it requires extensive infrastructure for larger attractions, both in terms of barriers preventing access to visitors that have not paid, but also manned entry points (and/or gates and scanners) to prevent unauthorised admission and to take payment. This also requires payment processes, either for credit cards or for cash handling. Any site without such infrastructure would not receive any revenues. This infrastructure is both costly and could, in some cases, reduce the quality of the visitor experience, especially in the Icelandic context where natural beauty and open space are intrinsic to the appeal.

Secondly, this model directs almost all revenues to a few key sites that receive the bulk of the country's visitors. The Golden Circle sites, for example, receive around three times as many visitors as Iceland's eighth most visited attraction, Landmannalaugar. Many sites will receive only a few hundred or thousand visitors a year. Charging at individual sites, therefore, does not meet the objective of ensuring an efficient distribution of revenues among existing sites. It also does not allow for investing in new sites.

Finally, cash handling at individual sites would also create an unnecessary administrative burden for the purposes of tax collection.

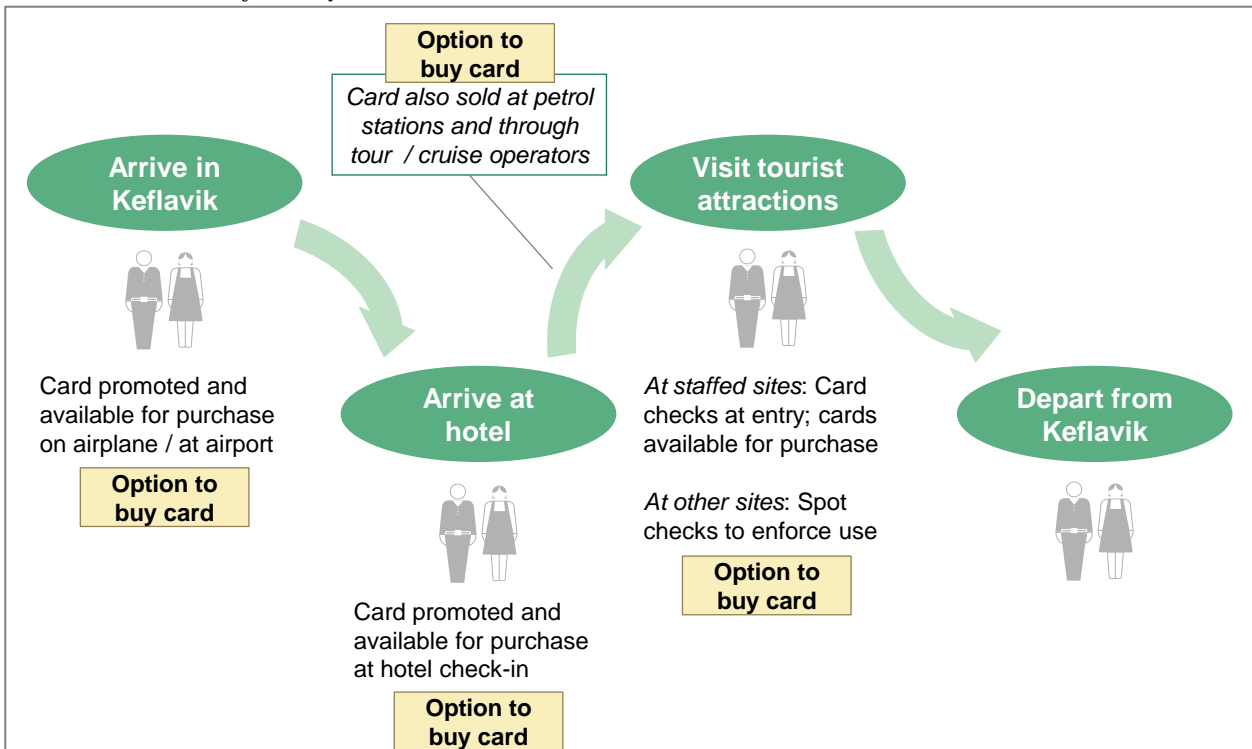
### ***5.2 Our proposal: An environment card, with value-added services at sites***

We believe the best solution to raise new revenues for Iceland is to restrict access to Iceland's major natural sites (e.g. top 30) to visitors in possession of an Environment Card. This would then be supplemented at individual sites by a range of additional services, from meeting facilities to exhibitions to children's shows, which sites could provide in exchange for additional ticket fees.

Exhibit 17 below shows a high level schematic of the visitor experience under an Environment Card system. The typical visitors arrive at Keflavik and are offered to buy a Card both on the plane and on arrival at the airport. They make their way to their hotel, where the Card is again prominently displayed for purchase. Visitors who do not purchase their Card at this point can still buy it at petrol stations on their way to the sites. Similarly, visitors arriving by cruise or organising their trip through tour operators will be asked to purchase the Card by their travel provider or onboard.

Restricting access under an Environment Card scheme would not involve a heavy enforcement regime, since there is no need to track 100% of visitors at every site. Instead, we would expect the most popular sites, where staff are on hand and where the point of entry is relatively confined (e.g., at Geysir and Gullfoss), to put in place simple checks of visitors to ensure they had a Card. At other, more open or less-frequented, sites, ad hoc spot checks would suffice. To avoid visitors passing cards between each other, the Card would have a maximum validity, for example of 30 days.

Exhibit 17. Visitor journey under an Environment Card model



Source: BCG analysis

**Card pricing.** The price of the Card is clearly a critical factor in its future success. Unfortunately, there is currently limited evidence in Iceland for what an appropriate price should be. Research from 2004 showed that visitors do have a willingness to pay for entry to key natural sites.<sup>16</sup> This research, however, both predates the growth of tourism in Iceland and does not test the Card model. Reviewing benchmarks from around Europe and North America, including pricing of city tourist passes and entrance fees to national parks, we believe a price of several thousand ISK could be appropriate. However, we highlight and underline, that further research on this topic is essential before a final price is selected. Under-estimating the price which visitors would be willing to pay by just ISK 100 could reduce annual Card revenues by ISK 30 – 100M. Pricing the Card too high, by contrast, could deter some visitors or drive non-compliance in a way that would cause lasting damage to the tourism sector. We believe a simple survey, using an established technique such as Van Westendorp analysis, would provide a robust answer on the right price for the Card.

**Access to sites by Icelanders.** We do not believe that Icelanders should be fully exempt from the Card scheme, both because of the regulatory issues this might cause and also because visits by Icelanders to natural sites create the same need for conservation and product development as do visits by foreigners. This is consistent with the approach taken for camping and fishing licenses, where Icelanders have not been exempted from new charges. However, to reflect the importance of local people accessing their natural assets, we propose to introduce a version of the Card with a 5-year validity, priced at or just above the cost of the 30-day tourist version. This could be paid for very simply, for example by ticking a box on a tax return form, reducing the administrative burden.

**Implementation.** Given the state of technology, the long-term solution for the Card should be virtual. The Card would in effect be a database of customers that have purchased it; the proof of purchase could then take the form of a contactless plastic card, a barcode on a mobile app, a printed electronic receipt, or a key fob. This form of device would allow tourism authorities to collect extensive customer data on visitor travel patterns, as well as to offer discounts and promote deals directly to customers during their trip.

In the short run, however, to ensure the scheme can be set up quickly and cheaply, a very simple "dumb" plastic card could be introduced. This would be pre-marked with a validity date and would include a signature strip (signed manually by visitors) to avoid the re-use of cards by other tourists.

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<sup>16</sup> "Willingness to pay entrance fees to natural attractions: An Icelandic case study"(M. Reynisdottir, H. Song, J. Agrus, 2008)– data from 2004

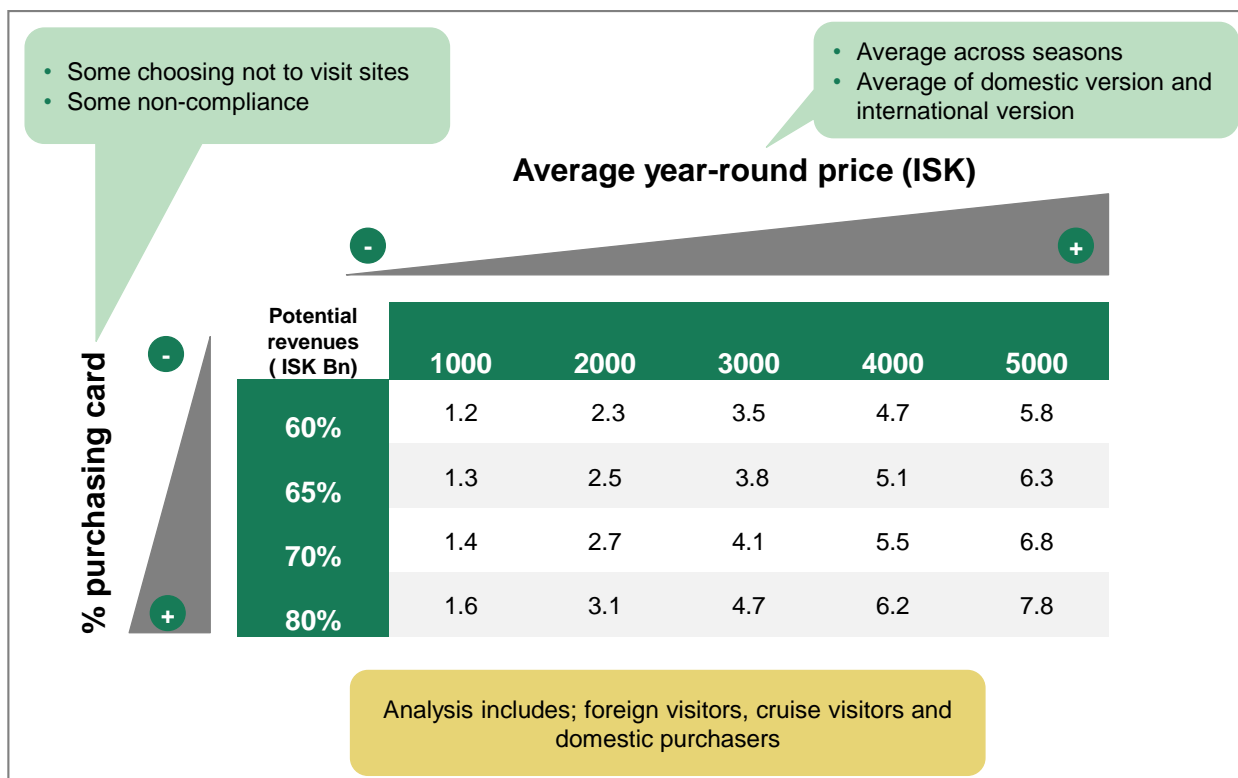
Aside from operational implementation, setting up an Environment Card may also require careful assessment of relevant legislation, including on land use and the rights of the public to access natural sites. The July 2013 ALTA report conducted for the Icelandic Tourist Board highlights some of the potential issues that will require further attention as implementation progresses.<sup>17</sup> For our part, the interpretation of Icelandic law was beyond the scope of our research.

**Financial forecasts.** Based on our forecast of visitors numbers rising from 0.7M to 1.5M by 2023 (see Section 7), we believe the Environment Card could raise ISK 0.7 – 4.6Bn in its first year, rising to ISK 1.2 – 7.8Bn by 2023 (see Exhibit 18). Our cost estimate for implementing the Card, including card printing, marketing collateral and website, headquarters and local enforcement staff, IT costs, and a margin of 5% of the Card cost for distributors (e.g., petrol stations, hotels), amounts to approximately 9 – 12% of Card revenues, which is broadly in line with international benchmarks of contactless card systems, such as Tasmania's Green Card for public transport.

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<sup>17</sup> Fjármögnun uppbyggingar og viðhalds ferðamannastaða - Yfirlit yfir gjaldtökuleiðir

Exhibit 18. Potential revenues from an Environment Card at different price points



Source: BCG analysis

### 5.3 Distributing the funds

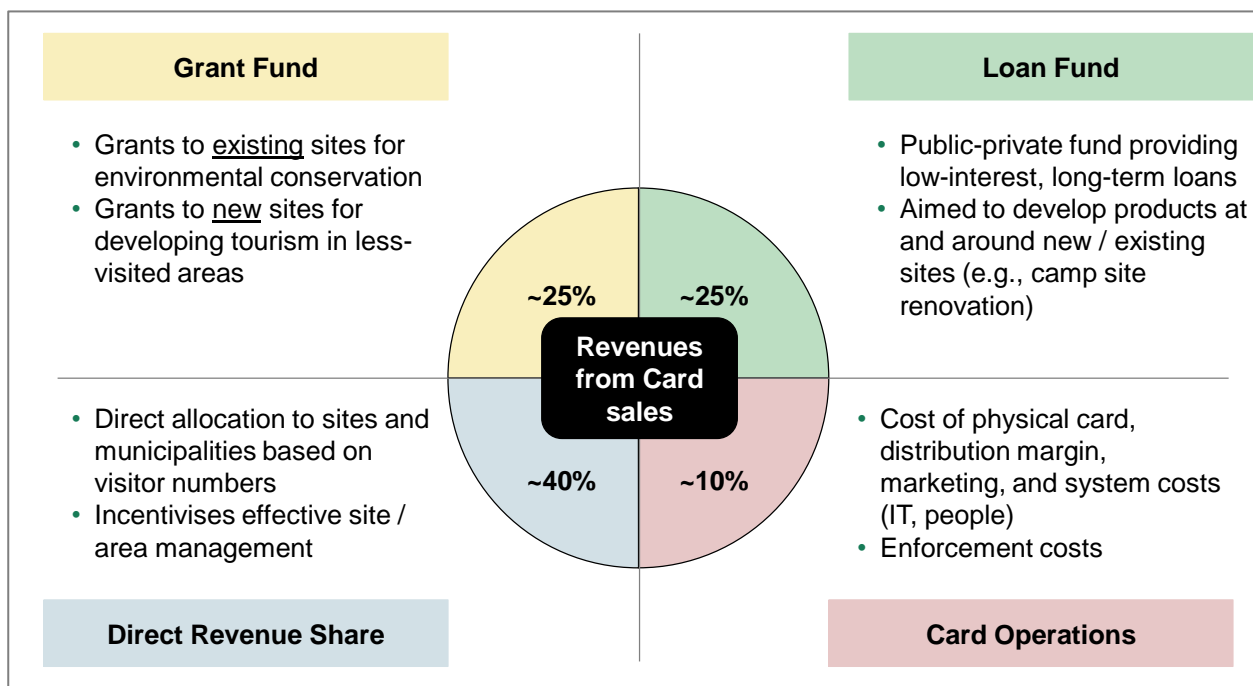
For the Environment Card to win public support, it must be clear and transparent how the funds are to be put to use. As discussed, the objective of raising new revenues is to support the development of tourism products and complementary infrastructure at new and existing sites, while also funding conservation programmes to ensure the sustainability of those sites in the future. At the same time, municipalities and site owners that have been successful at attracting visitors up to now also need to see that they are being recognised for their efforts, and appropriately incentivised to continue growing the appeal of their attractions.

In effect, Iceland should view its tourism attractions as a portfolio: Some currently attract large numbers of visitors; others need to be developed. The use of Environment Card funds should both drive further growth at popular sites, while also directing funds towards the development of new ones. Over time, of course, this distribution will change, as the balance of need shifts from investment in new facilities to maintenance of existing ones. This re-balancing will be important to ensure the long-term sustainability of investments made in the initial years.

We, therefore, suggest that, the funds raised are distributed in four ways (see Exhibit 20 below), although we recognise the need to adapt these to meet the requirements of Icelandic legislation around land use, site access and other key elements:

- **Grant fund**, focused on conservation and developing tourism in less-frequented areas
- **Loan fund**, providing access to finance for sites with potential to generate a commercial or near-commercial return from their investments
- **Direct revenue share** with site owners and municipalities, providing a direct link between visitor numbers and Card revenues
- **Card operations**, so that the Card pays for its own operating costs

Exhibit 19. Four potential uses of funds from the Environment Card



Source: BCG analysis

**Grant fund.** This fund would provide non-repayable grants to any site within the Environment Card network (or associated tourism businesses). Projects should be focused on environmental conservation or developments with broad social benefit (e.g. road network in less-visited region). The funds would cover up to 75% of project costs, ensuring all applicants are themselves invested in the project outcomes. Grants of ISK 500k-10M could be provided on a multi-year basis, with disbursements each year dependent on the achievement of defined milestones. Grant applications would be reviewed by a committee of public and private sector representatives, appointed by the Tourism Task Force Steering Group (see Section 6: Organising for success).

**Loan fund.** This fund would provide low-interest or longer-term repayable loans to any tourism site within the Environment Card network (or associated businesses). These loans would fund projects to develop value-added services at sites, for which additional charges could be applied, or

the development of products or infrastructure that could attract more visitors. Loan applications should be accompanied by a robust business plan that clearly shows how the investment would generate new revenues for the site and, therefore, fund loan repayments in the future. In effect the loan would be secured against future direct revenue shares of the site. Given that loans are recyclable (i.e. the loan fund should build up over time), the permissible loan size could be ISK 2-50M to facilitate the development of major projects. As per the Grant fund, applications would be reviewed by a committee of public and private representatives.

Loan funds have been successfully used to develop tourism products in a number of countries. For example, France's Oséo fund offers loans and loan guarantees to hotels to invest in service improvement, renovations, or equipment and furnishings. Similarly, Cumberland County, Pennsylvania, has created a Tourism Infrastructure Loan Fund to provide low-interest loans to businesses looking to make job-creating tourism investments.

**Direct revenue share.** This would provide a direct payment to tourism sites and municipalities based on their visitor numbers over the year. The payment rate per visitor would be set in advance, according to both a forecast of future visitor numbers, with the aim of distributing roughly 40% of the year's Card revenues in this way. We estimate that in the first year, the payment to sites could be ISK 120 – 700 per visitor and ISK 40 – 230 to municipalities, based on a 75/25 split of the revenue share between sites and municipalities. The number of visitors would be estimated through an established survey process, agreed by the same public-private committee that assesses grant and loan applications. For example monitors could count visitors to each site on random sampling days in the year, or both Icelandic and foreign tourists could be asked about the sites they had visited during their stay or over the year as part of a broader regular visitor survey. This direct revenue share is essential to gaining the support of existing sites and, therefore, making the Environment Card a success. It is also a fair reward for site owners and municipalities that have worked to attract visitors (see box below for an example).

**Card operations.** We estimate that the full cost of the Card scheme, including staff costs, marketing, card printing, enforcement, and distribution costs would amount to approximately 10% of total revenues. This is in line with international benchmarks, as discussed above.

The box below shows, through an illustrative example, how Gullfoss and its municipality could benefit from the Card revenues in year 1 of the scheme.

### **How Card revenues could help Gullfoss conserve and invest**

Gullfoss is one of Iceland's most popular attractions, with over 200,000 visitors each year. If Environment Card funds were distributed in the manner described above, Gullfoss could benefit in the following ways:

**Grant fund:** Gullfoss site owners could apply for a grant of ISK 1M for a conservation project, for example to conserve the vegetation around the main visitor paths.

**Loan fund:** Gullfoss could apply for a loan of ISK 20M, repayable over seven years, to develop a new visitor centre attraction, such as a multimedia educational exhibition for the "Older Relaxer" segment, or helicopter rides for the "Affluent Adventurers".

**Direct revenue share.** Based on last year's visitors, Gullfoss could receive approximately ISK 90M as a direct payment. At the same time, the municipality of Bláskógabyggð would receive around ISK 30M, equivalent to more than 10% of its staff salary bill in 2012.

In exchange for this, Gullfoss would be expected to implement a basic checking process to ensure visitors to the site were in possession of an Environment Card.



## 6. Organising for success

## **6. Organising for success**

We firmly believe that, just as form must follow function, organisation must follow goals. Having laid out our view of the goals for Icelandic tourism (section 2), the target visitors needed to achieve these (section 3), and the actions and investments required to attract target visitors in the future (sections 4 and 5), we can now turn our attention to the organisation of the tourism industry, including governance structures, regulation, policy, and human resource management.

### **6.1 Governance**

Tourism governance in Iceland is split over a number of Ministries (primarily the Ministry of Industries and Innovation, but also the Ministry for the Environment and Natural Resources, Ministry of Finance and Economic Affairs, and Ministry of Foreign Affairs), a range of government agencies, including the Icelandic Tourist Board and Promote Iceland, and a set of regional and private sector representative bodies.

