Economic aspects of investments in ski areas

by Peter Feuz [(1)]

Guests are becoming more demanding

"A hotel alone does not create tourism". That old marketing adage is often quoted in Switzerland – especially in academic circles. The same comment also applies to facilities built to transport tourists: "A cable car alone does not create tourism". The question that remains is whether we have taken account of this elementary observation in our daily work.

The modern guest does of course have fixed ideas about what constitutes an attractive ski area: in addition to mountain scenery (preferably grandiose) he wants a full range of other services: arrival, reception, lodging, food, entertainment, all kinds of sports, shopping, opportunities to hire and test out equipment, careful attention to his needs and suitable facilities on departure are just some factors that make the whole stay turn out "just right".

When it comes to cable cars, the guest is looking for more than just comfortable, safe and efficient transport. Transport as such is just a means to an end for him. The experience opportunities available when he reaches the mountain station are more important: extensive choice of runs with dependable snow cover, special snowboard facilities, toboggan runs, winter hiking trails, trend sports, gastronomic restaurants and above all a great deal of fun are among the features expected in every winter sports resort.

The inexperienced, one-dimensional and uncritical guest no longer exists. That is why we should now in all logic speak of winter sports or mountain experience areas rather than "ski domains". Once again the question rises as to whether we – especially in Europe and Switzerland – have recognized the fact that the market has changed in this way.

From single business to service chain

In many areas, there has certainly been a change of attitudes and action. However, these changes have often come about because of external pressure and not through inherent conviction. Let me mention a few typical examples: we used to develop southern slopes to sell sunshine; today they lack snow. We used to delimit ski domains rigidly: today we offer a single ticket giving access to extensive regions. We used to

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focus exclusively on our own business: today we are looking for partnerships with other suppliers of tourist offerings.

One typical example of modern thinking with the guest in mind is the recently introduced joint Swiss Tourism quality seal. The principal national tourist organizations have joined forces to promote concepts of quality at every level and to design a unified two-stage award which is easy to administer. This is a response to the uncontrolled proliferation of quality marks in tourism and is intended to pave the way for more comprehensive certification in future (e.g. ISO standards).

The core concept of this joint quality seal is the “service chain”: for the first time in Switzerland, we have made it clear that service in the tourist sector is made up of countless small services provided by individual suppliers from the first contact right through to departure. Experience shows that the guest does not take away with him the finest aspects of his stay – for instance in a winter sports resort – he always remembers the weakest link in the chain. All the other tourist businesses which together provide a competitive offering are also adversely affected.

Different ownership – different offerings

A succession of winters without much snow in Europe provide the best illustration of an inadequate service chain: if snow is lacking on the ski run customers have no interest in buying. Significant sales losses are then suffered by everyone - not just the cable car operators.

The lack of alternatives to the insufficient natural snow covering can have many and varied causes. Perhaps the transport operator omitted to use snowmaking machinery. Perhaps the building project was hit by unreasonably stringent requirements imposed by the State authorities or environmental protection organizations. Perhaps the other tourist suppliers (e.g. accommodation/food, ski schools) or the banks and the local authority at the resort did not cooperate closely enough to put up the necessary financial resources.

This is a typically European problem. Take a ski resort in Switzerland. Practically every hotel, every restaurant, every (sports) store, all the entertainment premises and other service providers are in the hands of different private owners. The local tourist organization, the ski school, the snowboard school and the mountaineering school appeal to the same clientele, but they are under different management and ownership. Sometimes, we still even have the luxury of several cable car operators in the same resort, all charging different fares.

These historical small business structures with small premises certainly have their advantages. But they also have unmistakable weaknesses from the modern marketing angle: it is, for instance, difficult to offer the guest a well-rounded and homogeneous package for his stay. The guest will notice several times each day that countless suppliers are competing for his favours, with little or no coordination between them. And raising finance for (major) new investments is increasingly becoming an almost impossible obstacle race. Network thinking and network management are still in their infancy in the (European) tourist industry.

Spending by overnight tourists and day trippers is underestimated

With the existing structures, each tourist industry supplier only has eyes for his own profit and loss account. He is therefore only aware of a minute part of total tourist spending and is to all intents and purpose unable to determine his particular contribution to value creation throughout the branch. In practice, this lack of knowledge is causing increasing problems. This isolated bookkeeping mentality makes operators blind to higher interests and the economic environment.

