

Response to the Productivity Commission's Draft Report on Services Exports

Tourism Australia

September 2015

Contents

1	Background to this document.....	1
1.1	Overview of the Commission's recommendations	1
1.2	The rationale for public funding of destination marketing.....	2
1.3	The distinction between destination marketing and major events	3
2	The measurement of returns to destination marketing	5
2.1	The return on marketing investment and the net economic benefit	5
2.2	Should Tourism Australia focus on net economic benefit?	6
2.3	Tourism Australia's efforts to measure the returns to marketing	7
3	Cost benefit analysis of destination marketing programs	9
3.1	Ex-ante and ex-post CBAs of individual marketing programs	9
	Conclusions	12
	Limitation of our work.....	13

Liability limited by a scheme approved under Professional Standards Legislation.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity.
Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

1 Background to this document

The Productivity Commission's (the Commission) draft report (the Draft Report) into barriers in service export markets provides timely analysis in relation to what is an increasingly important driver of growth in the Australian economy. Ensuring policy settings related to these markets are conducive to them functioning in their most effective fashion, is a critical prerequisite to maximising the benefit from our comparative advantages in these industries.

As one of the nation's largest service exports, Australia's international tourism sector has grown consistently above trend since the global financial crisis. This has been driven in part by external macroeconomic factors such as continued growth in the size of the middle class population in Asia. At the same time, growth has been facilitated by a variety of targeted policies on both the supply and demand side of the market – emanating, most notably, from Tourism 2020, the Australian Government's national tourism policy.

This trend of outperformance is expected to continue over the next two decades, with tourism forecast to be one of the fastest growing sectors across the global economy. The Commission's report identifies further areas where it views that policy settings could be adjusted to drive efficiencies, remove barriers and, ultimately, capitalise on the sizeable economic opportunity that exists in the global tourism market.

This document analyses several aspects of these recommendations, in particular the recommendations associated with destination marketing. The analysis contains a particular focus on the activities of Tourism Australia as distinct from those of the various state, territory and regional tourism organisations. These organisations have different charters and different funding and governance mechanisms to Tourism Australia and while many of the observations made in this document apply equally to them, others do not.

1.1 Overview of the Commission's recommendations

The Commission makes a raft of recommendations for reform of Australia's service export markets. The primary recommendation considered in this document is draft recommendation 8.1. As the box below describes, it recommends cost-benefit analysis (CBA) being undertaken prior to, and after, each destination marketing program and major event by the responsible government.

There are three aspects of the recommendation that are analysed in this document:

1. The combining of destination marketing with major events, which are in both practice and analysis two quite separate activities;
2. The requirement to undertake a CBA, both prior to and after, each marketing program when the benefit of doing so is likely to be modest; and

3. The recommendation not considering the value of other research and analysis that may substitute for CBA when analysing the appropriateness of funding individual campaigns.

Draft recommendation 8.1 - The Australian, state and territory governments should:

- undertake an analysis of the costs and benefits to Australia of government provision or funding of destination marketing or major events, both prior to funding or providing a destination marketing program or major event and following the activity's completion. The complexity of this analysis should be commensurate with the value of government funding being provided to the activity
- publicly release the analyses of costs and benefits of funding or providing a destination marketing program or major event as soon as practicable
- not provide or fund a destination marketing program or major event unless an analysis of the costs and benefits of the activity demonstrates that government funding would provide net benefits to the Australian community

1.2 The rationale for public funding of destination marketing

Marketing of Australia as a tourism destination is designed to overcome a market failure. This is recognised in the Commission's report on page 226 where it outlines the public good nature of destination marketing: that is, the non-excludable and non-rival nature of marketing the Australian tourism sector internationally. When Australia is marketed internationally there is no single business that benefits. Instead, the benefits from the increased demand that effective destination marketing generates are widely dispersed across the Australian economy.

As a sector defined by the consumer rather than the producer, and where the industry definition is forged by the expenditure patterns of travellers, the tourism services sector – even in its most aggregate form – falls across 13 distinct industries in its classification in the nation's economic accounts. The level of dispersion, and the associated challenges in terms of coordination, is amplified by the fact that the tourism services sector is predominantly made up of small businesses. To take just one example, over 93% of businesses in the accommodation, and café and restaurant industries employ less than 20 staff.