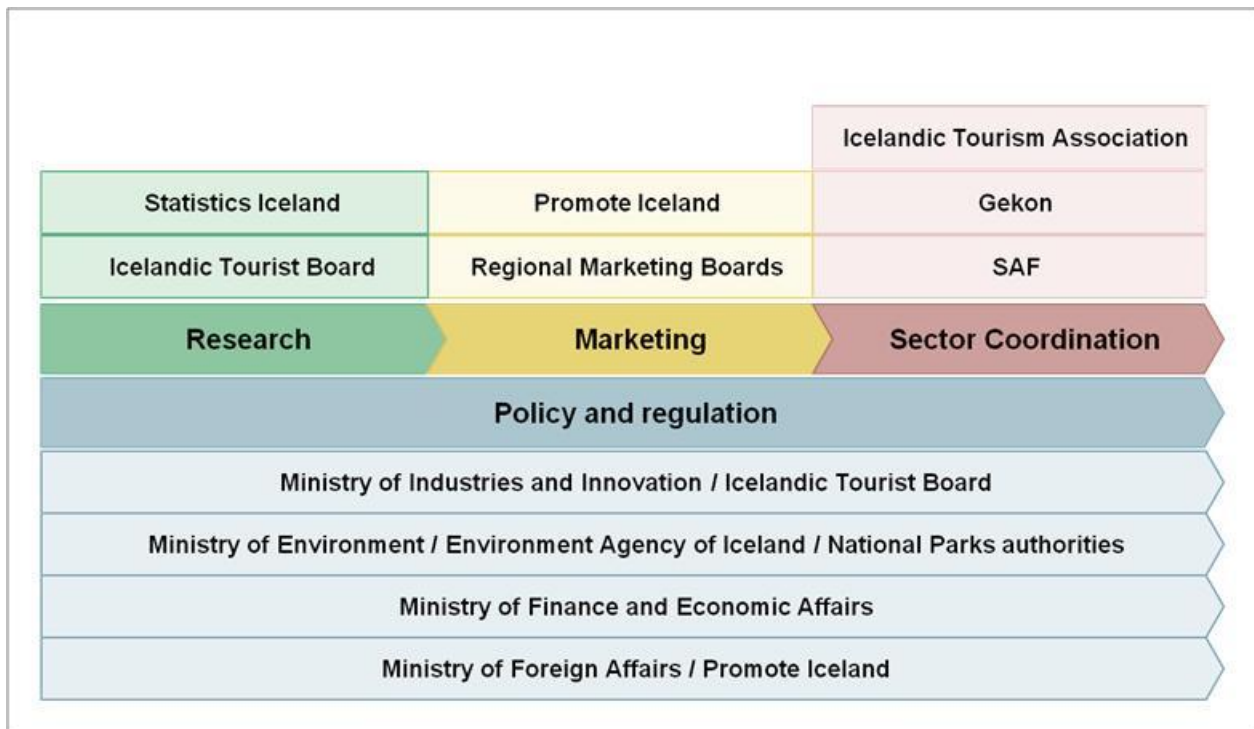
We believe there are three important challenges for the current governance structure. First, how can Iceland drive greater central accountability for the overall tourism strategy? Currently, no single body takes overall responsibility for delivering the strategy through coordination, tracking, and decision-making.

Second, how can the split of responsibilities be improved across the different bodies? In particular, the split of marketing and research functions between several entities may be driving a lack of coordination in these areas.

Finally, how can the overall governance model be streamlined to improve clarity around responsibilities and to minimise overhead costs?

As a starting point to develop our recommendations, we identified the full range of activities required within tourism governance. These consist of research, marketing, and sector coordination, underpinned by policy and regulation. We then mapped Iceland's current governance structure on to these activities to show which bodies cover the different areas. The result can be found in Exhibit 20.

Exhibit 20. Tourism governance in Iceland



Source: BCG analysis

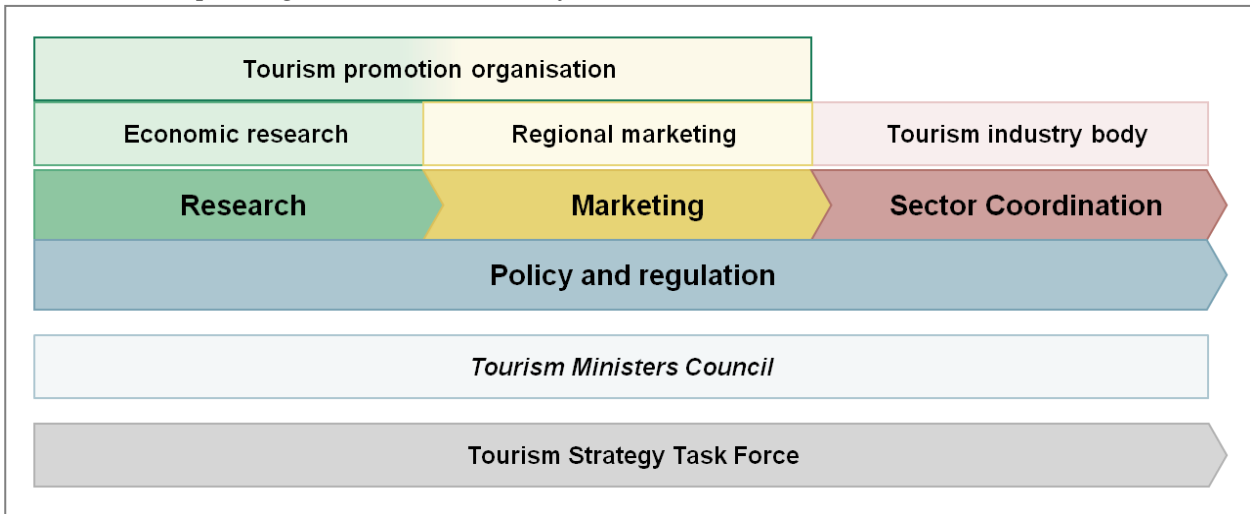
This map highlights some of the challenges described above. First, the lack of central accountability, with four ministries covering different aspects of policy and regulation, and research, marketing and sector coordination split between different groups. Second, the sub-optimal split of responsibilities, with research and marketing conducted independently by different organisations. This makes it hard to justify research funding (since it is less clearly linked to tangible promotional activity) and also limits the ability of marketing organisations to base their actions on a rich consumer understanding. Finally, the map highlights the sheer number of entities and organisations involved in Icelandic tourism governance.

Our proposal for the future governance structure is driven by a set of design choices:

- Single point of accountability preferred to distributed responsibilities
- Marketing closely linked to research is preferred to research conducted independently of marketing needs
- Centrally-driven national authority needs to be balanced against the need to strengthen regional tourism, especially outside of Reykjavik and the South-West
- Fewer entities preferred to maximise budget efficiency than a large number of entities

Based on these choices, we propose the following structure (see Exhibit 21).

Exhibit 21. Proposed governance structure for tourism in Iceland



Note: Tourism Ministers Council includes Ministry of Industries and Innovation / Icelandic Tourist Board, Ministry of Finance and Economic Affairs, Ministry for the Environment and Natural Resources, Ministry of Education, Science and Culture – as per Tourism Ministers Council in Australia / New Zealand

Source: BCG analysis

We believe this proposal has a number of attractive features. Firstly, it creates a much stronger degree of central coordination and overall ownership of the tourism strategy. This is achieved primarily by creating a Tourism Strategy Task Force, chaired by the Minister for Industries and Innovation, and including representatives from other ministries, public sector bodies, and private sector organisations. Gekon's work on sector coordination shows one promising approach for bringing together such diverse players.

The Task Force would be responsible for the overall strategy: setting the vision and defining targets; coordinating activity across the different governance bodies; and tracking progress and resolving conflicts. The Task Force would have very limited operational responsibility, except to manage the new Environment Card and the associated Loan and Grand Funds. Instead, it would provide momentum for change, taking decisions, holding different players to account, and publishing regular reports on progress to celebrate success and highlight risks of delay.

Another feature that would drive coordination is the Tourism Ministers Council, a committee of Ministers with tourism responsibilities (ideally chaired by the Prime Minister), whose function would be to agree required reforms and coordinate investments (for example, targeted development of tourism products in a new area). It would also be responsible for coordinating the new infrastructure required to support the expected visitor growth. This Council is based on similar bodies in both Australia and New Zealand that have been credited with successfully coordinating those countries' approach to successful tourism expansion.

The second attractive feature of our proposed model is that it connects marketing with research in one organisation. This will be particularly important in the process of refining and better understanding the target visitor segments that we assessed in section 3. It will also make it more likely that critical future visitor research, such as the tourism visitor survey last conducted in summer 2011 and winter 2011-12, receives funding. Research is only a small fraction of the cost of marketing, yet makes a big impact on the effectiveness of promotional activity. Therefore, it is much easier to justify a comparatively small research cost within a large marketing budget than it is to justify research on its own account.

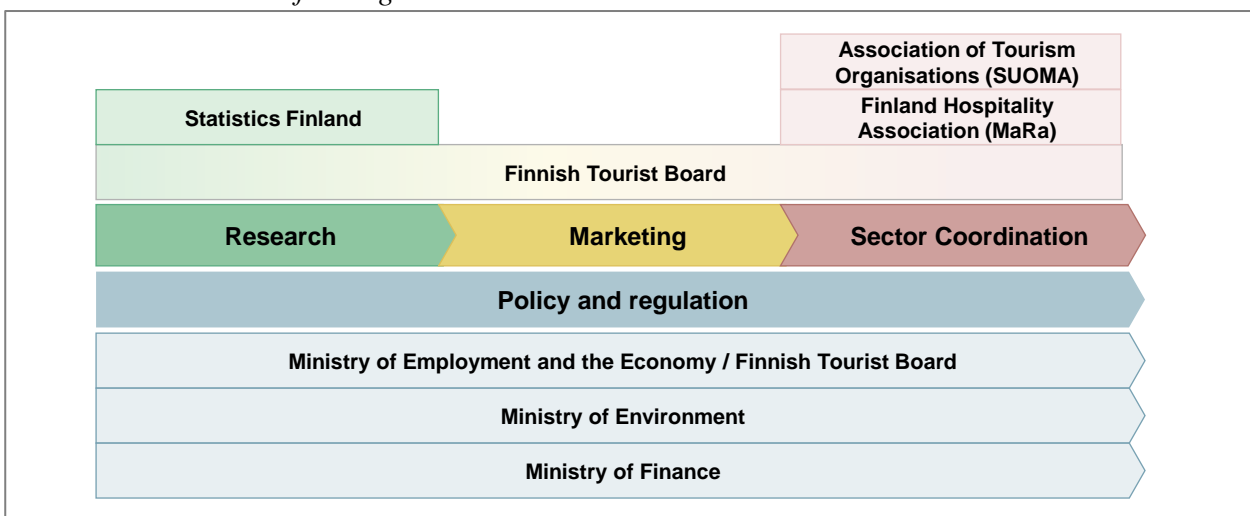
Finally, our proposed model considerably reduces the overall number of entities involved in tourism governance. This would be driven by a consolidation of some entities' functions within the remit of the Tourism Task Force, while other entities might join together to simplify operations.

Moving towards this model, or a similar, model of governance is an important enabling step towards ensuring that the full range of activities proposed in this tourism strategy could be effectively delivered.

### Case study: Tourism governance in Finland

The structure of Finnish tourism governance provides an interesting analogy for Iceland. As shown in Exhibit 22, Finland's core governance structures are relatively simple. In particular, the Finnish Tourist Board plays an overarching role to coordinate activity across the sector, conduct research, promote product development, and execute marketing campaigns for the country.

*Exhibit 22. Overview of core governance structures in Finnish tourism*



Source: BCG analysis

Finland's key annual visitor research, the "border survey", is conducted in partnership between the Finnish Tourist Board and Statistics Finland, the latter providing robust research capabilities.

Outside of the Tourist Board, sector coordination is provided principally by two bodies, the Association of Tourism Organisations and the Finland Hospital Association, with a range of smaller entities covering niche or specialist areas (e.g., Finnish Festivals).

## **6.2 Policy and regulation**

One of the challenges in organising tourism for success is its dependence on a supportive policy and regulatory environment. Our survey of Icelandic tourism stakeholders highlighted policy and regulation as a potential area for improvement: 54% of respondents rated national laws and regulation as "bad" or "very bad" in terms of their supportiveness to the tourism sector; 56% rated government policy negatively in the same way. In particular, we have identified four areas that are important for tourism development where policy and regulation could be enhanced:

- **Industry licensing**
- **Planning and zoning**
- **Environmental regulation**
- **Tax**

**Industry licensing.** Tourism is a regulated industry, with tour operators and hotels required to purchase licenses from the Icelandic Tourist Board. In our interviews with tourism stakeholders, the issue of black or grey market tourism operators was raised on multiple occasions. These operators undercut compliant businesses, because they pay no tax, and potentially put both tourists' safety and the reputation of the industry at risk.

We recommend launching a temporary amnesty for black market operators to allow them to normalise their operations. This would then need to be followed up robustly by a series of checks so that any businesses continuing to operate outside of the law are sanctioned. In some cases, we believe organisations may have attempted to acquire a license, but were put off by either onerous paperwork or requirements that are hard to understand. We, therefore, suggest a review of the licensing process to simplify it, ideally making it feasible to complete online.

**Planning and zoning.** We recommend that planning regulations are reviewed, potentially to establish an accelerated or simplified process for tourism projects. This would be along the lines of Australia's review of "Regulatory Reform Priorities" in 2011, which recommended adopting consistent criteria for tourism zoning around the country. We also believe our proposal to include municipalities in the direct revenue share from the Environment Card funds would rightly allow local authorities to share in some of the benefits of increased visitors in their area.

**Environmental regulation.** The Ministry for the Environment and Natural Resources in Iceland provides oversight on the use and management of key natural tourism sites. Given the increase in visitor numbers to these areas, some sites are now at risk of over-use and potentially damage. We recommend the establishment of a simple framework to categorise sites by level of risk.

In addition to this regulatory change, the "grant fund" to be established as part of the Environment Card revenue distribution will provide a useful injection of funding into environmental conservation at key sites. This could, for example, be used to expand the current Conservation Volunteer programme.

**Tax.** Changes in tax policy have an immediate impact on the cost of trips to Iceland and, therefore, both tourism demand and tourism spend on other services. Recent proposals around both a large increase in the VAT on hotels and around potential inbound or outbound tourism taxes have created a degree of uncertainty that could deter future investment in the sector. Although there is no way to structurally impose policy certainty around the tax regime, we believe that the Environment Card revenue mechanism would be an important step in increasing tourists' contribution to Iceland and, therefore, mitigating the need for other tax changes.

### 6.3 Human resource development

Iceland already has a strong area in tourism human resource development. It was ranked third overall in the World Economic Forum's Travel and Tourism Competitiveness Report 2013, coming fourth in the sub-category for "availability of qualified labour" and 12th in the category on "education and training".

Despite this, our stakeholder interviews indicated that there is a continued need to promote tourism as a career in schools and universities, as well as to articulate and define clear career paths so that ambitious young people see a future for themselves in the profession.

We recommend that the Tourism Task Force uses its coordination role to identify gaps in the provision of training and development, and support private and public players to address them, potentially using grant or loan finance from Environment Fund resources.

## 7. Economic impact



## 7. Economic impact

The most important component of tourism's contribution to Iceland is its economic impact. We believe that the strategy outlined above will enable Iceland to generate greater economic growth, spread more evenly across the country, contributing to the creation of high-quality jobs and supporting public finance through increased tax receipts.

To estimate the effect of both existing tourism trends, as well as our proposed strategic initiatives, we first created a bottom-up model to project future visitor numbers for all Iceland's key inbound markets, broken down by the key visitor segments in each market. Whilst this section of the report presents a summary of the results, a detailed methodology and additional findings are included in Annex B.

### 7.1 Growth in visitor numbers

As shown in Exhibit 24 below, we estimate that foreign visitor arrivals will grow from 0.67 million in 2012 to around 1.2 million in 2023 under existing trends. If, however, Iceland effectively attracts the target visitor segments described in this report, and puts in place the measures we recommend, then we believe this would rise to approximately 1.5 million in ten years (see Exhibit 23).

Exhibit 23. Projections of tourism visitor numbers over the next ten years



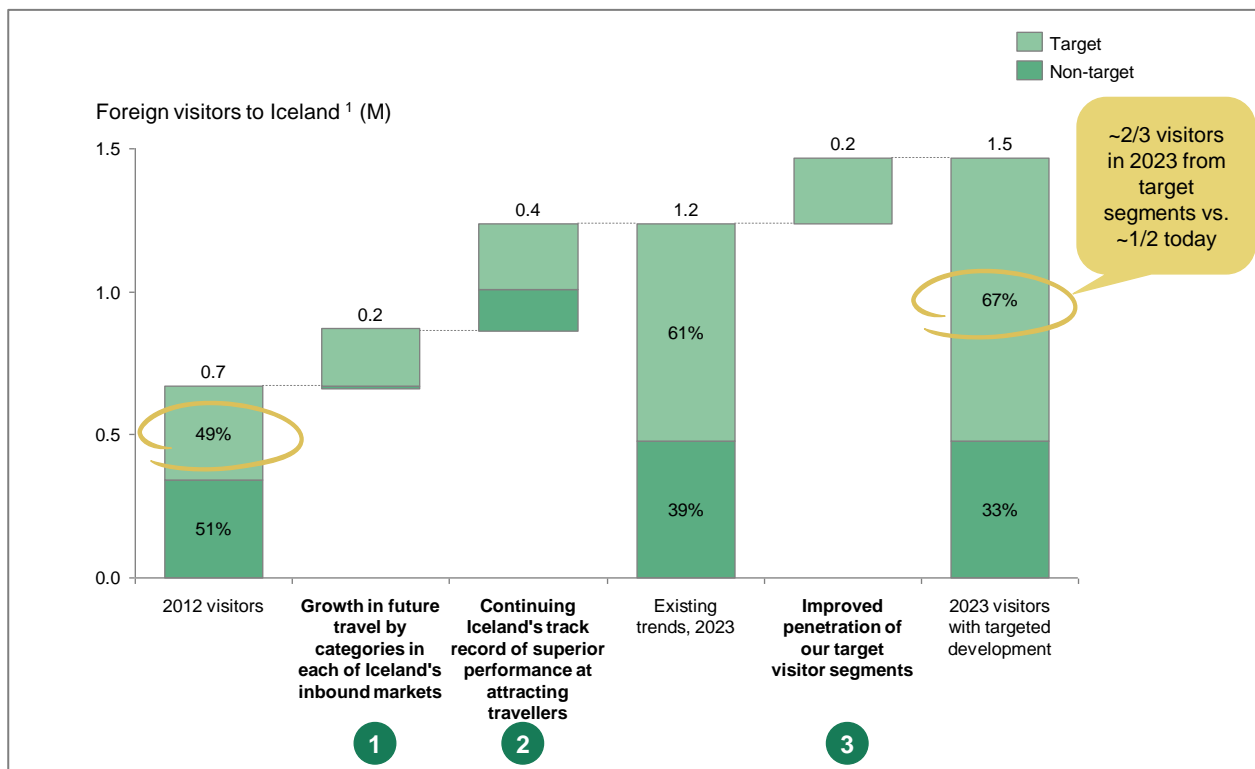
Note: Not including cruise passengers. Domestic tourism assumed to grow in line with population

Source: Icelandic tourism board, Isavia, EIU, Euromonitor, UNWTO; BCG analysis

This visitor projection is based on three key drivers of future growth: (1) Growth in future travel by categories in each of Iceland's inbound markets (adjusted for expected demographic trends); (2) Iceland's track record of superior performance at attracting travellers from these inbound markets, based on recent trends and expectations on how this might develop in future; and, finally, (3) the improved penetration of our target visitor segments that we would expect if Iceland pursues the strategy described in this report.

We believe this is the first attempt at disaggregating future visitor numbers by grouping. This allows us to show the impact of these demand drivers on Iceland's future visitor mix. Today, around half of Iceland's visitors are "target" visitors (e.g., Older Relaxers, Affluent Adventurers, Emerging Market Explorers). Under existing trends, this is likely to rise to just over 60%, as the population in Iceland's inbound markets ages and the trend towards adventure travel continues. However, sharpening our focus on target visitors (through promotion, product development, and other measures) could drive this up to two thirds, meaning that only one in three future visitors would fall outside the target segments (see Exhibit 24).

Exhibit 24. Mix of tourists predicted to skew towards target segments both due to market trends and active targeting

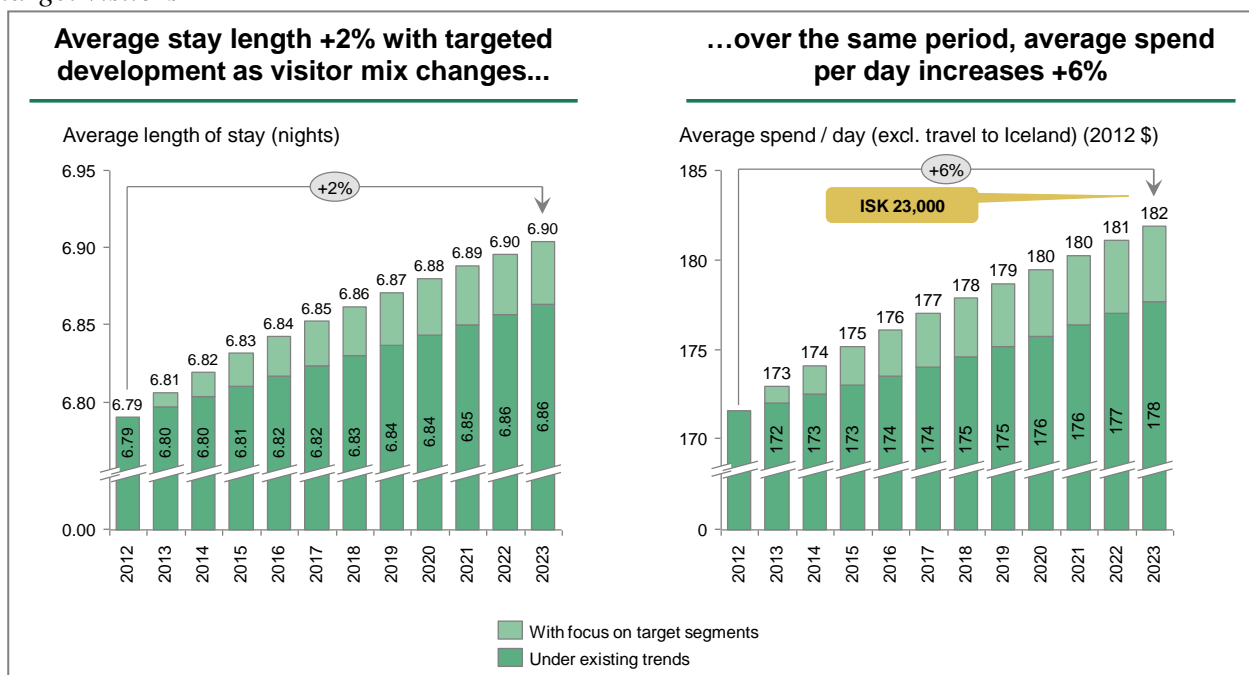


Note: Not including cruise passengers  
 Source: Icelandic tourism board, Isavia, EIU, Euromonitor, UNWTO, BCG analysis

### 7.2 Direct economic impact

This model, and the analysis of the data from the Iceland Tourist Board's visitor surveys, allows us to show exactly how this improved focus on target visitors will benefit the country. Shifting from around half to two thirds of visitors coming from target segments will lead to a 2% rise in average length of stay and, more impressively, a 6% rise in average spend per day in Iceland (see Exhibit 25). Improved targeting, therefore, will directly improve the contribution of tourism to Iceland without relying on growth in visitor numbers.