That is why - especially here in Switzerland – a number of economic studies have been commissioned in the last few years. Their purpose is to highlight relationships and motivate the parties concerned to think and act on a larger scale. These studies are of a new kind and no doubt also provide useful comparative information for ski domains with more extensive structures.

Our national tourist statistics unfortunately only mention overnight guests. Media reports focus almost exclusively on the hotel nights which are best documented and present the greatest general economic interest. This creates the impression among readers or listeners that the hotel trade is the only yardstick of tourist “sensitivity”. The picture created in this way among the general public is one-sided and shortsighted.

A number of extensive studies have shown that, depending on the ski domain, between 50 and 90% of all the guests present are day trippers. They come from their homes in the morning and return in the evening. They do not spend the night in the resort and therefore figure in no tourist statistics. Each such day tripper spends between CHF 50 and 80 per person per day. At least half this expenditure is accounted for by the ski pass and therefore goes to the cable car operator. In Europe, most winter sports guests (still) bring their own equipment. The remainder of their spending is therefore accounted for by meals and a few other purchases.

The spending pattern of overnight guests is quite different. Taking the average for all categories of accommodation, it is reasonable to assume that these guests spend between CHF 110 and 150 daily in winter. This confirms the great importance of the hotel trade for the economy as a whole. Taking an average for all hotel categories and depending on the destination, these winter guests spend between CHF 180 and 280 per day. In both cases, outward and return journey costs, together with theoretical depreciation of winter sports equipment, are not included.

Many people benefit from spending by guests

Unlike many North American ski resorts, this money goes to all kinds of beneficiaries who keep different accounts: on average, only 14 to 18% of the daily spending of overnight guests goes to the ski pass or cable railway operator. The overwhelming bulk is distributed to widely varying degrees between many other beneficiaries: the restaurant trade, retailers, ski schools, the building industry, other sports and rest and recuperation facilities, souvenir stores, public transport, banks, insurance and so on.

This broad circle of direct and indirect beneficiaries is vastly underestimated by most observers. For example, in the entire Canton of Berne – which has only a small number of tourist resorts – one in nine francs earned by the banks, one in ten in the communication sector, one in eleven in the building industry and one in fifteen in the retail trade depend on tourism. Seen in that light, it is hardly surprising that in our major tourist regions (such as the Grisons, Valais and Berne), the following general economic effects have been shown: the value created by the cable car operators indirectly generates almost identical indirect value creation in the region. And for ten year-round jobs created by the cable cars, another eight are created in the region. This clearly demonstrate the broad economic importance of the cable car sector.

Attention must be drawn time and time again to such dependencies and relationships. And even if – as was all too often forgotten in the past – we can now argue with hard facts and figures, motivation is still no easy matter. Most people remain convinced that only the cable cars and hotel/restaurant trades profit from tourism. In Europe in general and Switzerland in particular, it is therefore no easy matter to motivate a broad circle of investors to put up capital for tourist projects.

Structural change and excessive dependence on single activities

There are other reasons why our present offer structures are likely to prove a dead end in the medium and long-term. First of all, the cable car branch overall is heavily dependent on the winter season in Europe: on average 85 to 95% of all revenue is earned in the winter. This heavy seasonal dependence cuts profitability. Other tourist industry suppliers in the same resort have an equally strong pillar of summer business. Because of the different ownership structures, mixed calculations and cross-subsidies are very hard to achieve. This diminishes economic efficiency.

Similar considerations also apply to the classical ski market: only a few years ago, cable car users were all skiers or else they did not use cable cars at all. The classical ski market is now declining constantly: in the past ten to fifteen years, 1 in 6 skiers has given up that sport in both Switzerland and Austria. The new snowboarders have only partly offset this downturn.

But other winter sports activities with growth potential have made their appearance: tobogganing, winter hiking and cross-country skiing are just some examples. These new markets have practically no impact on the conventionally structured cable car operators because other suppliers benefit. Or else they only provide a fraction of previous earnings because single journey tickets are purchased instead of day passes as used to be the case. The lack of vertical depth of the cable car offering makes its adverse effect felt here too.

Finally attention must be drawn to the phenomenon of population ageing. The average life expectancy in Switzerland has increased by around ten years since 1950. In 1950, young people represented 35% of the overall population in Germany but by the year 2005, this figure is likely to have fallen to 14%. In 1995, 18.3% of the European population were aged 60 or more; by 2025 this population segment will grow to 27%, according to the latest forecasts. Older people prefer activities other than downhill skiing. On the other hand, we also know that in Austria non-skiers spend around CHF 185 per day during their holidays. These markets too will not prove beneficial in future to classically structured cable railway operators. Diversification and cooperation are the order of the day!