The inability of individual businesses to fully capture the benefits of their own marketing activities means that, in the absence of government intervention, the level of marketing that takes place is below that consistent with optimising the socio-economic benefits generated. Though larger businesses are in the strongest position to capture the benefits of destination marketing to a point sufficient to justify unilateral investment, even they have commonly seen value in contributing to larger collective pools through the provision of partnering funding with Tourism Australia.

The correction of this market failure should be the starting point for analysis in relation to the policy settings around destination marketing. However, the Commission's Draft Report takes a relatively cautious view towards the ability of centralised marketing to achieve this

correction. In particular, it argues that the existence of the market failure presents a necessary but not sufficient condition for government funding, and that whether it is justified should be assessed on a case-by-case basis. It then goes on to argue that the quality of the analysis used to justify government funding has at times been poor.

That the market failure should only be addressed if the benefits of doing so outweigh the costs is indisputable. However, it is further noted that:

- the Federal Government currently provides around \$150 million a year to Tourism Australia to undertake marketing on behalf of the tourism sector;
- the decision to commit this amount of funding is undertaken at the Federal budgeting level, with Tourism Australia tasked only with allocating it in such ways that will generate a maximum return for investment;
- analysis undertaken by Tourism Australia, and independent research, has previously shown that the returns on this investment, against various metrics, are high and above the cost of funds (discussed in more detail below); and
- the existence of past analysis that has not appropriately estimated the benefits of destination marketing or major events should not divert attention from the existence of the market failure nor those higher quality analyses which indicate the net benefits associated with this market failure being addressed.

These considerations are taken up in more detail in sections 2 and 3 below.

1.3 The distinction between destination marketing and major events

The Draft Report combines destination marketing and major events in its analysis and subsequently in Recommendation 8.1. However, major events, such as large sporting events, and destination marketing are distinct in several important respects:

- The analysis of major events tends to be more specific, with clearly defined timelines, audiences, locations and legacy impacts. In contrast, destination marketing provides more dispersed impacts to the tourism sector, with individual campaigns having a less clear impact by time and location;
- The attribution of visitation to major events is typically more clear, with tighter bounds around the additional level of visitation they generate;
- The mechanisms through which major events will generate additional visitors are relatively clear, in contrast to destination marketing where returns to individual campaigns depend on a range of factors which are often only observable after the campaign; and
- Major events tend to be large one-off events with significant quantum of funding attached to them, in contrast to destination marketing programs which tend to be smaller and form part of larger branding campaigns.

Further, the securing and delivery of major events is, for the most part, the responsibility of state and territory governments, with Commonwealth support for events on a national scale and which attract an international audience. At the same time, the concentration of

expenditure at major events also allows for greater private sector involvement in funding and capturing the returns through sponsorship arrangements.

Combined, these points indicate both that the analysis of major events is typically different to that of destination marketing and, crucially, that the concentration of returns to individual sponsors of events reduces the market failure justification for centralised funding. These differences should be taken into account when considering recommendations regarding the need for CBAs to be undertaken on major events and destination marketing. While the uniqueness of individual major events, and the quantum of funding involved for individual events, will facilitate and encourage CBAs to be undertaken, this is less the case for destination marketing.

This does not mean to say that the analysis of the benefits of destination marketing should not be undertaken. Rather, that this is an exercise that is more appropriately taken at a more aggregated level that reviews the effectiveness of Tourism Australia's effectiveness over time.

2 The measurement of returns to destination marketing

A variety of studies have sought to value the benefits of either tourism marketing or individual tourism campaigns. The Commission notes its concerns over the application of various metrics that these studies have used to justify the provision of Government funds to the sector (Box 8.2, page 227). It then recommends that ‘net benefits to the community’ should be the relevant metric for evaluating future destination marketing expenditure. This is in line with the Commission’s previous recommendations, as seen in the *Australia’s International Tourism Industry*, and *Public Infrastructure* reports.

This section outlines the following points in response to the Commission’s recommendation:

- Agreement that net economic benefits is the best metric to evaluate whether an additional dollar of destination marketing is in the national interest.
- Welfare measures derived from CGE modelling are a rigorous, and in some sense the only, method of measuring the net economic benefits resulting from destination marketing.
- There is value in the other metrics used, despite not being a measure of net economic benefits, in answering alternative questions of interest.
- The appropriate metric to be used varies at the decision-making level, and in particular what the funds would otherwise have been used for. For Tourism Australia which trades off alternative marketing programs, basing decisions on which campaign yields the highest return on marketing investment is likely to be entirely consistent with the national interest.