Exhibit 25. Average length of stay and spend per day in Iceland expected to increase with more target visitors

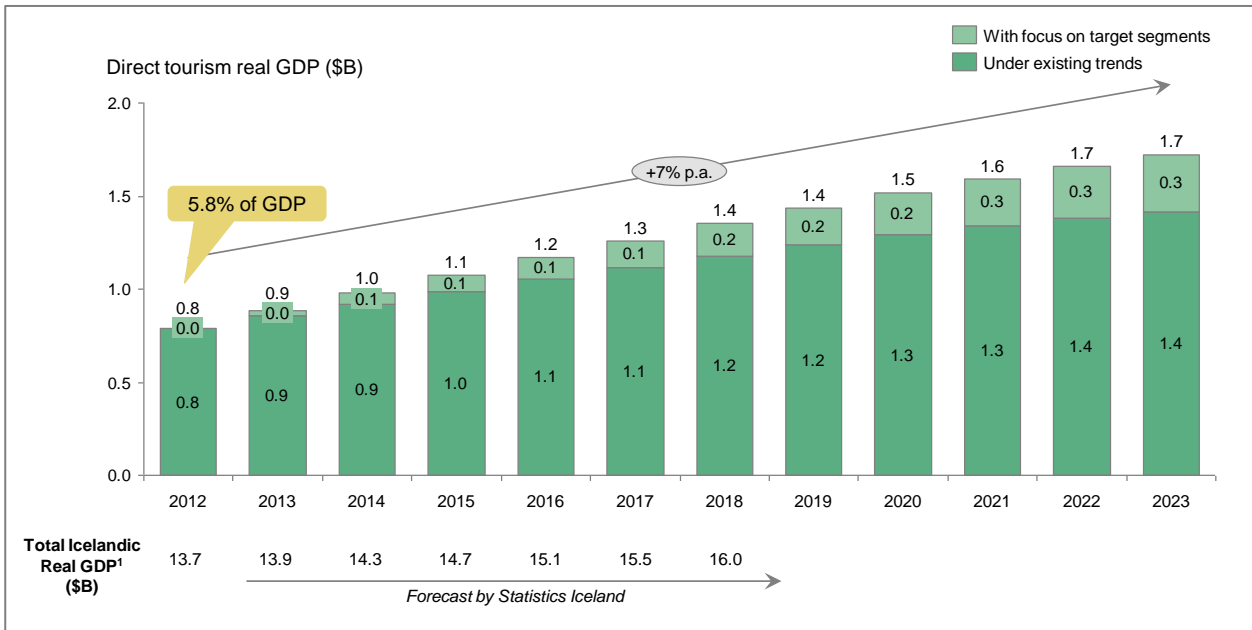


As discussed up-front in Section 2, we believe Iceland's future aspirations for tourism should focus less on visitor numbers and more on tourism's overall contribution. We have, therefore, used our forecast of visitor numbers by segment to drive a model of tourism's impact on future economic growth.

As shown in Exhibit 26, we estimate that tourism's direct contribution to Iceland's GDP will rise from \$0.8Bn in 2012 to \$1.7Bn (ISK 215Bn) by 2023. This implies an annual growth rate in the direct tourism economy (i.e., airlines, hotels, tour operators, restaurant spend, etc.) of around 7% per year. This compares with the current forecast growth rate of Icelandic GDP of 2.6% per year by Statistics Iceland. Clearly, this implies a substantial increase in tourism's share of Iceland's

GDP, making it one of the key potential growth engines of the Icelandic economy in the years ahead.

Exhibit 26. Forecast growth of tourism's direct contribution to Icelandic GDP



Source: Icelandic tourism board, Isavia, EIU, Euromonitor, UNWTO; Statistics Iceland; Oanda; HVS; Icelandic Road Administration; BCG analysis

Note: 2012 prices, 2012 USD: ISK exchange rate applied, Domestic tourists' incremental spend on tourism and cruise passengers' spend in Iceland also included in calculation

As important as the overall impact on GDP is its distribution across the country. By focusing on segments that are more likely to visit outside Reykjavik and the South-West, as well as developing new products in the regions, we project that the tourism economy will grow significantly faster outside the Capital region and the South than it will in those areas. In particular, the East, North, West, and Westfjords will see an improvement of 162% over ten years versus 117% in the Capital region and South.

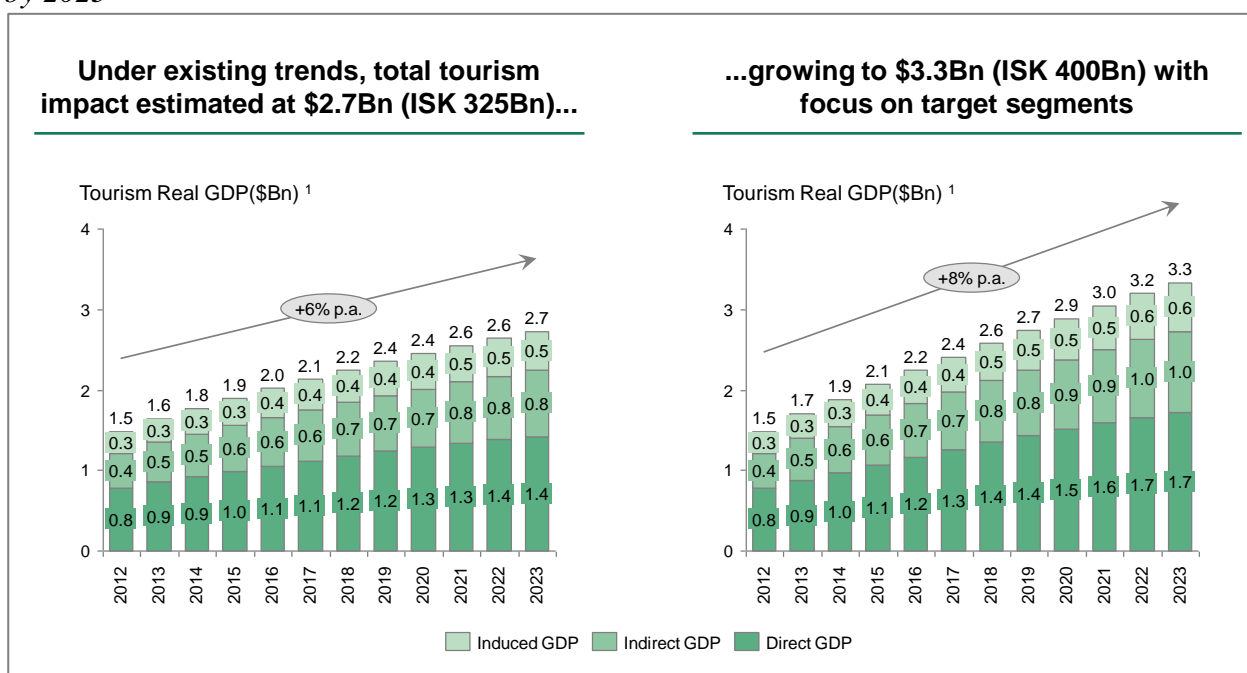
### 7.3 Seasonality

By a similar logic, we also project that the seasonality of Icelandic tourism will be reduced. Whereas today the number of nights spent in Iceland during the "shoulder" months of April, May, September, and October are between 20% and 30% of the number of nights spent in July, we predict this will rise to between 40% and 70%. Overall, this will constitute a marked decline in the gap between peak and non-peak months.

### 7.4 Indirect and induced economic impact

Aside from the direct impact of tourism on GDP, there is also likely to be a significant indirect and induced impact. This arises both from the capital expenditures that will be made to support the future tourism economy (hotels, airport, tourism site development) and also from the spending of Icelanders employed in the tourism industry on other goods and services. Although these estimates, especially of induced spend, are by their nature more speculative and rely on projections of future "slack" capacity in the economy, we believe they could double the impact of tourism on the economy overall. The total tourism contribution would, therefore, rise from around \$1.5Bn today (including indirect and induced impacts) to \$3.3Bn (ISK 400Bn) by 2023 (see Exhibit 27). It should be noted that this calculation assumes investment and development is driven by Icelanders (versus foreign investment) to the same extent as it is today.

Exhibit 27. Including indirect and induced impacts, tourism could contribute \$3.3Bn to GDP by 2023



Note: 2012 prices, 2012 USD: ISK exchange rate applied. Domestic tourists' incremental spend on tourism and cruise passenger spend also included in projections

Source: Icelandic Tourist Board, Isavia, EIU, Euromonitor, UNWTO; Statistics Iceland; Oanda; HVS; Icelandic Road Administration; BCG analysis

### 7.5 Tourism employment

This substantial increase in economic activity will stimulate a considerable increase in new job creation across multiple sectors in Iceland: Direct tourism-related occupations (hotel and airport staff, tour guides, etc.); construction; and other "overhead" roles such as marketing, administration, administration, logistics, etc.

Our projections of the impact of tourism growth on employment show more than 5,000 new direct tourism-linked jobs being created over the ten years to 2023, up from around 7,400 today. This increase is lower than might be expected from our forecast that visitor numbers and tourism GDP will more than double from today's numbers. This reflects anticipated improvements in productivity, output that each worker can generate, both from long-term productivity trends (as workers get more experience and skills) and also because reduced seasonality will allow each employee to work more hours per year and, therefore, earn a higher salary. In short, the growth in tourism will create more jobs, but it will also create better, higher-paying jobs.

It will also create more jobs outside of the Capital region and the South. The number of tourism employees will rise by around 60% in the Capital region and 80% the South, but by around 110% in the North and East and 100% in the West, and Westfjords.

### ***7.6 Tourism taxes***

Finally, the increased economic activity from tourism will lead to increased tax receipts, as tourists pay more VAT on goods and services purchased. Based on an effective tourism tax rate of 15% in 2009 (of tourism GDP, at market rate, calculated from Statistics Iceland data), direct tax receipts from tourism could reach ISK 33Bn by 2023 (or ISK 52 Bn including indirect contributions), more than double today's income. If the Icelandic government had to raise this revenue from citizens instead, it would be forced to raise VAT by 1.7 points, or levy a charge of ISK 120k on each Icelandic household instead.

## **8. Conclusion**

The story of Iceland's tourism sector is much like that of its underground geothermal energy. Dormant for many years, with considerable untapped potential, it is now all fired up and ready to go. Encouraged by effective marketing, increased international news coverage, a devalued currency, and an expansion in air routes, it has shown how quickly it can develop.

Yet, as with the extraction of underground energy, there are risks to growing too far, too fast: Damage to the natural environment; congestion in critical infrastructure; stresses and strains at peak times; and an over-concentration of visitors in a few key areas.

We have shown in this report that there is a path to a sustainable, managed expansion of tourism, and that this path can deliver many benefits for the Icelandic population.

By targeting its efforts on a core group of attractive visitors, for whom Iceland has a strong intrinsic appeal, the tourism sector can shift its focus from pure volume towards measures of success that reflect visitors' overall contribution to Iceland. We have seen how a three-pronged approach, including Building the Destination, Funding the Vision, and Organising for Success, can help draw the right visitors to Iceland and provide them a more engaging experience, while at the same time conserving the environment.

With so many different elements to this transformation, we have also shown how an overarching governance body, such as a Tourism Task Force, will be critical to keeping up the momentum and coordinating the overall programme of change.

Iceland is blessed with a wide range of natural resources: From its bountiful oceans to its abundant sources of energy. These assets have proved a reliable source of economic wellbeing for the Icelandic people for many decades, if not centuries. Today, a relatively new resource is ripe for development: That is the international appeal of Iceland's extraordinary nature, unique culture, and authentically warm-hearted people.

Gaustave Flaubert said "travel makes one modest. You see what a tiny place you occupy in the world." There is nowhere like Iceland to turn a brash tourist into a humble supplicant to the wonders of nature. Tourism is one of Iceland's gifts to the world. Let's make it even better.

## **Authors**

Alastair Flanagan is a Senior Partner and Managing Director in the London office of The Boston Consulting Group. He can be reached at [Flanagan.Alastair@bcg.com](mailto:Flanagan.Alastair@bcg.com)

Pedro Esquivias is a Partner and Managing Director in the London office of The Boston Consulting Group. He can be reached at [Esquivias.Pedro@bcg.com](mailto:Esquivias.Pedro@bcg.com).

Adam Swersky is a Project Leader in the London office of The Boston Consulting Group. He can be reached at [Swersky.Adam@bcg.com](mailto:Swersky.Adam@bcg.com).

Amy Stevens is a Consultant in the London office of The Boston Consulting Group. She can be reached at [Stevens.Amy@bcg.com](mailto:Stevens.Amy@bcg.com).

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We would also like to thank the Icelandic Tourist Board, Promote Iceland, SAF, Gekon, Statistics Iceland, Meet in Reykjavik, the Icelandic Tourism Research Centre, and Arion Bank, as well as Capacent and the respondents to their survey and focus group for the information and support they provided.



## Annex A: Detailed analysis of potential visitor segments

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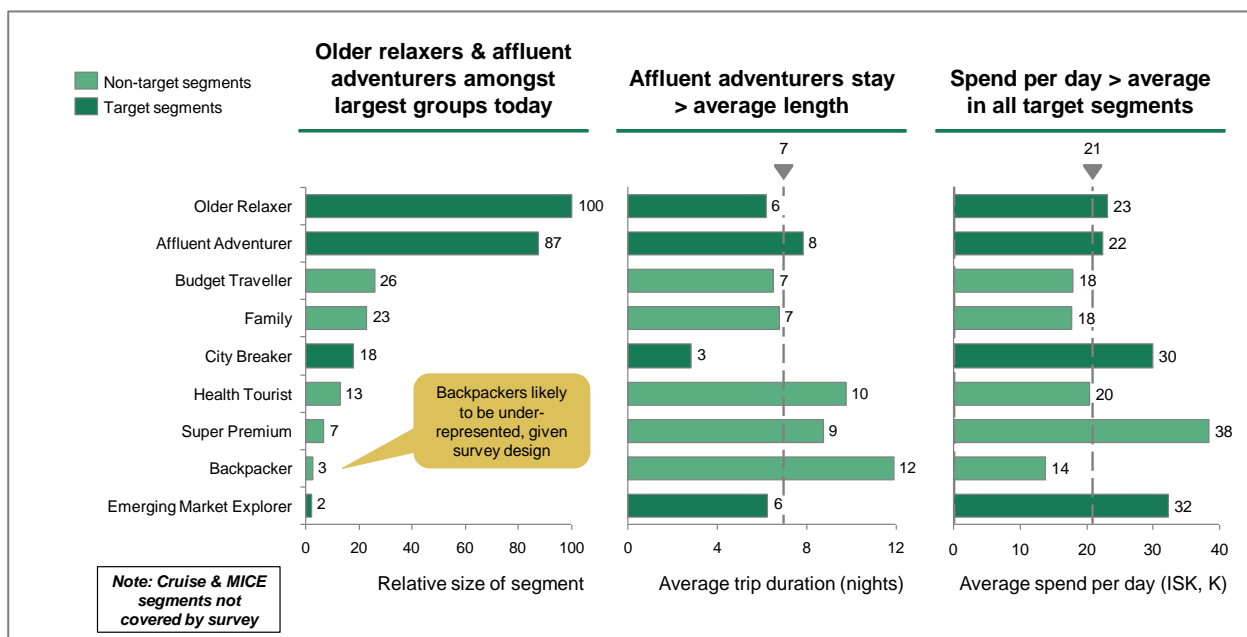
As discussed in Section 3, we assessed a range of potential visitor segments according to their attractiveness to Iceland and the appeal of Iceland to them. The results of our analysis allowed us to position each segment within the matrix shown in Exhibit 10.

In this annex, we provide further material for each segment to support our assessment. In addition to data from global benchmarks, reports, and input from BCG's experts and past project experience, we were able to access for the first time the raw data of the Icelandic Tourist Board's summer and winter visitor surveys. This allowed us to analyse key characteristics of each visitor segment.

Exhibit 28 shows the results of this analysis for all segments represented in this survey, with a focus on the size of the segment in Iceland today, their stay length, and their spend per day.

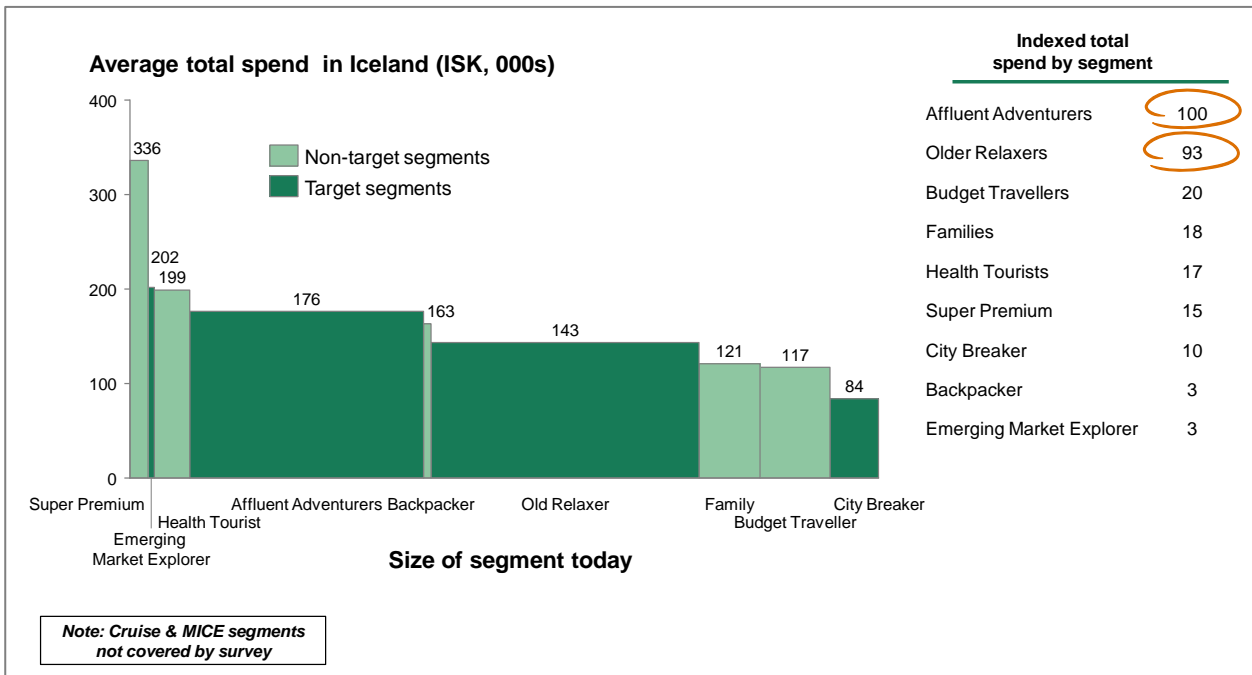
Exhibit 29 highlights the implications of this analysis for each segment's overall spend in Iceland, providing a view on their current importance to the tourism economy. As shown below, two of our target segments (Older Relaxers and Affluent Adventurers) are also the most important groups to Iceland today in terms of their spend. The other targets, City Breakers and Emerging Market Explorers, are much smaller, but have other attractive features (i.e. tendency to visit during winter, high spend per day and very high expected future growth).