Despite these changed background conditions, another point must still be made: in fine weather, our cable railway operators continue to record large numbers of customers at the valley station. This must not cause a false sense of security: skiing is no longer a growth market; the aging of the population is gradually causing guests' needs to change. We must adapt!

Our competitors in winter sports tourism

Now that transport prices are on the whole low – especially for air travel – the winter sports resorts are no longer simply in competition with each other: in winter, "summer destinations" have now become potential tourist attractions and demand for city flights is strong. The prices on offer are highly attractive. The economic impact on the destinations is, however, much lower than in the case of "classical winter" holidays: a large part of the revenue remains with the foreign carrier or foreign tour operator.
This process is still under way: cheaper offers for other types of holiday in other countries are giving our own winter sports resorts a hard time. No trend reversal can be observed at this stage. That is why we cannot afford any let-up in our efforts to remain competitive by optimizing our operating and economic structures.

Uncertain weather conditions – snow in short supply

On 6 January 1999, the highest January temperature since records began were reported by all the mountain weather stations in Switzerland. Climatic warming has become another important factor to add to the overall picture. In early January, some ski stations were a desolate "winter" sight: countless facilities lay idle. Winter sports fans were searching for the few remaining snow-covered areas in the domains.

Scientific research enables the economics of such climatic change to be calculated with some accuracy: in Switzerland, a 10% decline in Alpine winter sports days is equivalent to a direct economic loss of around CHF 250 million. Including the indirect loss to supplier companies and so on, the total loss to the economy amounts to around CHF 450 million. Most of this has to be borne by the mountain region which is already economically disadvantaged because of its location.

The hotel and restaurant trades suffer the biggest loss of income. They are followed by cable cars, the retail trade, industry and commerce, the banks, other forms of transport and other service concerns. Poor snow cover in winter is therefore not just a threat to the existence of cable cars, but also a serious setback to the whole mountain economy. Future investments in winter tourism must therefore be carefully considered and soundly based.

The option of snowmaking equipment

Can technology save a ski season? To answer that question, the primary issue is not technical feasibility but whether tourists are prepared to accept ski runs in a landscape which does not really look winter-like. Once that aspect has been clarified, the next issue to address is that of technical feasibility. The third step is to analyze the business aspects of the investment and the operating costs involved.

With snowmaking machinery, winter visitors can be assured a basic availability of ski and snowboarding runs and other winter sports opportunities, provided that water and electricity are available and meteorological conditions are ideal. Nowadays, every ski resort must be able to guarantee some snow. It is of course preferable to operate ski runs in places where natural snow is more likely – i.e. higher altitude runs – than to rely on technology alone. The risk of operating snowmaking equipment at lower altitudes should not be underestimated. Sunny slopes can therefore be eliminated from the outset as unsuitable for artificial snow.

The operator must determine which slopes within a ski domain are suitable for snowmaking and what costs are involved in installing and operating the equipment. When he has the right answer, the next step is to determine whether a run with artificial snow will appeal to skiers. If the answer is yes, snowmakers should be regarded as a feasible option.

I am firmly convinced, however, that a tourist who is interested in snow sports prefers to pursue them in a winter setting. He is unlikely to return to an area with no more to offer than a few basic runs covered with artificially made snow. He will choose a different leisure or holiday activity instead.

Different legal and political background conditions

Aside from the economic and technical feasibility of snowmaking equipment, the legal and political environment also plays an important role. A great difference exists here between the leading winter sports countries. In particular, regions with a greater environmental awareness are at a definite disadvantage in relation to more liberal areas. This fact in itself distorts competition.

Comparisons between ski regions with artificial snow in France, Italy, Austria and Switzerland clearly show that the type and size of the snowmaking equipment for which approval is given vary widely: in 1997, around 1000 hectares were given an artificial snow covering in Switzerland (= 4.5% of the total piste areas). On the basis of existing plans, this area is expected to increase to 1,700 hectares by the year 2003 (=7.7% of the piste surface). Switzerland will then continue to lag seriously behind its foreign neighbours: in Austria, artificial snow is already made on 7,930 hectares or 34.0% of the ski run area. In France, the equivalent area was 2,250 hectares last year, while in Italy around 2,150 hectares of ski runs were already covered with artificial snow in 1995.