2.1 The return on marketing investment and the net economic benefit

As the Commission acknowledges, net economic benefit is the appropriate metric when determining whether a dollar spent on destination marketing is in the national interest, when that dollar could alternatively be spent on some other use. In line with Forsyth¹, it is noted that CGE-derived net economic benefit measures can be a rigorous estimate of net economic benefits, and offer several advantages over alternative approaches to CBA:

- CGE analysis is based on an economy-wide approach that captures linkages between sectors, aggregate resource constraints and price effects;
- These resource constraints captures the opportunity costs associated with increasing production in a particular sector, something that is not possible to include in a partial equilibrium analysis; and
- Open economy modelling considers the effects of an increase in inbound tourism on the exchange rate, and therefore the crowding out of other exporting sectors.

¹ Forsyth, P., 2015, *Submission 6 to the Productivity Commission’s Draft Report on Service Exports*.

CGE modelling, like all modelling techniques, has its limits and needs to be appropriately applied. CGE models take a whole-of-economy approach and can show how particular economic changes or policies flow through the economy. They also capture that increased activity in one sector necessarily draws on resources from other sectors, thereby ‘crowding out’ existing activity. As the Commission notes, the increased expenditure that destination marketing generates is not a benefit in itself, as it is necessary to adjust for the cost of producing the tourism services to which this expenditure flows. This cost is the foregone activity that is crowded out by the increased tourism output. In this sense, a rigorous CBA of destination marketing activity requires some form of general equilibrium analysis to be undertaken to convert expenditure into net economic benefits.

Various results from CGE models can be reported. These include gross domestic product (GDP) which captures the amount of economic activity occurring in a region, gross national product (GNP) which captures the net income in a region and various welfare metrics such as real consumption. Where used to estimate changes in GDP, the results from CGE models provide useful indicators of economic activity, but may not be appropriate for use in CBA as they don’t adjust for the cost of all resources used to create that activity. However, once adjusting for these costs, CGE models can provide output that closely resembles standard welfare measures appropriate for use in CBAs.

While alternative metrics such as output or visitor expenditure are not welfare measures, they are useful in their own right and are widely used in the tourism literature. For instance, output metrics can be useful when considering the macroeconomic impacts of projects (Forsyth, 2006²), while return on marketing investment (ROMI) is useful for benchmarking a particular campaign against other marketing efforts (Dwyer et al, 2014³).

Further, ROMI can be an important first step for estimating the net economic benefits of destination marketing. The estimated *inbound tourism expenditure*, as informed by ROMI studies, can be converted to an *inbound tourism benefit* value to be used in the CBA framework, and is used directly as an input in the CGE modelling process.

2.2 Should Tourism Australia focus on net economic benefit?

When deciding on the use of funds for destination marketing the appropriate metric to use is net economic benefit, as outlined above. This takes into account the opportunity cost of the funds used – that is, the benefits that the funds would have yielded in their best alternative use. The annual appropriation to Tourism Australia is set, at least in principle, on a net public benefit rationale, with the assumption that the average return on those funds outweighs their next best alternative use, given government’s policy priorities.

However, having allocated funds to Tourism Australia, it is no longer necessary or appropriate for a net economic benefit for each program to be estimated. The trade-off is

² Forsyth, P., 2006, ‘Martin Kunz Memorial Lecture. Tourism benefits and aviation policy’, *Journal of Air Transport Management*, Volume 12, 3-12.

³ Dwyer, D., Pham, T., Forsyth, P., and Spurr, R., 2014, ‘Destination marketing of Australia: return on investment’, *Journal of Travel Research*, Volume 53(8), 281-295.

no longer about whether the funds should be used for marketing as against some other public service, but whether one particular marketing program should be funded over another. That decision is therefore best based on which of those marketing investments is likely to lead to the highest return.

In this way, maximising the dollar increase in visitor expenditure in Australia per dollar of marketing expenditure is entirely consistent with the goal of maximising net economic benefits *once this appropriation has been made*. Destination marketing programs are not generally funded by additional appropriations from the Government, and assessing them as if they were yields no additional information on their merit.

Hence, while it is agreed that the net economic benefit of funding provides the appropriate metric for understanding whether destination marketing is the best use of public money (and therefore whether government is able to successfully correct the market failure), it is not necessarily the case that it should be used as the appropriate metric for all decisions. Estimating relative returns on marketing for competing marketing options, that is, the approach taken by Tourism Australia whether explicitly or implicitly in assessing alternative programs, is consistent with maximising community welfare.