Exhibit 28: All target segments spend more than average per day



Note: Total respondents:4408. Calculations weighted to adjust for seasonal bias. 2011 / 2012 average exchange rate used to convert from Krona. Indexed (Older Relaxer = 100). Respondents answered according to range, e.g., 1–2 nights. Mid-point of range used for calculations. Spend per day calculated as total spend per person/length of stay; Survey based on online responses and in-person survey at KEF. Source: MMR—International Visitors in Iceland, 2011 / 2012. BCG analysis

Exhibit 29: Affluent Adventurers and Older Relaxers highest value to Iceland today



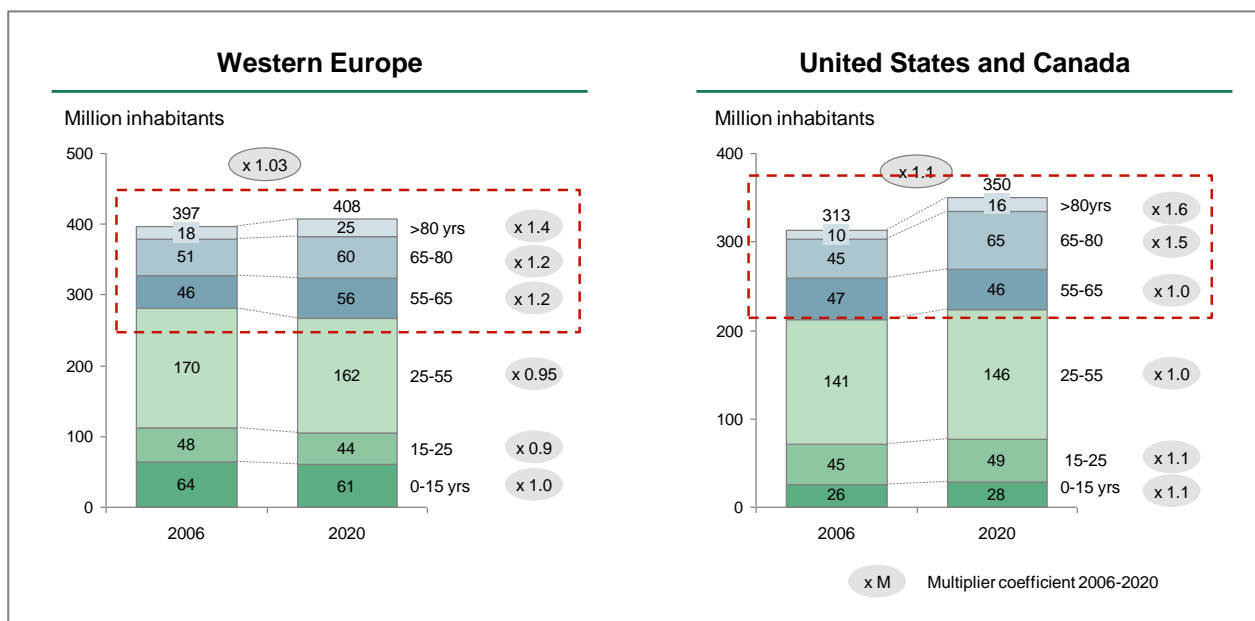
Note. Calculations weighted to adjust for seasonal bias. 2011 / 2012 average exchange rate used to convert from Krona. Groups not MECE. Index: Affluent Adventurer total spend = 100  
 Source: MMR—International Visitors in Iceland, 2011 / 2012. BCG analysis

**1. Older Relaxers**

Older Relaxers are over 50 travellers with mid-high incomes, generally from mature markets. They have a strong affinity towards cultural and relaxing activities and less towards overly active excursions.

**Attractiveness to Iceland.** In terms of the global size of the segment, around 30% of the population of Western Europe and North America (Iceland's core market) are over 55 and this is the fastest growing age group (see Exhibit 30).

Exhibit 30: ~30% of Iceland's core market are over 55 and this is the fastest growing age group

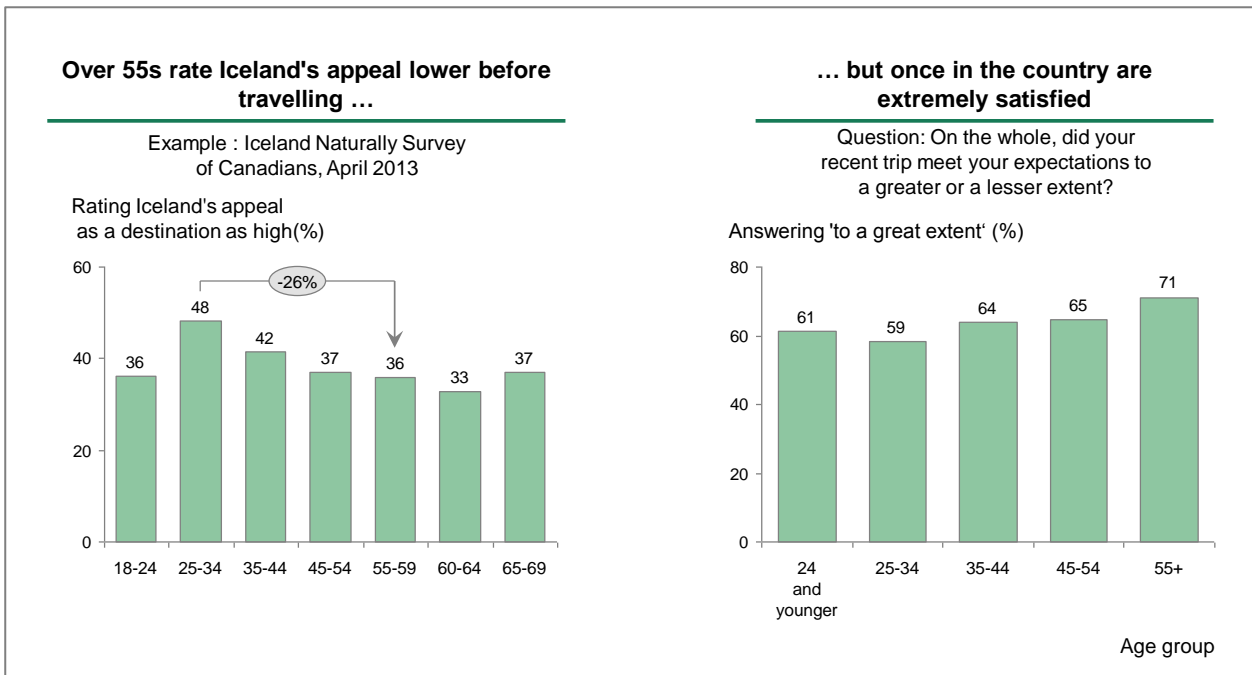


Note: Western Europe is. EU15 and Switzerland  
Source: Prognos

Globally, over 55s tend to stay for longer at their destinations with lower seasonality than other groups, whilst generally spending more. Around 35% of Iceland's defined segments today are Older Relaxers. They spend more than average per day in the country but currently stay for fewer days, thus overall are the second largest defined segment in terms of value to Iceland today, behind Affluent Adventurers.

**Appeal of Iceland.** Today, before visiting the country, Older Relaxers rate the appeal of Iceland as lower than younger age groups, however once in the country they report being extremely satisfied (see Exhibit 31). This may be due to Iceland's advertised product mix of highly active trips focussed on younger travellers. These data do suggest that targeted marketing could both attract more Older Relaxers to Iceland and attract them to stay longer

Exhibit 31: Over 55s rate Iceland's appeal lower before travelling, but are extremely satisfied once in the country



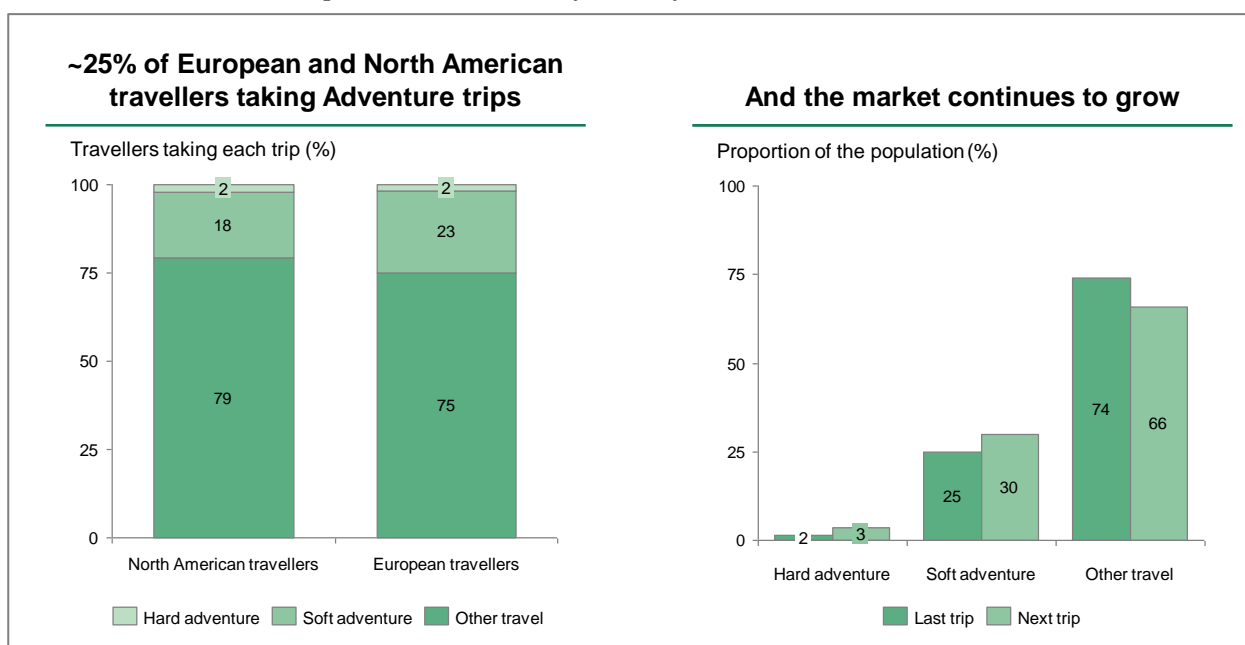
Note: n > 2.1K for each of summer, winter surveys. For Canadian survey, n=01; %s for in-country satisfaction are average of summer and winter, weighted by % of tourists visiting in each season. High score indicates 8-10/10  
 Source: Icelandic Tourist Board: " Visitor Survey Summer & Winter 2011/2012"; Iceland Naturally survey of Canadians, April 2013

## 2. Affluent Adventurers

Affluent Adventurers are younger with medium to high incomes and originate from mature markets. They are likely to pay to undertake adventure activities in Iceland, both of the 'hard' and 'soft' variety.

**Attractiveness to Iceland.** Adventure trips constitute 25% of travel from Iceland's core markets and this segment is anticipated to grow through a general trend of increased preference for adventure trips globally (see Exhibit 32). Supporting this growth is a rise in wealthier households in developed markets, implying both greater numbers of future adventurers who will be in possession of more wealth.

Exhibit 32: Adventure trips constitute 25% of travel from Iceland's core markets

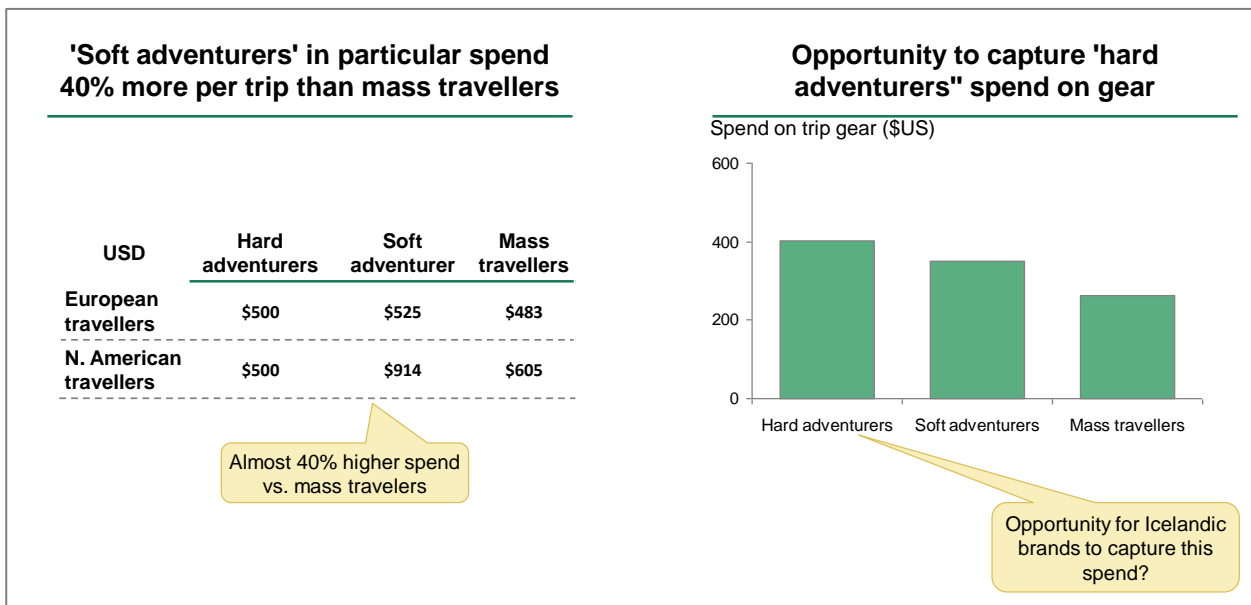


Source: Tourism Victoria, Market profile for year ending June 2012; "Adventure Tourism Market Report" (Adventure Travel Trade Association, August 2010), "Adventure Tourism Development Index: 2011 Report"

Note: Hard adventure includes e.g., trekking, climbing, caving; Soft adventure includes e.g., backpacking, canoeing, kayaking, safari, sailing, rafting, surfing, skiing/snowboarding, Right hand graph includes North American, European and Latin American travellers

Soft affluent adventurers tend to spend around 40% more than mass travellers per trip whilst hard affluent adventurers will spend more on specialist gear, creating demand for Icelandic adventure brands (see Exhibit 33).

Exhibit 33: Soft adventurers spend 40% more vs. mass travellers



Note: Hard adventure includes e.g., trekking, climbing, caving; Soft adventure includes e.g. backpacking, canoeing, kayaking, safari, sailing, rafting, surfing, skiing/snowboarding, Right hand graph includes North American, European and Latin American travellers  
 Source: June 2012; "Adventure Tourism Market Report" (Adventure Travel Trade Association, August 2010), "Adventure Tourism Development Index: 2011 Report; BCG analysis

In terms of travellers to Iceland today, Affluent Adventurers deliver the most value of all defined segments, being the second largest group, staying longer than average and spending more than average per day.

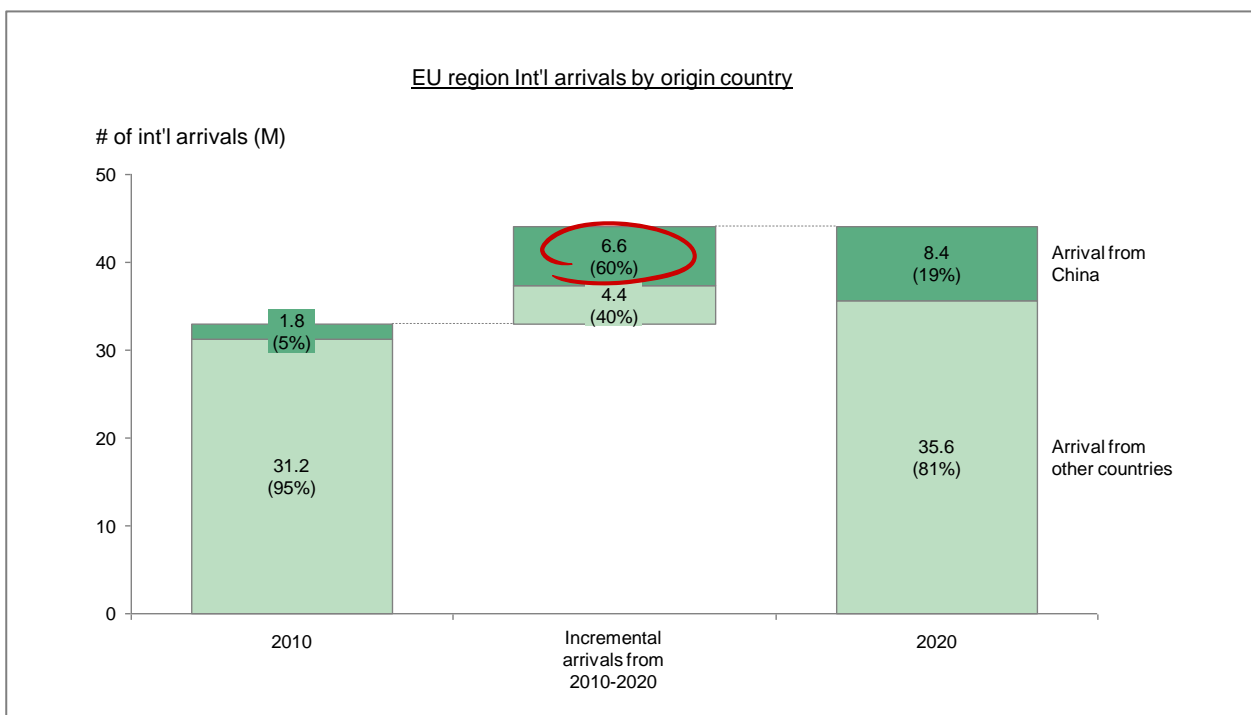
**Appeal of Iceland.** Iceland consistently ranks among the top 5 adventure destinations; coming 1st in 2009, 2nd in 2010 and 5th in 2011, in the Adventure Tourism Development index. Iceland's scores for natural and adventure activity resources were particularly high whereas its adventure *image* and sustainable development were poorly rated. There is clearly room for improvement via better sustainability scores and marketing. This will become increasingly important as other adventure destinations launch campaigns to capture this rising market segment.

### 3. Emerging Market Explorers

Originating from emerging markets, these travellers are increasingly more affluent and accustomed to international travel, with China representing the most significant pool of visitor growth.

**Attractiveness to Iceland.** China will represent over half of European inbound tourism growth to 2020 and the ability to capture a portion of the megatrend of Chinese overseas travel growth makes this segment attractive to Iceland (see Exhibit 34).

Exhibit 34: China will represent over half of European inbound tourism growth to 2020



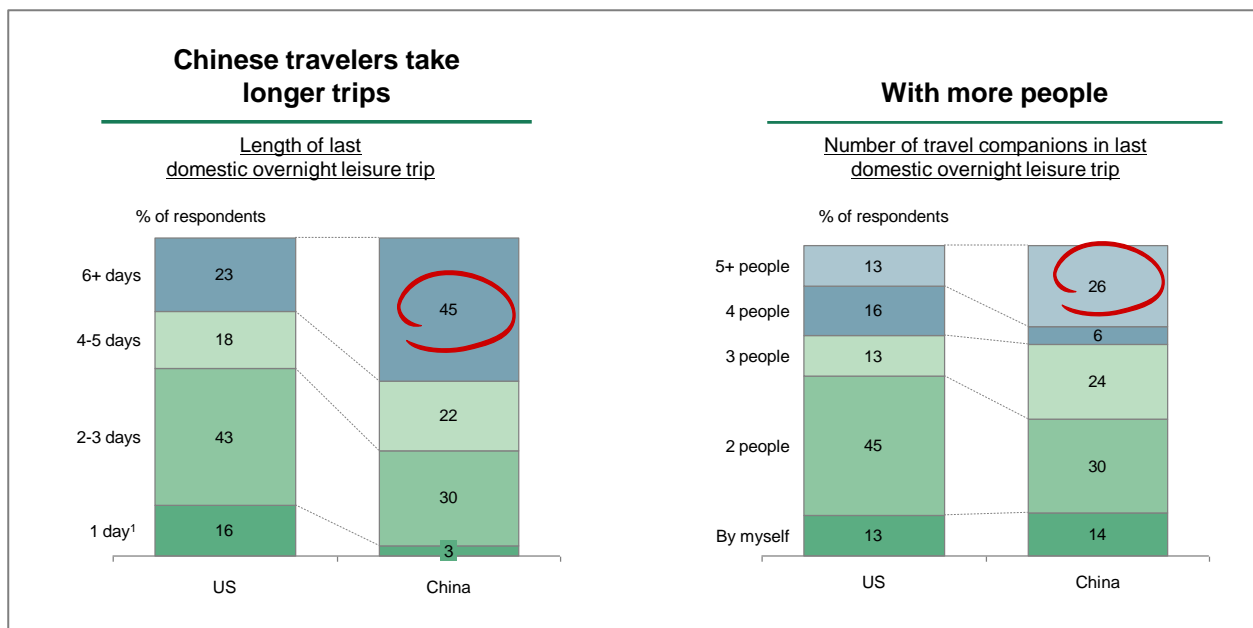
Note: Excluding intra-region trips

Source: WTO (World Tourism Organization); WTTC (World Travel and Tourism Council); BCG analysis

Chinese travellers tend to spend more of their income on travel. Whilst they take longer trips and usually travel in large groups, they tend to visit several locations during their trips and typically stay in one place for 1-2 nights in a group but >5 nights when travelling alone (see Exhibit 35).



Exhibit 35: Chinese travellers take longer trips and usually visit several countries when travelling to Scandinavia



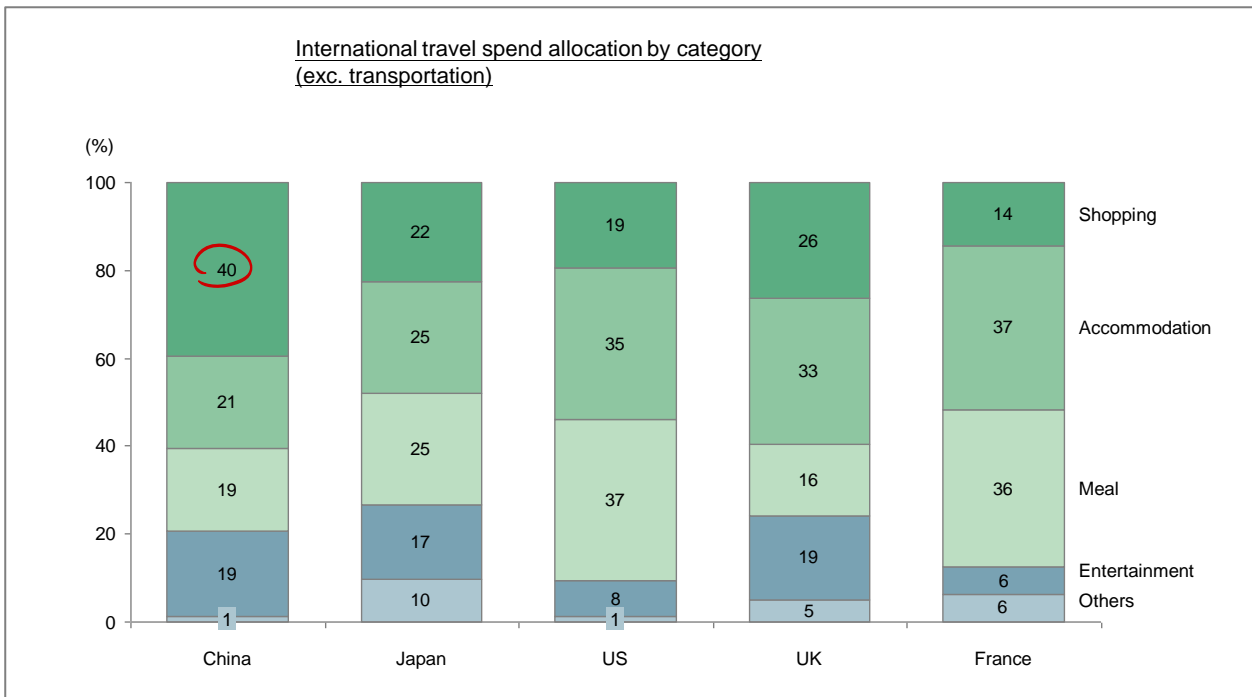
Note: 1 day here equals to 1 night; weighted response based on national traveller income distribution 2. Friends include colleagues and business partners

Source: BCG Chinese Consumer Survey in July 2010, 2009 BCG Consumer Travel Survey (for US data)

In Iceland today, Emerging Market Explorers represent a small proportion of defined segments visiting the country, however they spend considerably more than average per day. As per global trends, their stay in Iceland is currently under the average reported stay length. Icelandic Tourism industry stakeholders are divided on the importance of Asian tourists for future growth, as is evident from the Capacent survey conducted during May 2013, which found 38% of industry stakeholders viewed Asia as the most important region for Icelandic tourism growth while almost 20% viewed it as the least important.