I believe that snowmaking equipment must be integrated from the very outset into the feasibility study and investment planning for any new cable car project. If the market price for ski passes is elastic enough, a sufficient percentage of profits must be allocated from the outset to finance snowmaking equipment.

Problems of technical snowmaking in Switzerland

I want now to look briefly at the issues surrounding snowmaking in Switzerland. As I said earlier, Swiss winter sports domains have grown up over the years and the incorporation of snowmaking equipment into existing structures is therefore a more likely option than the creation of new facilities. In addition, Swiss law on water resources, energy consumption, noise and environmental protection is highly restrictive. In most cases, the individual cantons of our country are responsible. Our association has tried to harmonize the snowmaking regulations of the different cantons at Federal level in Switzerland in order to make the legal environment for snowmakers as liberal as possible and create a level playing field for all concerned.

Our association is even willing to pay a high political price for the liberalization of technical snowmaking regulations: we expressly support the Federal authorities' policy of ruling out the development of new ski regions in High Alps when licensing policy decisions are taken. We are firmly convinced that the issue of snowmaker construction should be addressed before the licensing of new mountain cable car systems begins.

Factors which cable car companies must analyze before making an investment decision

Aside from clarifying technical details, a company which has to decide whether to replace an old cable car system or build a new one must consider a number of business and economic factors. First and foremost, the company must decide whether the investment itself is financially justifiable. Then it must weigh up the operating costs involved.

Financing of the planned investment is another crucial issue. The question must be addressed on the basis of precise financing and investment planning. Borrowing must not exceed the interest burden allowed for in the business plan over a ten-year period. Write-offs also represent costs which must be taken into account from the outset.

A glance at the past shows that the economic success of a company is influenced by the broader business cycle. In periods of high inflation (e.g. between 1965 and 1985), the prerequisites for cold debt clearance were much better than they are today. In times of economic stability, such as we are enjoying today, a cable car tends to be a risky investment. Banks cannot be expected to finance more than 60% of the total investment today. Leasing is an alternative, but entails tying up uncertain passenger revenues over the longer term. It is true that money is plentiful today – but nobody wants to take the risk of losing that money!

As mentioned in our comments on snowmakers, the costs of this equipment must be taken into account right from the start. Investing purely in transportation without considering the many other links in the chain of services involved is economically shortsighted, and therefore carries a higher risk. If these accompanying services are provided by others, steps must be taken to ensure that the quality and scope of the offerings satisfy guests' requirements. That is why I consider it important for every investment decision to be examined to find out whether it is complete and reasonable from the guest's point of view. The entire chain of services must meet his requirements or the cable car installation will have no chance of economic success in the future.

The overall economic perspective: advantages of big domains and companies

What is it that makes the investment decision difficult? Ideally (as is the case here in North America), the whole offering will be put together by a single company. Not so in good old Europe! There, a great many service providers cooperate with each other. As a result, there are always weak links in the chain which cannot be directly influenced and which colour the overall stay for the guest, turning it into a bad experience. We must therefore find quality assurance mechanisms and integrate ways of influencing weak points into the service chain. As you know, a chain is only as strong as its weakest link. Ineffectual businesses must be eliminated by taking them over if need be. A company only has a chance of surviving on today's market if it is willing to eliminate all discernible weaknesses during the decision-making process on the investment; it must figure in the costs of replacing the weak links and, if necessary, accept responsibility for those costs.

But these are not the only important aspects. When considering an investment decision on the replacement of an installation or construction of a new one at a traditional ski resort with established infrastructures, we must determine from the very outset whether all the possibilities for cooperation in transportation and ski run operations have been exhausted or whether competing businesses should be merged beforehand. The prevailing situation will dictate whether businesses cooperate or, as a final step, merge.

Cooperation could be an interim step in certain special cases. Merger is, however, the only desirable solution from the financing perspective. Mergers may create opportunities to shut down certain individual installations which are unprofitable as they stand and could be replaced at a better location by a new installation. Another area in which ski region operators have more leeway than the operators of individual installations is the coordination of catering by establishing segments based on price and food type.

More than mere transportation: the mountain experience

To succeed as a business, a cable car operator must, in our view, have annual revenues of at least CHF 20 million. Mounting cost pressures will force companies any smaller than this to merge. Different winter sports regions might also conceivably be operated together on the basis of management contracts by a parent company with the necessary marketing structures. Today’s tourist wants to be courted and to reap the benefits of the wide selection of products and services on offer. In meeting these needs, we must – as we saw earlier – always focus on our guests’ overall “mountain experience”.