2.3 Tourism Australia's efforts to measure the returns to marketing

Consistent with the aim of maximising the socio-economic return Australia's destination marketing generates, Tourism Australia is tasked with growing demand and fostering a competitive and sustainable Australian tourism industry through partnership marketing to targeted global consumers⁴. To achieve this goal, it invests in understanding the factors behind return on investment, including:

- The potential growth rates of key source markets;
- The average expenditure by visitors of different markets and segments; and
- The marketing return and responsiveness associated with each market.

To evaluate the relative effectiveness of its campaigns, Tourism Australia routinely commissions independent research on key marketing return metrics, such as ROMI. These reports are transparent, publicly available, and are based on methodologies that have been refined over time. Two recent reports that provide useful insights into the returns on marketing, and the methodologies used are considered below.

A tracking survey by Insignia Market Research (2014)⁵, estimated market-specific returns on Tourism Australia campaigns in ten key inbound markets over the 2013-14 period. Tracking the survey sample over time, it estimated the proportion of 'converted travellers' as those who were able to recall the campaign, and identified as being strongly influenced by it, before booking a trip to Australia. Based on the average tourist spend profiles of each particular key group (provided by Tourism Australia), multiplied by the converted travellers rate and the size of the campaign target market, Insignia estimates an average ROMI of

⁴ Tourism Australia, *Agency Resources and Planned Performance*, 2014-15 Portfolio Budget Statement.

⁵ Insignia Marketing Research, 2014, *Tourism Australia TNLA Campaign ROI Measurement – 2013/14*.

16:1 across the ten key markets. This means that each dollar spent on the destination marketing campaign studied generated an estimated incremental \$16 dollars of inbound tourism expenditure.

Multivariate regression analysis by Webber Quantitative Consulting (2014)⁶ was used to estimate Tourism Australia's marginal and average ROMI over the four years to March 2014. It regressed inbound tourism spending against a number of explanatory variables, including Tourism Australia marketing spending, airline capacity, global economic activity, Australia's trade weighted index (TWI), and seasonal variables. It found a marginal ROMI of between 13:1 and 16:1, depending on the regression model used. That is, each additional dollar spent on destination marketing was estimated to generate between \$13 to \$16 dollars of inbound tourism expenditure.

From these reports, Tourism Australia has estimated that an average ROMI of around \$15 return per dollar invested. This analysis appears robust, and evidence-based, and assists in determining the average benefit that marketing creates for the economy. As the Commission notes, this ROMI should not be interpreted as a benefit-cost ratio itself. However, by converting this visitor expenditure to a net benefit using the multipliers that tend to be realised from appropriate CGE modelling exercises, this return is commensurate with a significant positive overall return to Australia.

In summary, research on alternative metrics, such as ROMI, has value and is consistent with net economic benefit measures:

- It indicates that, overall, the historical marketing activity undertaken by Tourism Australia has yielded net benefits;
- Tourism Australia maximising its return on marketing investment is commensurate with Australia maximising its net economic benefit *once its appropriation has been decided*;
- ROMI measures are an appropriate metric to use in targeting high yield markets, and evaluating the effectiveness of *individual* campaigns; and
- Combining these points, the value from marketing research and metrics should not be discounted and the adherence to net economic benefit measures may not be appropriate at all levels of decision making.

⁶ Webber Quantitative Consulting, 2014, *Estimates of the Return on Marketing Investment for Australian Inbound Tourism*.

3 Cost benefit analysis of destination marketing programs

The draft report advocates a greater role for CBA in determining which destination marketing programs are funded. In particular, it recommends that such an analysis is undertaken both before and after each program. Further, it states that *‘the complexity of this analysis should be commensurate with the value of the government funding being provided to the destination marketing or major event’*, and that *‘the analysis should be based on a technique that measures the net benefits to the community, rather than metrics such as increases in visitor expenditure or output’*⁷.

This recommendation may well be suited to the analysis of major events for the reasons set out in Section 1.3, in particular, the quantum of funding involved and the relatively unique characteristics of each event. However, for destination marketing it represents a relatively burdensome requirement that is unlikely to yield levels additional value sufficient to justify the associated costs. This section sets out these points in more detail.