**Appeal of Iceland.** Iceland has greatest appeal to the second generation of Chinese traveller, which is the 'experienced mass-market traveller'. These travellers like to explore cities outside of nearby regions, and trips abroad are an indication of status and special occasions. Their typical activities are sightseeing and relaxed entertainment. However, to attract the fast-growing third generation, 'Experienced Affluent traveller', development of more luxury products and shopping facilities will be needed along with premium accommodation. Chinese travellers have a unique spending pattern, shopping not only for themselves due to a strong gift-buying culture. They spend high proportions of their travel budget on shopping (see Exhibit 36), generally looking for offerings not available at home, familiar brands at competitive prices and luxury categories. Additionally, Duty Free Stores are one of the major shopping destinations.

Exhibit 36: To gain full value from Chinese tourists, product development is needed because unlike others, they allocate most of their budgets to shopping



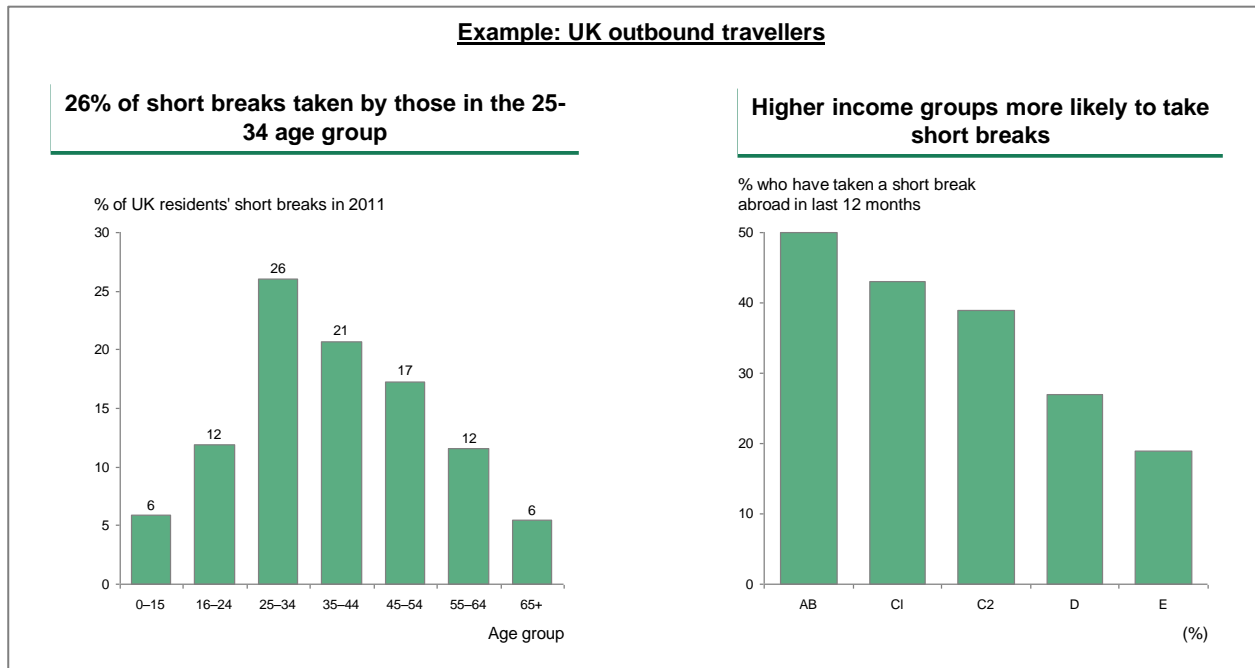
Note: Use data of BCG Chinese Consumer Travel Survey for China and Euromonitor data for benchmark countries  
 Source: BCG Chinese Consumer Travel Survey in July 2010; Euromonitor; BCG analysis

Chinese travellers are less likely to travel with children, a behaviour that most industry stakeholders believe that Iceland should be targeting. In addition, the opportunity to combine travel to Iceland with other Nordic / EU countries is likely to prove a draw to Chinese travellers until such time as Iceland is perceived as a destination within its own right.

#### 4. City Breakers

City Breakers are generally young to middle aged adults on higher incomes travelling without children (see Exhibit 37).

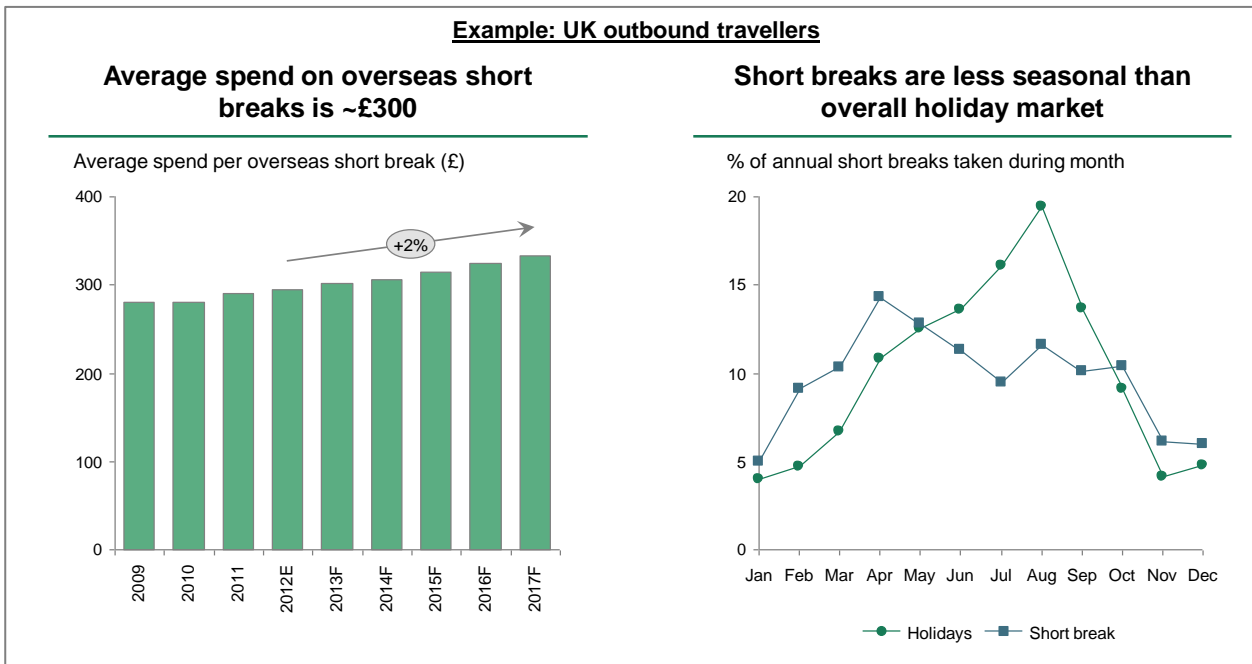
Exhibit 37: City breakers tend to be younger adults from higher income groups



Note: For all graphs, overseas short breaks are defined as 1-3 nights away from home  
Source: Mintel short/city breaks 2012, UK

**Attractiveness to Iceland.** Benchmarks suggest that overseas short breaks account for ~14% of all overseas holidays, with over half of them to cities. Therefore City Breakers constitute around 10% of outbound travel from Iceland's inbound markets and are an affluent section of the overseas traveller market. Globally, their average spend per day is higher than that of visitors on longer holidays and they are also less seasonal than the mass holiday market (see Exhibit 38). This combination makes City Breakers a particularly appealing group to Iceland.

Exhibit 38: City Breakers spending and stay patterns

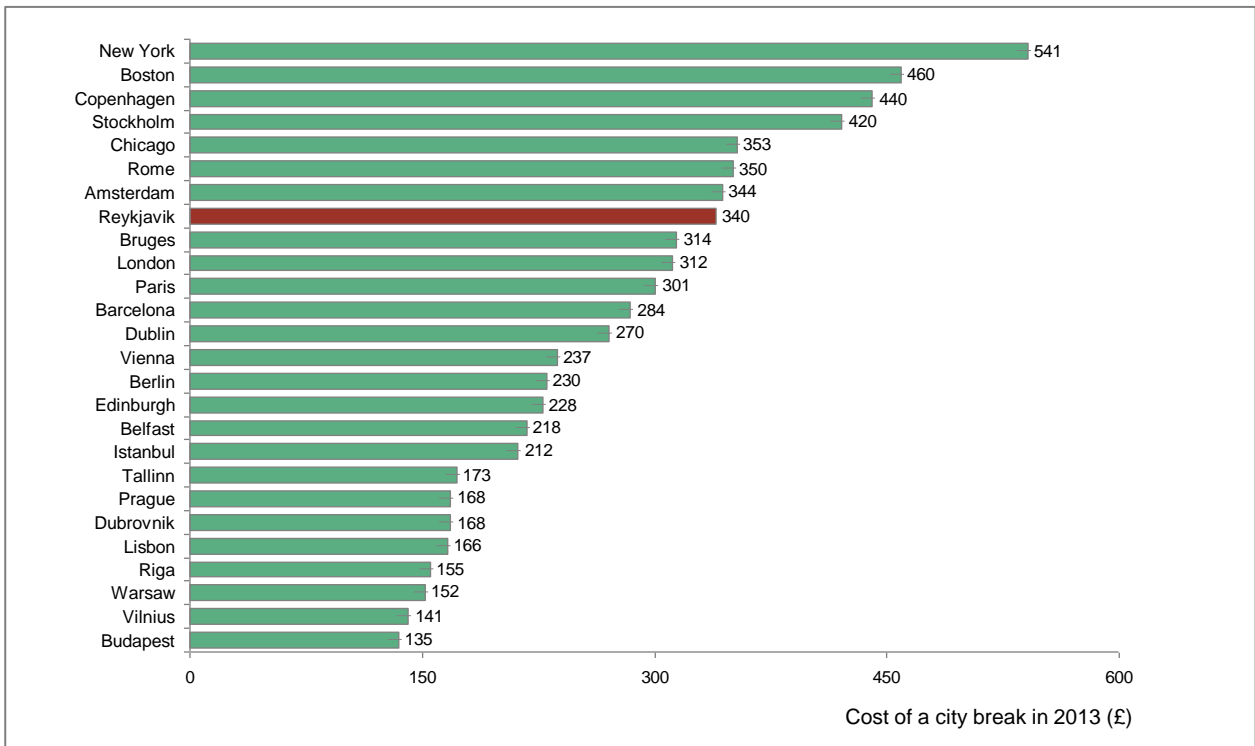


Note: Base: Adults aged 15+ who have taken a holiday/short break in the last 12 months. Short break is defined as 1-3 nights away from home. Number of short breaks taken includes domestic and overseas  
 Source: Mintel short/city breaks 2012, UK

In Iceland today, the segment is medium sized but with the third highest spend per day of all defined segments.

**Appeal of Iceland.** Iceland has a strong appeal to City Breakers. Direct flights to Reykjavik from other major cities, Iceland's unique culture and lively social calendar make it a popular destination. However, there are many cities within Europe competing for this segment and Iceland is a relatively expensive short break destination, potentially limiting the growth of this segment (see Exhibit 39).

Exhibit 39: Within Europe, Reykjavik & surrounds is a fairly expensive short break destination



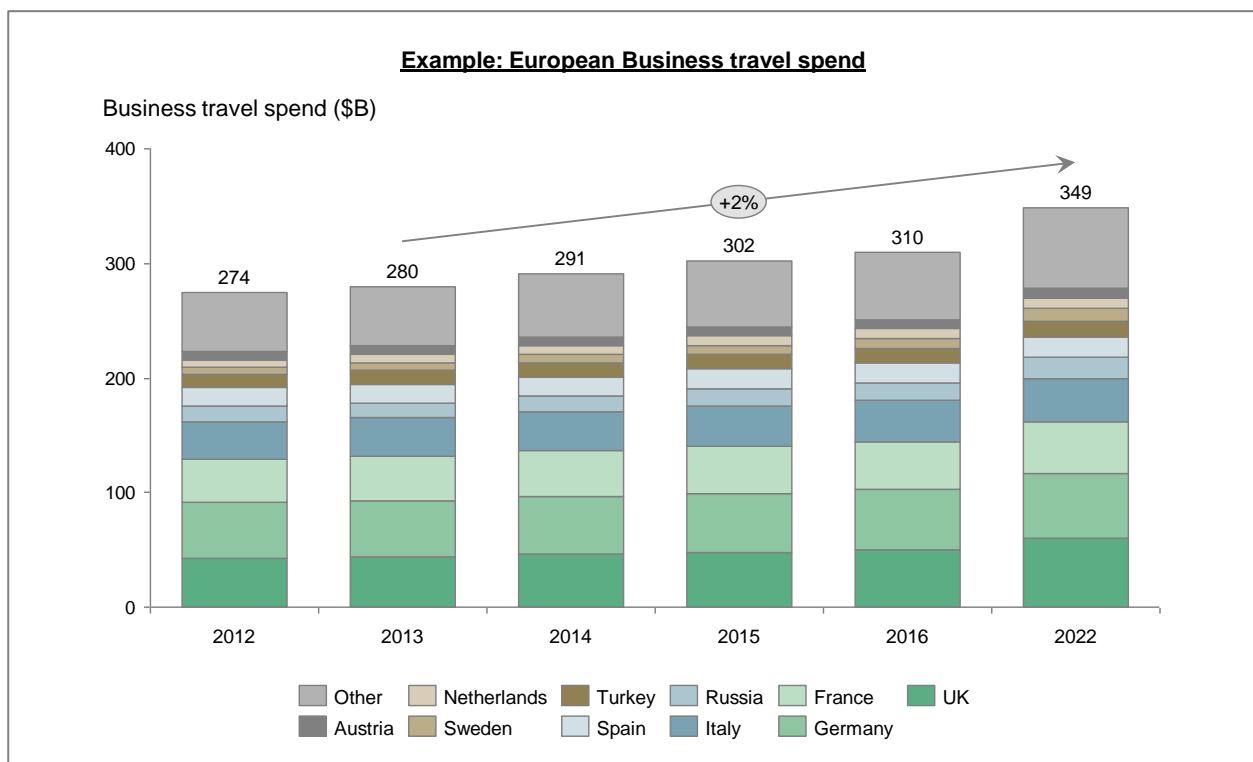
Note: Consisting of 12 holiday purchases: A cup of coffee in a bar/café; bottle of lager in a bar/café; bottle/can of Coca-Cola in a bar/café; glass for wine; 3-course evening meal for two adults including bottle of wine; return bus or train transfers from airport to city centre; 48-hour travel card; sightseeing city bus tour; top heritage attraction; top museum; top art gallery; 1-night 3-star hotel accommodation for two adults (hotels.com)  
 Source: Post office 2013 City costs barometer for benchmarks. For Iceland – field research, hotels.com

## 5. MICE

MICE travellers are those visiting Iceland for business purposes; Meetings, Incentives, Conferences and Events. The segment is comprised of business travellers on higher incomes, generally from mature markets.

**Attractiveness to Iceland.** The MICE segment is attractive to Iceland given their much higher spend per person than normal visitors. According to the Managing Director of Meet in Reykjavik, "MICE visitors are staying on average 4 days and spend per day is 2-3 x that of an average tourist". This compares similarly to other nations such as New Zealand and Malaysia where stakeholders have spoken of the additional spend MICE visitors bring compared to tourists. In addition this segment is forecast to grow at a rate of 2% until 2022 (see Exhibit 40), although the volume is lower than general tourism. Whilst this segment is unlikely to spend much outside of Reykjavik, the segment is far less seasonal.







Exhibit 40: MICE segment forecasted to grow at 2% CAGR 2012–2022



Source: Mintel, the European MICE industry, October 2012

**Appeal of Iceland.** This segment is in its infancy in Iceland, with Reykjavik hosting just 33 international association meetings in 2011 (according to ICCA), vs. Amsterdam's 114, Budapest's 108, Copenhagen's 98 or Stockholm's 93. This is reflected in Iceland's current average performance across a range of key MICE location criteria (see Exhibit 41).

Exhibit 41: Reykjavik's performance across a number of MICE location criteria

Criteria	Reykjavik performance	Rationale
1 # direct flights to the city		<ul style="list-style-type: none"> <li>• 35 Icelandair destinations</li> <li>• Lower than major cities</li> </ul>
2 Relatively low cost of flights & hotels vs other destinations		<ul style="list-style-type: none"> <li>• Estimated as average cost for transatlantic companies</li> </ul>
3 Max 1-3 hotels of similar 4/5* standard to host all attendees, close to venue		<ul style="list-style-type: none"> <li>• No large city centre hotels</li> <li>• No 5* hotels</li> </ul>
4 Ability to cater for 20+ meetings in the year of variable size		<ul style="list-style-type: none"> <li>• Harpa with different size rooms</li> <li>• Low availability of accommodation in peak season</li> </ul>
5 Conference centre in city centre		<ul style="list-style-type: none"> <li>• Harpa in city centre</li> </ul>
6 Office located in the city		<ul style="list-style-type: none"> <li>• Few international company large offices in Reykjavik</li> </ul>

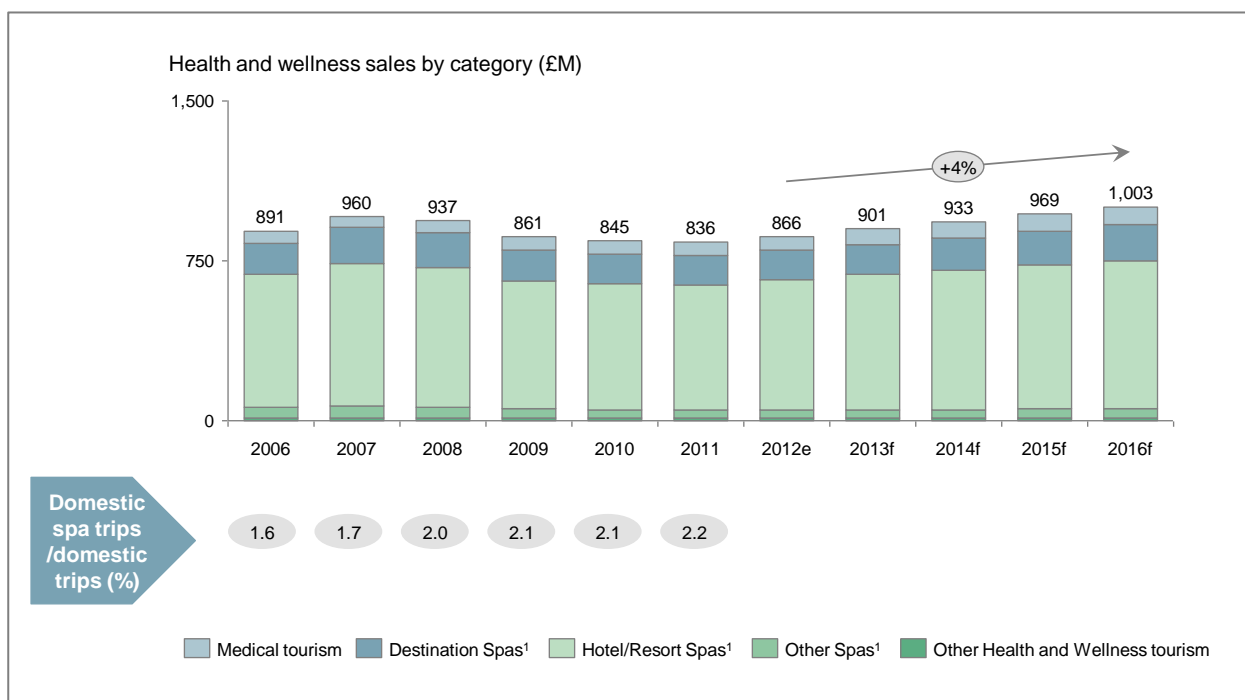
Source: Interviews with BCG Global planning department, Meet in Reykjavik

## 6. Health Tourists

Health Tourists are typically middle aged with an above average income or higher. They are based in mature markets and travel to destinations specifically seeking activities that are wellbeing orientated such as spas, retreats, etc.

**Attractiveness to Iceland.** Whilst this is a small segment, globally representing as little as 2% of travellers, they hold attractive features. Within the UK who have a similar rate of domestic spa visitors the sector is forecast to grow at a rate of 4% per year, developing into a £1Bn industry by 2016 (see Exhibit 42). This is reflective of a wider trend towards more active, experiential tourism that Iceland may tap into.

*Exhibit 42: Spa trips just 2% of domestic trips made in the UK—Industry forecast to grow at 4% CAGR to £1Bn value in 2016*



Note: "e" indicates expected value; "f" indicate forecast value

1. Destination Spas, Hotel/Resort Spas and Other Spas comes under "Spas"

Source: Euromonitor Passport, Health and Wellness tourism in the UK, Aug 2012

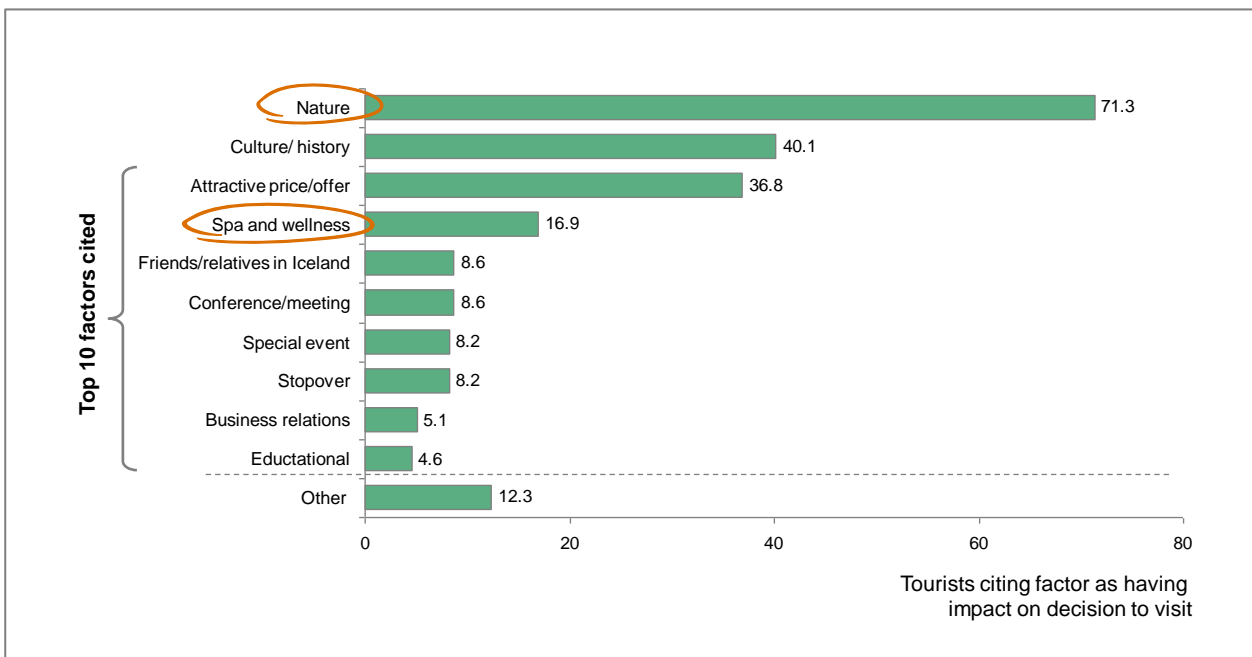
Health Tourists also tend to be more affluent, health activities are often associated with longer stays and a higher spend. Indeed, in Iceland today the segment stays second longest of all defined segments, surpassed only by Backpackers. Whilst on a per-day basis their spend is average, over the period of the stay their total spend is higher.

The infrastructure created to cater for them such as spas, exploitation of natural 'wellbeing' attractions, high end accommodation, etc is also desirable to other groups.



**Appeal of Iceland.** The Icelandic spa and wellness sector is in its infancy but emerging brands are establishing potential. Whilst only 17% of visitors cite spa and wellness as a reason to visit Iceland, vs. 71% for nature (see Exhibit 43), the two factors are not mutually exclusive. Forbes magazine ranked Iceland as the 'World's healthiest country' in 2008, making a clear link between wellness and nature: 'Icelanders enjoy one of the world's highest healthy life expectancies...giving them plenty of time with the country's mountains, glaciers, volcanoes, waterfalls and coastal lands. The country is also one of the world's least polluted'. Up-and-coming skincare brands such as BIOEFFECT and the use of Icelandic moss in Boots make up, show the growing appeal of Icelandic wellness & beauty products.

Exhibit 43: Only 17% of visitors cite spa and wellness as a reason to visit Iceland today



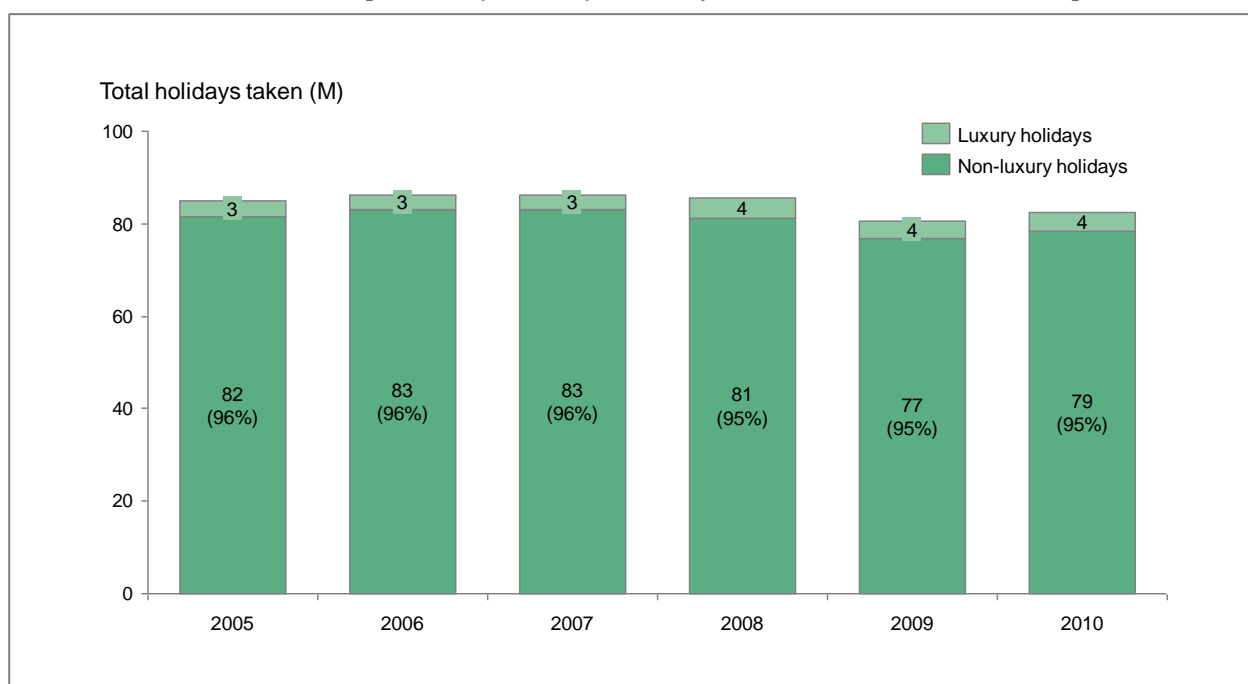
Note: 10.3% in summer survey versus 79.7% for Nature  
 Source: Icelandic Tourist Board, " Visitor Survey Winter 2011/2012", BCG experience

## 7. Super Premium

The Super Premium segment is defined as aged 35+, with a high income, located in all markets of the world. They typically seek high end, unique experiences that the majority of travellers are unable to afford.

**Attractiveness to Iceland.** This is a relatively small group within Iceland's core markets of Western Europe accounting for as little as 5% of outbound travel (see Exhibit 44). Whilst they may spend a great deal of money, their low numbers, search for the 'unique' and high service requirements mean that they may be unlikely to become 'repeat' visitors and it may be costly to cater to their tastes.

*Exhibit 44: In Western Europe, luxury holidays ~5% of outbound travel—UK example*

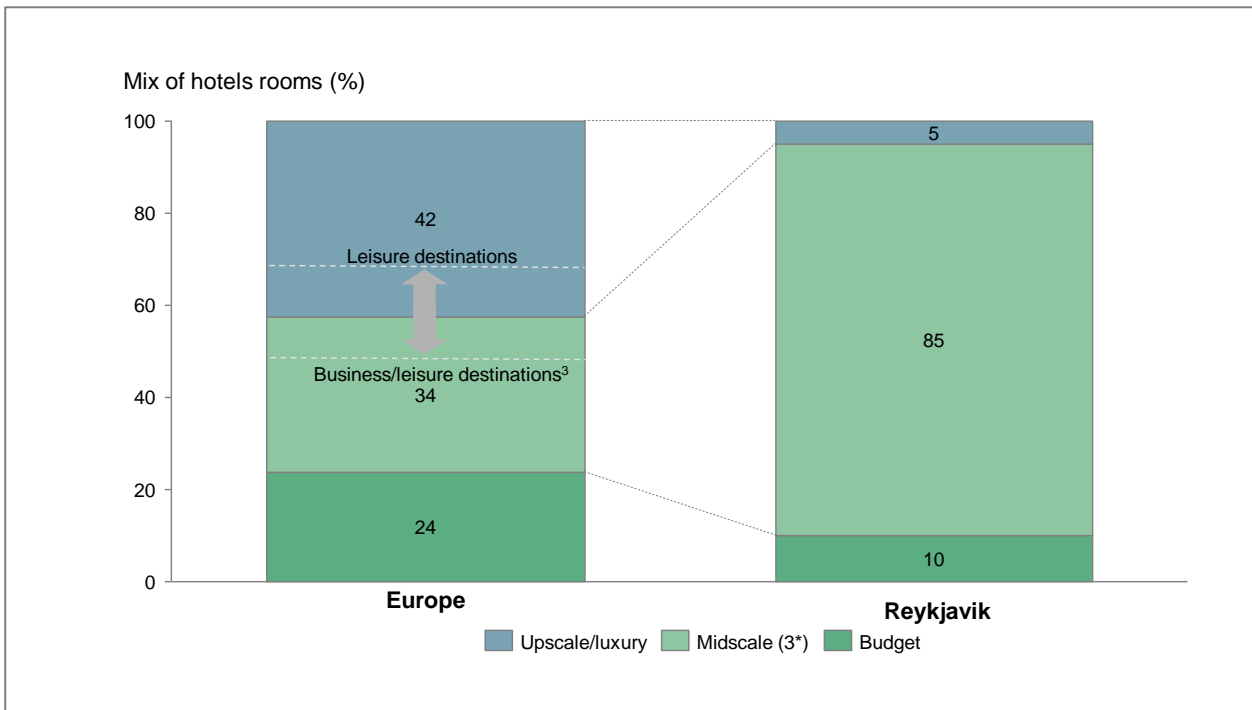


Source: Mintel, Luxury holidays report June 2012

It should be noted that whilst a small segment in Iceland today, outbound travel by this segment from markets with new direct routes to Iceland, such as Russia, is higher.

**Appeal of Iceland.** Iceland currently lacks the infrastructure to attract this segment. Within European cities the share of upscale and luxury hotels averages ~40% whilst in Reykjavik this averages only ~5% (see Exhibit 45). Whilst they are a complex segment to attract even with unique offerings, high end 4/5\* hotels would need to be built as a foundation to securing their custom.

Exhibit 45: Within Europe, share of upscale/luxury hotels averages ~40%, whilst in Reykjavik only ~5%



Note: Chain hotels only considered from STR global, Reykjavik % from discussions with Icelandair hotels  
 Source: Mintel International Hotel Industry, Travel & Tourism Intelligence, December 2009; STR Global; BCG analysis

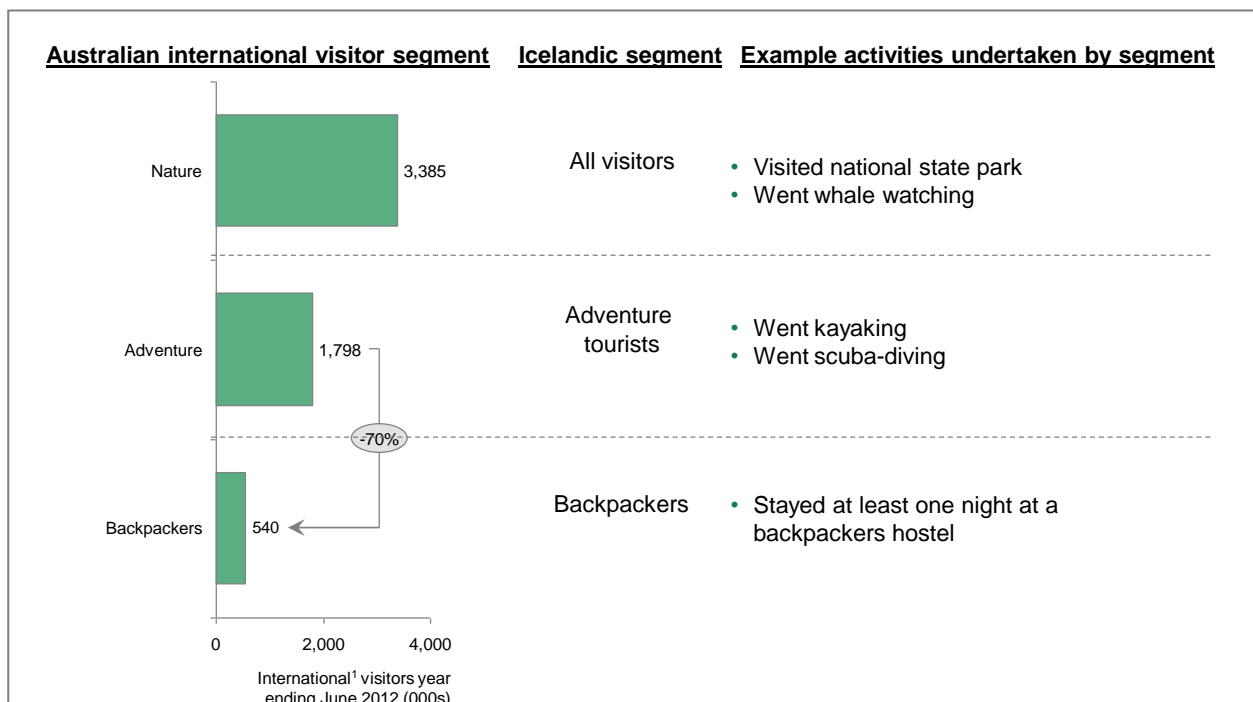
Whilst Iceland lacks infrastructure it has unique attractions that are relatively underdeveloped. Should Iceland pursue Super Premium targeting strategies, e.g. the Bentley Power on Ice event offered in Finland, it is likely Iceland's natural assets would prove a strong draw to this segment.

## 8. Backpackers

Backpackers to Iceland tend to be younger and from lower income groups. They typically look to experience 'hallmark' activities whilst travelling on a budget.

**Attractiveness to Iceland.** Backpackers are a small segment globally, ~30% the size of adventure tourists (see Exhibit 46). Equally, in Iceland today few visitors answering the visitor survey would appear to be part of this segment (see Exhibit 28). However, we believe this is an under-estimation of their numbers, firstly due to the nature of the survey, conducted online. Secondly, in Iceland, where all travellers enjoy activities connected to nature, we believe there will be significant overlap with the Budget Travellers segment.

*Exhibit 46: Size of backpacker segment ~70% lower than adventurers—Example: Australian international visitors*



Note: International tourism taken as most representative of global profiles  
Source: Tourism Victoria, Market profiles for year ending June 2012; BCG analysis

Whilst Backpackers in Iceland spend the least per day, they stay the longest and tend to travel to more regions within Iceland. Thus are an attractive segment to achieve Iceland's aims of spreading the impact of tourism beyond Reykjavik and surrounds.

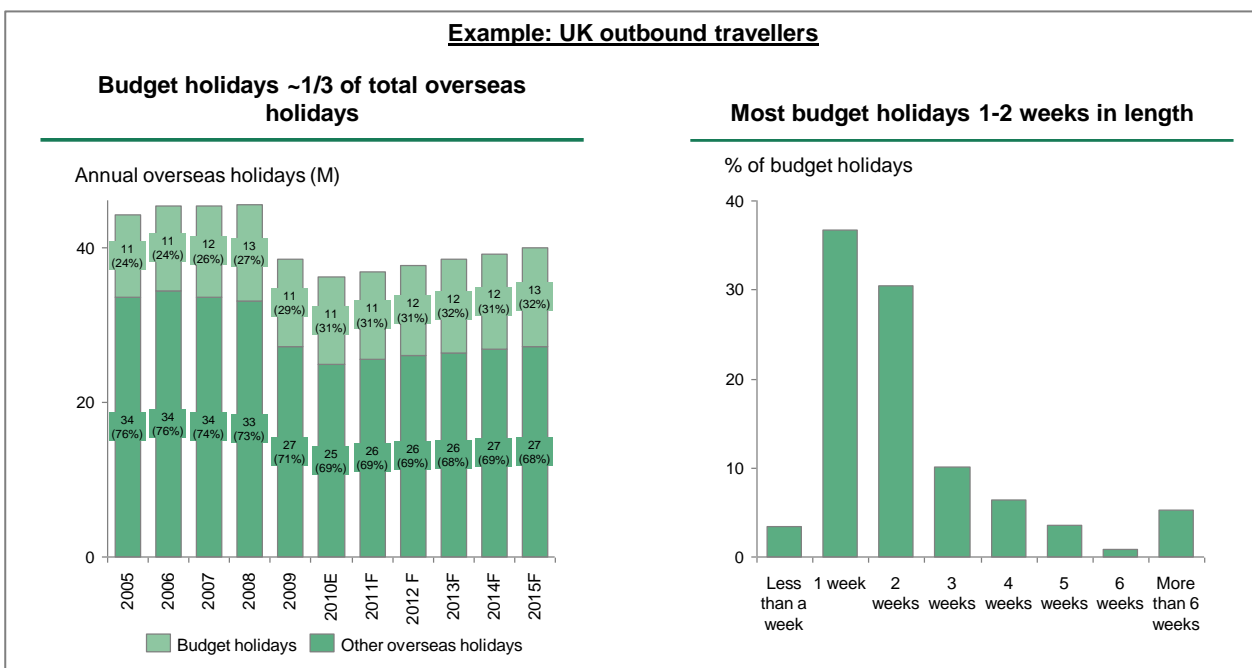
**Appeal of Iceland.** Iceland is an appealing destination to backpackers given its unique attributes and adventure activities. However, it is an expensive destination for backpackers (average price per day being \$64 according to the Backpacker index 2013), with limited low cost options.

**9. Budget Travellers**

Budget Travellers are a broad group who cover all ages and markets. Their defining feature is seeking travel on a lower budget.

**Attractiveness to Iceland.** This is a large group, who make up a significant proportion of overseas travel from Iceland's core markets. Budget Travellers tend to stay for extended periods of between one and two weeks at a given location, based on benchmarks (see Exhibit 47). In Iceland today, their reported stay length is about average of the defined segments (see Exhibit 28).

*Exhibit 47: Budget holidays ~1/3 of overseas holidays, most 1-2 weeks in length*



Note: Filtered by fieldwork period (January 2010–June 2010), Base: adults aged 15+ who have taken a holiday abroad and who spent a 'budget' amount in the last 12 months

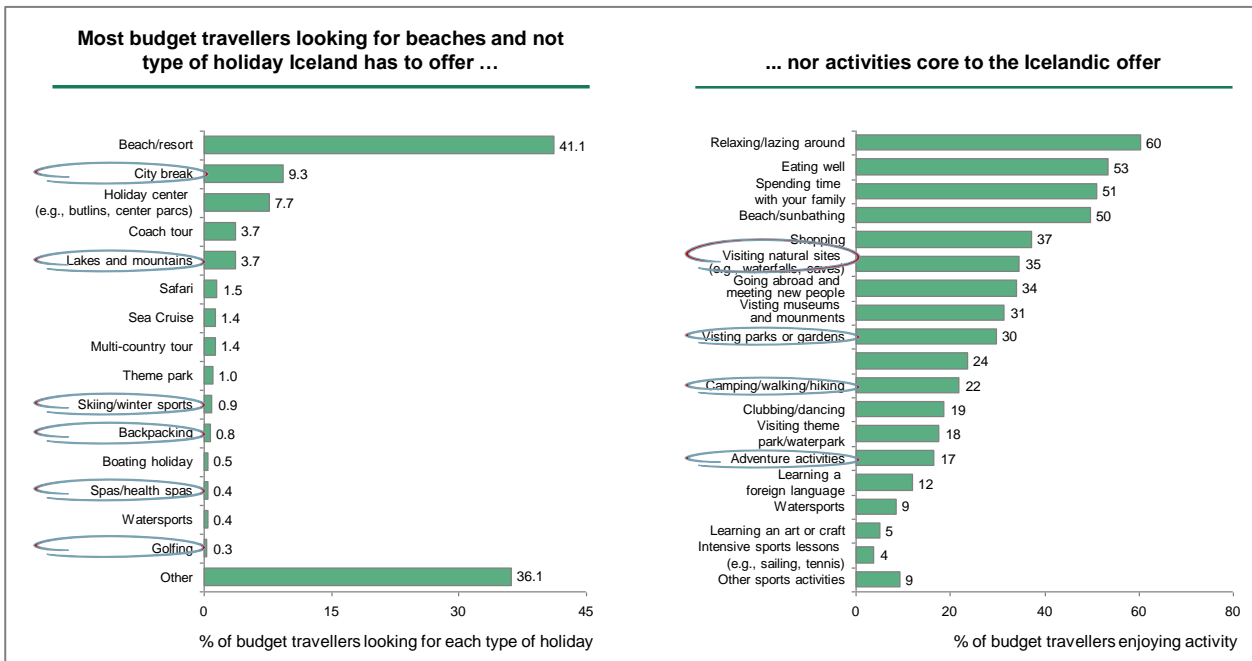
This report defines „budget holidays“ as overseas trips of longer than three nights“ duration where the costs (not including spending money) do not exceed £250 for one person, or £500 for two or more people. They must be taken outside the UK, and do not include staying with friends or relatives or at consumers“ own property overseas

Source: Mintel/ UK budget Holidays, March 2011

However, Budget Travellers typically spend less than average per visitor per day and are looking for 'budget' options. They instead drive volume without creating significant value for the country on a per-visitor basis.

**Appeal of Iceland.** Budget Travellers from outbound markets are generally not looking for what Iceland has to offer. Approximately 50% are looking for a beach / resort / holiday centre holiday of some sort, with the next largest group of ~10% looking for a city break. The activities they are seeking to do are also not aligned with those on offer in Iceland, with over 60% aiming to 'relax / laze around' (see Exhibit 48).

Exhibit 48: Budget Travellers' preferences not closely aligned to Icelandic offer



Note: This report defines „budget holidays“ as overseas trips of longer than three nights“ duration where the costs (not including spending money) do not exceed £250 for one person, or £500 for two or more people. They must be taken outside the UK and do not include staying with friends or relatives or at consumers“ own property overseas; Base: adults aged15+ who have taken a holiday abroad and who spent a ‘budget’ amount in the last 12 months. Right hand graph refers to % saying they enjoy the activities  
 Source: Mintel UK Budget holidays March 2011

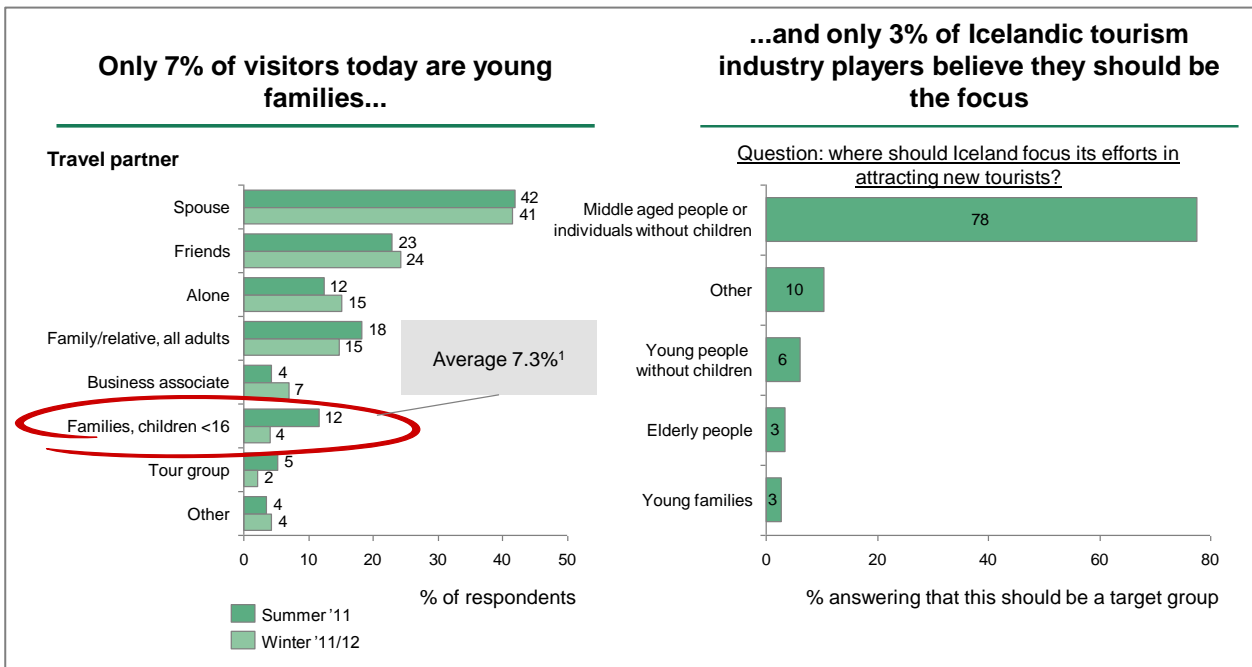
**10. Families**

Families are those travellers who bring children under the age of 16 with them when vacationing. They are generally unable to partake in many activities and require a unique set of products and capabilities in a holiday destination to enable them to visit.

**Attractiveness to Iceland.** Of Iceland's inbound markets, Families account for approximately 1/3 of outbound travel and this is forecast to remain fairly constant in next few years (according to Mintel, UK Family Holidays July 2012).

The attractiveness of Families is expected to vary according to how closely they align with other segments. For example Emerging Market Explorers travelling with young children may still be an attractive proposition for Iceland. Furthermore this is a large potential segment for Iceland to tap into. However, on the whole this is not an attractive segment for Iceland to focus on given the high levels of product investment that would be needed to suit their needs – only 7% of visitors today are young families - and only 3% of the Icelandic tourism industry believes they should be a focus (see Exhibit 49).

*Exhibit 49: Breakdown of types of travel partner to Iceland & most important target groups according to industry players*

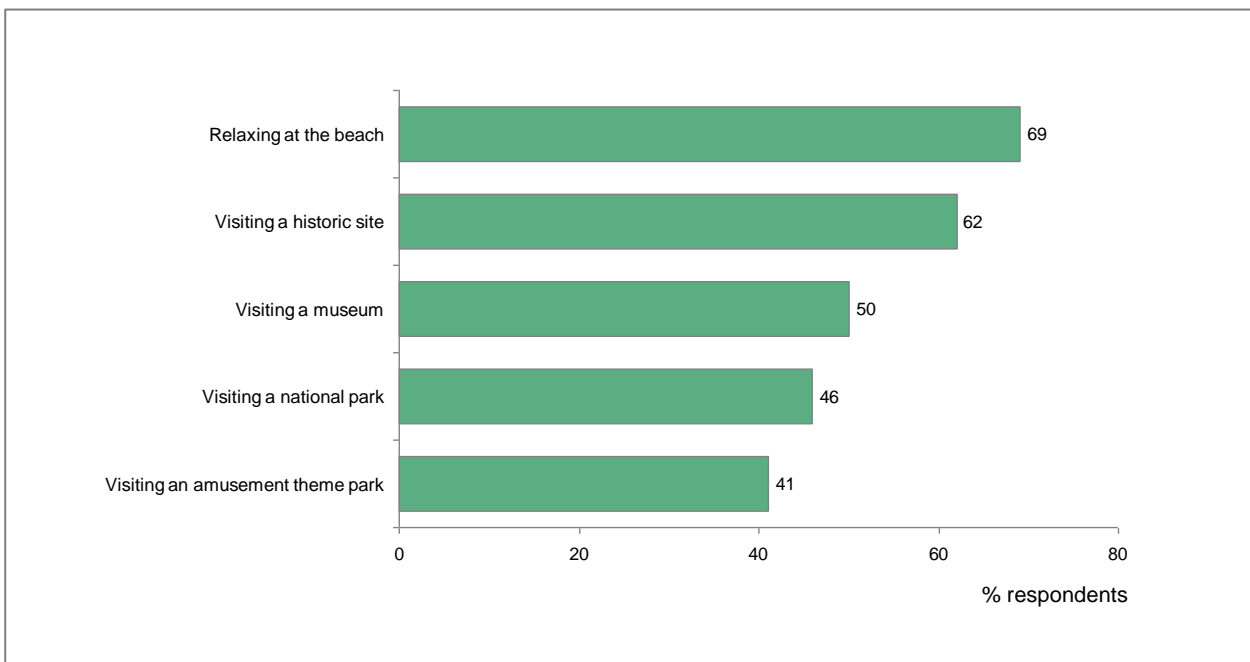


Note: Weighted by # visitors in each period  
 Source: Iceland Tourist Board Summer & Winter surveys 2011-12 ; Capacent survey of Icelandic industry players, May 2013

On the whole, in Iceland today, Families are spending an average length of time in Iceland but spending less per person per day (see Exhibit 28).

**Appeal of Iceland.** Today, Iceland's core attractions are not family-focused. According to a TripAdvisor survey (see Exhibit 50), activities such as relaxing at the beach and visiting historic sites are more popular than visiting museums and national parks. There is a common view amongst industry stakeholders that Iceland's offer today is not tailored to families, with responses to surveys and interviews such as: "We are lacking in family and children products. Families don't come here much." and "I'm not sure what I'd do with kids after going to the zoo".

*Exhibit 50: Only 50% of families report visiting museums / national parks as a popular family activity they have planned*



Source: TripAdvisor survey of family travel, March 2010

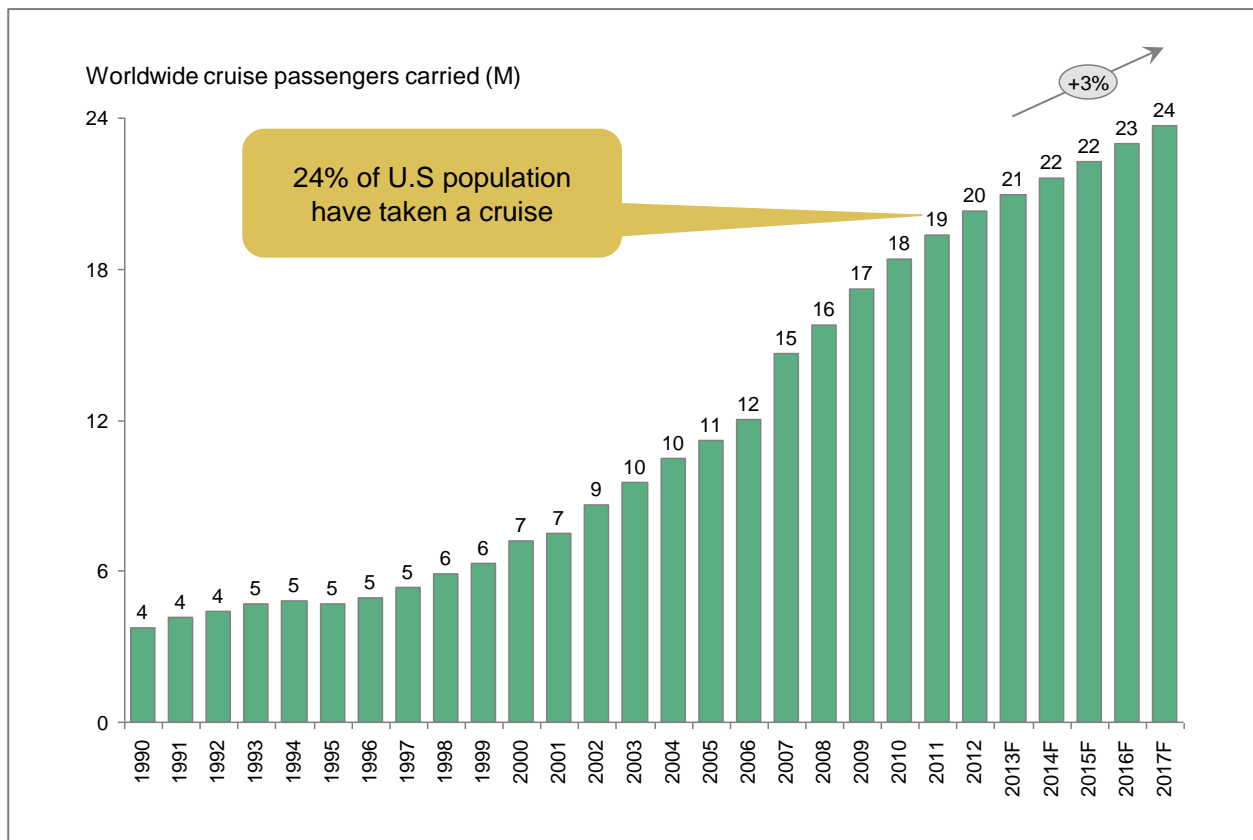


## 11. Cruise

Cruise passengers are defined as those travelling to Iceland on cruise ships. They are likely to be older and on higher incomes.

**Attractiveness to Iceland.** Cruise passengers are a growing segment, expected to grow at a rate of 3% per year to 2017. They are also a large group within Iceland's core markets, with 24% of US population having taken a cruise in their lifetime (see Exhibit 51)

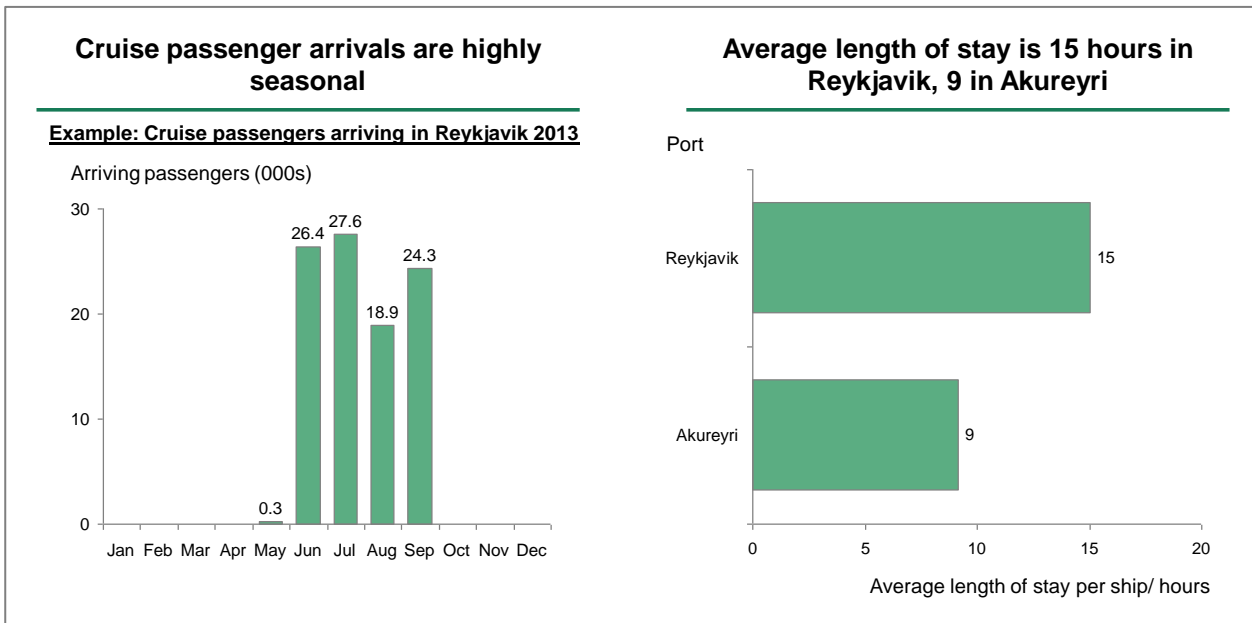
Exhibit 51: Cruise passengers expected to grow at 3% CAGR to 2017



Source: Cruise Market Watch

Cruise passengers however typically spend less per day at a destination than other tourists as they have much shorter stays: an average of 15 hours in Reykjavik or 9 hours in Akureyri in 2013. They are also a seasonal group with nearly all visitors arriving between June and September (see Exhibit 52).

Exhibit 52: Cruise visitors are highly seasonal and spend < 1 day on average in port



Source: Cruise Iceland, June 2013

**Appeal of Iceland.** Cruise visitors are most likely to visit Iceland as part of Scandinavian / transatlantic tours. Attractions such as the Blue Lagoon are expected to have a unique appeal to Cruise companies, however given the limited time in port, the majority of Iceland's offerings would not be experienced by the segment.

### Niche Segments

Niche segments can be attracted via specific events / catering. Examples of niche segments include music, golf, food and drink, sport and arts (see Exhibit 54). One major example is the Gay & Lesbian community.

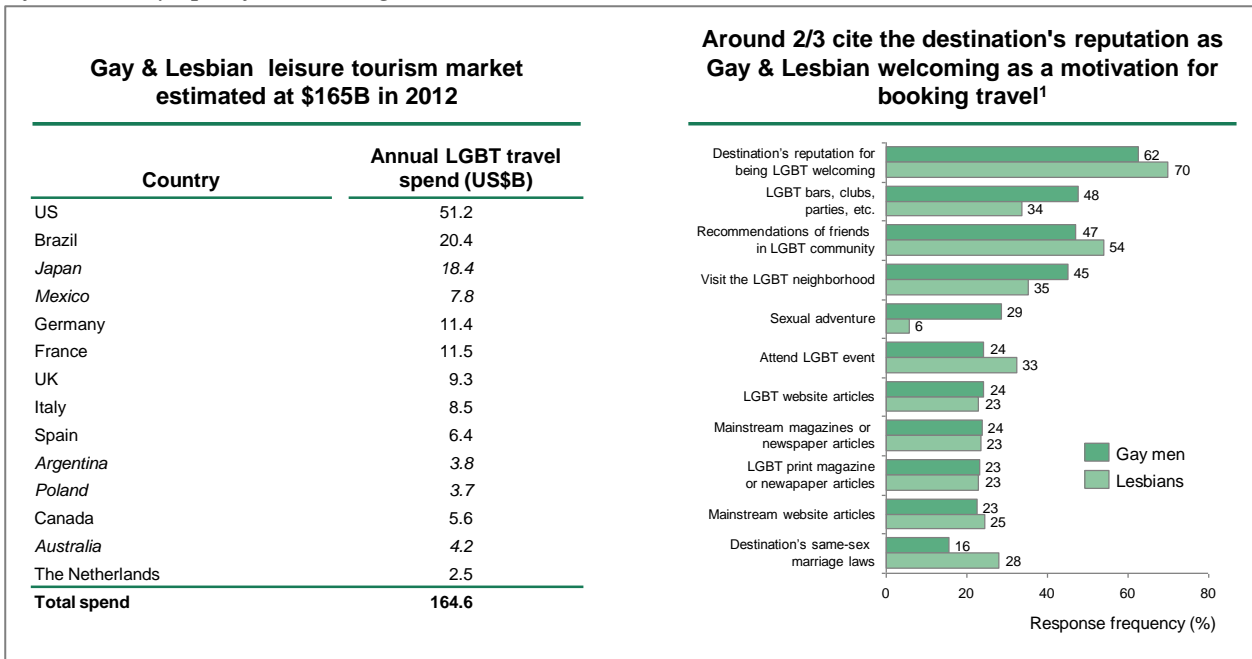
Exhibit 54. Niche segments and potential attractions

Example niche	Example attractions
<b>Music</b>	<ul style="list-style-type: none"> <li>• Iceland airwaves</li> <li>• Bræðslan music festival</li> </ul>
<b>Golf</b>	<ul style="list-style-type: none"> <li>• Midnight golf</li> <li>• The Arctic Open Golf Championship</li> </ul>
<b>Food &amp; drink</b>	<ul style="list-style-type: none"> <li>• Mid-winter festivals in Thorri</li> </ul>
<b>Gay &amp; Lesbian</b>	<ul style="list-style-type: none"> <li>• Gay Pride in August</li> <li>• Bears on ice</li> <li>• Pink party</li> </ul>
<b>Marathons</b>	<ul style="list-style-type: none"> <li>• Reykjavik marathon</li> <li>• Laugavegur marathon</li> </ul>
<b>Arts</b>	<ul style="list-style-type: none"> <li>• LUNGA festival</li> </ul>

Source: Web search

**Attractiveness to Iceland.** The worldwide Gay & Lesbian tourism market is estimated at \$165Bn in 2012, 2/3 of which is influenced by specific Gay & Lesbian catering. Over 50% of this market is concentrated in the US, Brazil and Japan, but even small players such as Poland, Canada and the Netherlands generate between \$3 – 4 Bn a year each from this segment (see Exhibit 55).

Exhibit 55: Gay & Lesbian worldwide market estimated at \$165Bn in 2012, ~2/3 of which influenced by specific catering

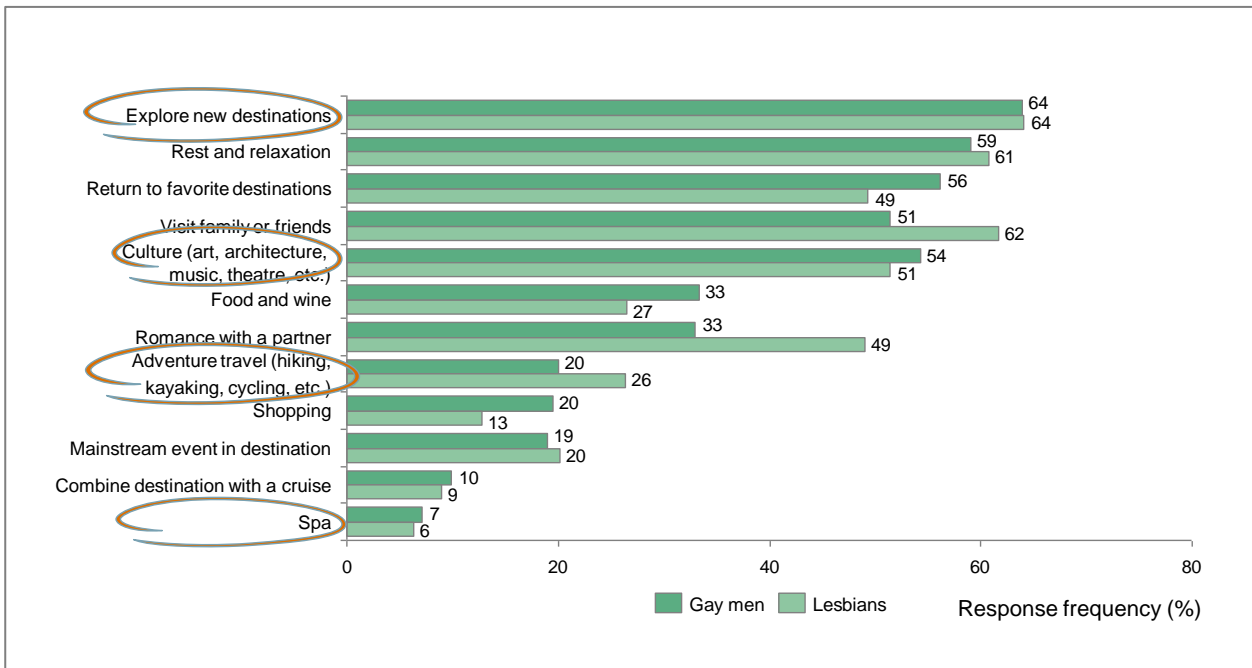


Note: LGBT = "Lesbian, Gay, Bisexual and Trans-sexual"

Source: OutNow global LGBT2020; Community Marketing 16th Annual Gay & Lesbian tourism report

**Appeal of Iceland.** Promoting Iceland as LGBT friendly and providing specific catering may prove effective levers to increase the appeal of this segment. In addition Iceland offers a number of other core motivators for LGBT travel such as the opportunity to explore new destinations, adventure travel and spas (see Exhibit 56).

Exhibit 56: Iceland's natural assets that may appeal to LGBT visitors



Source: Community Marketing 16th Annual Gay & Lesbian tourism report

## Annex B: Methodology for calculating economic impact

## Annex B: Methodology for calculating economic impact

### Definitions:

- **Gross Domestic Product (GDP):** The monetary value of all finished goods and services produced within a country's borders in a year,
- **Gross Value Add (GVA):** GVA measures the contribution to the economy of an individual sector, such as tourism. It is calculated at basic prices, not including taxes on products but including any government subsidies. GVA can be converted to GDP at market prices by adding taxes and removing subsidies. In this section we refer to GDP impact since values are at market prices.
- **General Sales Tax (GST):** Tax collected by merchants on consumer goods sold and submitted to the Government. In 2013 this is set at 26% of the purchase value.

**Introduction:** The economic impact of tourism on the Icelandic economy was estimated following a three-step process. The first step was to project visitor numbers over the next 10 years, to 2023. The second step was to translate visitor arrivals into GDP impact, by projecting the total spend per visitor and investments required to attract and serve them. In the third step, the GDP impact was translated into both employment numbers and tax receipts (see Exhibit 57).

*Exhibit 57: The economic impact of tourism was estimated following a three-step process*



Source: BCG analysis

In this section we describe the methodology behind each step. Two scenarios are considered:

- **"Under existing trends"** - projection assuming no focused targeting of visitor segments
- **"Focus on target segments"** - projection assuming targeted product development and marketing aimed at those segments identified as the most attractive to Iceland

## 1. Visitor numbers

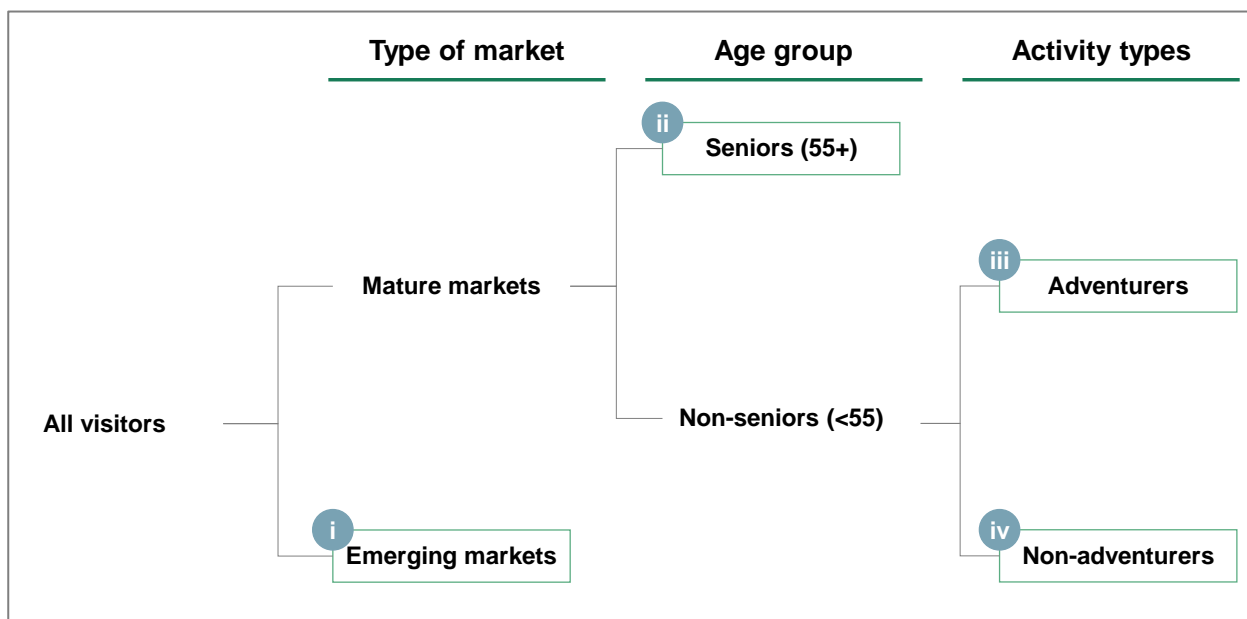
### Annual projections of visitors to the whole country

Annual tourist numbers to the whole of Iceland were projected, considering arrivals of three categories of visitor:

- Foreign visitors (excluding cruise passengers)
  - Including an estimate of % visiting Iceland for MICE<sup>18</sup> purposes
- Cruise passengers
- Domestic tourists

**Foreign visitors (excluding cruise passengers):** Four high level groups of foreign visitors were identified, defined by 1-3 variables (Exhibit 58); emerging markets, seniors, adventurers and non-adventurers. Each group has distinct behaviour in Iceland today in terms of average stay length, average spend per day, seasonality of visit and propensity to visit regions (see Annex B)<sup>19</sup>

*Exhibit 58: Four high level groups of foreign tourists considered when modelling economic impact*



Source: BCG

For each group, three drivers of increased visitation to Iceland were considered. Drivers (a) and (b) contribute to growth under both scenarios whilst (c) is only applicable with 'Focus on target segments'.

<sup>18</sup> Meetings, Incentives, Conferences and Events

<sup>19</sup> Segment behaviour determined via analysis of Icelandic Tourism Board surveys conducted Summer '11 & Winter '11/'12. Summer/ Winter responses are weighted by the number of visitors in each season in 2012. The summer survey was conducted from Jul-Aug and the Winter survey Sep-May. It was assumed that segment behaviour in June is equivalent to Jul-Aug. Weighting was thus 47% in Summer and 53% in Winter



*Inbound market traveller trends, weighted by demographic trends:* Annual growth of outbound travel from each of Iceland's top 14 inbound markets was determined from Euromonitor's projections for 2012-2017<sup>20</sup> and the same growth rate was applied to the period 2017-23. The weighted average annual growth<sup>21</sup> of 2.3% was applied to 'other' inbound markets.

By overlaying demographics shifts in each of these markets, reported by the EIU<sup>22</sup>, an estimate was made on how the total annual growth rate is split between growth of seniors (55+) and non-seniors (<55). In this calculation, the assumption was made that each age group is equally likely to be a traveller.<sup>23</sup>

Finally, it was assumed that between 2012-2023 the ratio of Adventure Tourists: non-Adventure tourists in the < 55 age group would increase from 0.4 to 0.5, in line with estimates of last trip vs. next trip behaviour in key European and Northern American markets.<sup>24</sup>

*Icelandic inbound growth above benchmarks:* Between 2009-2012 years, inbound tourism to Iceland has grown at an average annual rate of 10.8%. This can be compared to two benchmarks:

1. Worldwide tourism arrivals grew at an annual rate of 5% during this period<sup>25</sup>
2. Average growth rates of outbound travel from Iceland's key inbound markets (weighted by size of market in 2012) was 2.8% over the same period<sup>26</sup>

Thus Iceland's annual growth has been 7 percentage points above the average of these two benchmarks. It was assumed that over the next 10 years Iceland's growth rate will converge to average, that is in line with global trends, with the incremental growth rate decayed linearly.

*Improved penetration of target segments in inbound markets:* The number of visitors to Iceland today, by market, by group, was compared to total outbound travellers by market, by group. Inbound markets were then divided into 'core' (highest frequency of direct flights to Iceland) and 'non-core' (no or lower frequency direct flights to Iceland) and a weighted average penetration was calculated for both. In the **'focus on target segments'** scenario, it was assumed that at least weighted average penetration could be achieved in each market for target groups by 2023. No change in penetration was assumed for those already above average and for non-adventurers.

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<sup>20</sup> Euromonitor International, Passport forecast on outbound travellers by country, accessed June 2013

<sup>21</sup> Weighted by size of market in Iceland in 2012

<sup>22</sup> Age group growth to 2017 projected, same trends applied 2017-23

<sup>23</sup> This assumption was sense-checked in the case of France using Euromonitor Passport reports on outbound travel by inbound market

<sup>24</sup> Adventure Tourism Market Report, Adventure Travel Trade Association. Proportion of the population reporting their last trip was hard/soft adventure was 26%. For next trip 34% is reported.

<sup>25</sup> UNWTO

<sup>26</sup> Euromonitor, BCG analysis

**MICE visitors:** Whilst foreign visitor number projections described above include the MICE segment, it was important to estimate the proportion of these visitors due to the incremental revenue from company spend, above that spent by the travellers themselves. We estimated the number of MICE visitors at 30-65,000 in 2012, based on expert interviews<sup>27</sup>. Taking the mid-point, MICE visitors were 7% of foreign visitors in 2012. We have assumed a constant % between 2012-2023, projecting growth at approximately 5,000 visitors per year – a number which triangulates with stakeholder targets.

**Domestic visitors:** According to the Icelandic Tourism board, in 2012 90% of Icelanders took a domestic trip (~ 280,000). We assumed a constant 90% of the population complete domestic trips over the time period 2012-2023 under both scenarios. Population projections published by Statistics Iceland (medium scenario) were used to translate this percentage into number of domestic travellers.

**Cruise passengers:** Between 2009-2013 cruise passenger arrivals in Iceland averaged 13.5% of foreign visitor arrivals (weighted by number of passengers). Cruise passenger arrivals were projected to 2023 at 13.5% of foreign visitors who visit Iceland 'under existing trends' No incremental passengers were projected with 'focus on target segments'

### *Seasonality of visitors*

In the 'focus on target segments' a reduction in seasonality was assumed. A target seasonality was guided by the average of two benchmarks: arrivals from Sweden and arrivals from Finland. Today both markets show reduced seasonality compared to overall arrivals and the calculated shift by 2023 was considered to be realistic by tourism industry stakeholders.

### *Visits to regions*

Increased travel outside the South-West of Iceland by 2023 was projected considering the mix of visitors under each scenario, 'under existing trends' and 'focus on target segments', and their reported propensity to visit each region.<sup>28</sup> Under the 'focus on target segments' scenario, it was further assumed that the propensity to visit these regions could reach 20% higher than today, for each region. The average length of stay in regions was held the same as today, based on the average of all survey respondents in the Icelandic Tourism Board's surveys.<sup>29</sup>

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<sup>27</sup> Interviews with Meet in Reykjavik conducted during June 2013

<sup>28</sup> Based on question ' Did you visit any of the following sites/regions?' asked in the Icelandic Tourism Board's Summer and Winter surveys 2011-12.

<sup>29</sup> Questions 'BE03- Total length of your stay in .....'

## 2. GDP impact

An expenditure methodology was used to calculate the impact of tourism on GDP, according to the table in Exhibit 59.

Direct and indirect tourism were calculated using bottom-up analysis, whilst the induced impact was calculated using benchmark multipliers, as described in the following sections.

All reported values are real, that is the effect of inflation is removed and the reported value is in 2012 prices. Where \$US are reported, conversion from ISK is at the average bid rate for 2012, reported by Oanda<sup>30</sup>.

Exhibit 59: Methodology used to calculate the impact of tourism on GDP

	Category	Direct	Indirect	Induced
<b>Spending</b>	<b>Margin on core tourism spend</b>	✓		
	<ul style="list-style-type: none"> <li>Accommodation</li> <li>Internal travel by tourists</li> <li>Restaurant spend by tourists</li> <li>Tourist travel on Icelandic airlines to Iceland</li> <li>Tourist recreation</li> <li>Tourist retail spend</li> </ul>			
	<b>Taxes on core tourism spend</b>	✓		
	<b>COGS of core tourism spend (supply chain spend)</b>		✓	
	<b>Other tourism spend incl. fuel, groceries</b>		✓	
	<b>Spending by staff employed in tourism / tourism-related industries<sup>1</sup></b>			✓
<b>Capex investment</b>	<b>Airport expansion</b>		✓	
	<b>Hotel capex required</b>		✓	
	<b>Existing site development, e.g.,</b>		✓	
	<ul style="list-style-type: none"> <li>Visitor centres</li> <li>Paths</li> <li>Signposts</li> </ul>		✓	
	<b>New site product development</b>		✓	
	<ul style="list-style-type: none"> <li>Funded by tourism fund</li> </ul>		✓	
	<b>Infrastructure investment to support increased tourism incl.</b>		✓	
<ul style="list-style-type: none"> <li>Water treatment</li> <li>Wifi/mobile infrastructure</li> <li>Sewerage plants</li> </ul>		✓		

Note: WTTC impact of Travel & Tourism Economic Impact Iceland 2012: Induced GDP impact = 1.2 x (direct + indirect) GDP impact  
Source: BCG analysis

<sup>30</sup> Oanda foreign exchange website provides historic exchange rates.

### **Calculation of direct impact**

Direct GDP impact was calculated considering the spend by each type of tourist less an estimated cost of goods sold (COGS) in the following types of business:

- Accommodation/lodging
- Transport in Iceland
- Transport to Iceland, spent on Icelandic companies
- Restaurants/cafes
- Recreation
- Retail

### ***Foreign visitor spend***

*Spend per visitor per day:* Average total spend in 2012, by segment, was determined via analysis of the Icelandic Tourism Board's Summer and Winter surveys (see Annex A)). Spend per day was calculated by dividing by the average length of stay for each segment.

A conservative assumption was made that spend per day by each segment will not increase from 2012-23. Rather the shift in mix towards target segments increases the average spend per day of all visitors. This assumption was based on previous BCG project experience which found that different tourist groups spend on average \$200 per person per day in a number of different locations.

*Average length of stay:* The average length of stay by each group was based on reported behaviour in the Icelandic Tourism Board's visitor Summer & Winter surveys 2011-12. Since length of stay was reported in groups (e.g. 1-2 days, 3-4 days), the mid-point of each group was taken for the basis of this calculation. For the final group, 15+ days, a conservative assumption was made that these visitors stay 15 days. An average across all groups of 6.8 days was calculated.

The results were triangulated with the Icelandic Tourism Board's numbers of overnight stays in 2012 divided by the number of visitors in 2012, to give an estimation of average stay length of 4.3 days.

The average of these two estimations (5.6 days) was used in our projections, with the ratio between groups set by the ratio of stay length in the visitor survey.

No increase in stay length by each group was projected to 2023, however the average stay length of all visitors increased due to the change in mix. Again, we used a conservative estimate here.

*Spend on travel to Iceland per visitor:* Average spend on travel to Iceland was determined by group using the Icelandic Tourism Board's Summer & Winter visitor surveys 2011-12. The percentage of this spent with Icelandic companies was estimated as the percentage of foreign

visitors to Iceland who fly with Icelandair (including both their TO passengers and 15% of VIA passengers, estimated to stopover in Iceland when flying transatlantic).

*Additional spend by companies per MICE traveller:* Whilst visitor survey data captures spend by the MICE individual, no question is asked on the additional spend by the company on hotel rooms, dinners, incentive outings etc. It was estimated that total spend per MICE visitor is 1.5 times that of an average visitor.<sup>31</sup> This additional spend was assumed to be spent on businesses associated with direct tourism.

### ***Domestic visitor spend***

*Spend per visitor per day:* The incremental spend per day by domestic visitors on tourism vs. their normal spend in the country, was estimated as their spend on accommodation. This was estimated as \$100 per night, paid only by domestic tourists staying in hotels. This was projected at a constant spend from 2012-2023.

*Average length of stay:* In 2012, 850,000 overnight stays in all accommodation types by Icelanders were recorded.<sup>32</sup> Since 90% of the population reports having been on a domestic trip, an average domestic stay length of 3 nights per Icelandic traveller per year was estimated. This was projected to remain constant from 2012-2023

*Cruise passenger spend:* Cruise passengers were assumed to spend an average of just one day in Iceland. Their spend on that one day in Iceland was estimated to be ~50% that of foreign visitors arriving by other means as a result of no spend on accommodation and lower spend on other categories.<sup>33</sup>

### **Calculation of indirect impact**

Indirect impact on GDP was calculated as a result of three factors:

1. Value captured by the supply chain to direct tourism industries
2. Spend per visitor on industries not directly related to tourism
3. Investments made by private companies and the government, directly linked to tourism

### ***Value captured by the supply chain to direct tourism industries:***

The value captured by the supply chain to the tourism industry is estimated as average COGS<sup>34</sup> of direct tourism spend.

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<sup>31</sup> Based on external global benchmarks

<sup>32</sup> Icelandic Tourism Board, Tourism in Figures April 2013

<sup>33</sup> Based on 'Belly full, purse closed' academic paper on Cruise tourism in Norway

<sup>34</sup> Cost of Goods Sold

*Spend per visitor on industries not directly related to tourism:* Spend on other types of businesses within Iceland is included in indirect spend. The average spend by each group of foreign tourists was determined using the Visitor survey, using the methodology described for Direct tourism spend in section 2.1.1.

- Other transport costs (e.g. fuel maintenance)
- Groceries
- Liquor shops
- 'Other'

***Investments made by private companies and the government, directly linked to tourism:***

Capex investments were estimated in 4 key categories:

- Airport investments
- Hotel investments – new builds and renovations
- Investments in tourist site development and protection
- Investments in basic services necessary due to tourism

*Airport investments:* Average investment in Keflavik airport of ISK 1.5Bn per year from 2013-2023 was assumed, based on interviews with Isavia.

*Hotels:* A high-level estimation of additional hotel & guesthouse rooms needed by 2023 was made by considering

- Available room nights, by month, by region in 2012
- Room nights required by 2023 as a result of projected visitor numbers, projected seasonality changes and projected visitation to regions

The assumption was made that the same % of visitors will stay in hotels and guesthouses vs. other types of accommodation by 2023 as in 2012. Allowance was made for black market rooms available today. It should be noted that detailed modelling of rooms required would require more detailed data on rooms available today, however for the purpose of economic modelling of capex, the output was sense-checked with Icelandair hotels.

A capex requirement for each room required was estimated using external benchmarks for mid-range hotels. Costs do not include land expense but just the cost of building the rooms.

*Investments in tourist site development and protection:* For the purposes of economic modelling, it was assumed that an average price of ISK 5,000 could be charged for an Environment Card, which would provide 75% of funding needed for site development.

*Investments in basic services necessary due to tourism:* Investment in basic services was estimated as a percentage of the Government's acquisition of fixed capital, reported by Statistics Iceland in 2012. The uplift in population, due to visitors, on average was used to estimate this percentage by year.

### **Calculation of induced impact**

The induced impact on tourism was estimated as a multiple of the sum of direct and indirect impact. The multiple used, 1.2, was determined using the World Travel and Tourism (WTTC) report on the Economic Impact of tourism in Iceland in 2013. This high-level assumption is intended as a guideline to the overall impact of tourism in Iceland rather than a detailed modelling exercise.

#### ***3a. Employment impact***

Between 2000 and 2009, Statistics Iceland has published Employment in Tourism Characteristic industries (used as direct tourism employment) and Tourism Gross Value Add (used as direct tourism impact). The ratio gives the productivity per direct tourism employee. This grew at a compound annual growth rate of 2% from 2000-2009. This growth in productivity was projected to 2023 '**under existing trends**' whilst with '**focus on target segments**' an additional 0.1 percentage points of annual growth was assumed, based on initiatives to better educate employees in the industry and reduced seasonality.

#### ***3b. Tax receipts***

##### ***Tax receipts value projection:***

In 2009, tourism taxes reported by Statistics Iceland were 15% of tourism GVA at market prices. This 15% was applied from 2012-2023, under the assumption that the tax structure remains constant.

##### ***Comparison to GST:***

To compare the increase in tax from tourism to an equivalent rise in GST, the metric 'taxes on sales and services' was downloaded from Statistics Iceland. An assumed tax rate of 25.5% was projected forwards to 2023, and sales and services were projected to grow at the same rate as GDP.

## Annex C: List of organisations and individuals consulted



## **Annex C: List of organisations and individuals consulted**

Arion Bank  
BCG MICE team  
BCG Pricing Enablement team  
Blue Lagoon  
Director of Culture and Tourism, Reykjavik  
Europcar  
Gekon  
Iceland Farm Holidays  
Icelandair  
Icelandair Hotels  
Icelandic Tourism Board  
Icelandic Tourism Research Centre  
Isavia  
Meet in Reykjavik  
Minister of Industry and Commerce  
Promote Iceland  
SAF  
Statistics Iceland

In addition, a series of interviews and focus groups was conducted by Capacent, supplemented by a web survey, which altogether captured more than 200 responses from Icelandic tourism stakeholders.