3.1 Ex-ante and ex-post CBAs of individual marketing programs

Undertaking a CBA of a destination marketing program comprises the following steps:

- Estimating the additional visitation from the target market that can be expected to result from the marketing;
- Converting this visitation to dollar terms based on the average profile of visitor expenditure from that market; and
- Estimating the net benefit of this additional expenditure to the Australian community using CGE modelling to take into account the resource cost of servicing this demand and any crowding out effects that this may have on the domestic economy.

The Commission’s reservations regarding CGE modelling, as outlined in Section 2.1, are acknowledged. However, when correctly used for CBA purposes, for example by reporting an appropriate welfare metric, CGE models can present robust results. Further, there is no alternative way of rigorously estimating the net economic benefits from destination marketing other than to use a CGE model to convert expenditure into a net benefit measure⁸ by adequately adjusting for resource costs.

In keeping with the Commission’s recommendation that the burden of the analysis is commensurate with the size of the investment, there are alternative approaches through which the analytical intent of CGE modelling could be upheld without full incurrence of the associated cost. For example, it could assumed that a dollar of visitor expenditure creates

⁷ Draft report, page 228.

⁸ We note that this point is also made in Peter Forsyth’s submission to this enquiry.

the same net benefit to Australia regardless of where it is spent, what it is spent on and that this scales linearly with the amount of spending (over a prescribed range). This would allow a standardised ratio of expenditure-to-welfare to be used to convert estimated expenditure increases to net benefits. This would implicitly be based on CGE modelling of the net benefits of visitor expenditure, but would not see modelling being undertaken on a case by case basis. However, this relative simplicity would necessarily be traded for accuracy.

Perhaps more problematic is the difficulty in estimating the first stage of the analysis: the estimation of the additional visitation generated from a dollar of marketing expenditure. The best basis for this estimate is what previous campaigns have been measured to have contributed in terms of additional visitor expenditure. Each campaign will be unique, and their success can depend on a variety of factors. Some of these factors may only be observable after the fact.

Tourism Australia already undertakes a significant amount of analysis of target markets and marketing campaigns to determine how its funding is best spent. Hence, once various options have been narrowed, lower return options will have been excluded, and an analyst would have little better information to base a CBA on than historical calculations of marketing returns and their translation to net economic benefits. Such an exercise would be unlikely to add significantly to transparency, nor would it change decision-making around how Tourism Australia's appropriation is spent. It would, however, add cost and divert resources from more productive uses in marketing.

Instead, Tourism Australia needs little additional incentive to ensure its funds are well spent. Its board is accountable for performance on an annual basis and the previous section has identified research activity it undertakes to determine the success or otherwise of its activities. It is subject to parliamentary accountability requirements that include tabling its annual report, appearance at Senate Estimates hearings, production of an annual compliance report and compliance with Senate orders.

Further, its annual appropriation means that it is working to a fixed budget constraint and that any campaign or program undertaken comes at the cost of another program that this funding displaces. It therefore has the incentive to ensure that its fixed budget is spent effectively, and is accountable for demonstrating that this in fact occurs.

Taking these arguments as a whole, it is therefore unlikely that the requirement for CBAs to be undertaken for each destination marketing program would lead to an improvement on the current situation, either in terms of decision making or transparency. The incentives and research are already in place to guide appropriate funding decisions, and the difficulty in undertaking accurate assessments of individual campaigns in net benefit terms would mean that doing so yielded little additional insight.

Given this, the requirement to undertake both ex-ante and ex-post CBAs of individual programs is likely to lead to costs in excess of the benefit. It would see resources reallocated from marketing, to conducting CBAs. Further, given the rigour which these CBAs would require in order to be useful, this resource cost is unlikely to be trivial. Estimating the additional expenditure which each campaign would be expected to create given its unique features and target market, and converting this to a net economic benefit using an approach based on general equilibrium modelling would not be a simple exercise and is not

one which Tourism Australia is well-equipped to undertake. Hence, the requirement for CBAs to be undertaken for each campaign is itself not likely to pass the cost-benefit test.

Conclusions

High quality analysis on the returns from destination marketing can yield useful insights into the benefits that marketing can produce. Estimates of returns on marketing converted into net benefit terms using CGE modelling, or at least general equilibrium concepts, can be used to appropriately demonstrate these benefits from a whole-of-economy perspective.

However, whether undertaking net benefit assessments of each individual program has merit should be considered further in the Commission's final report:

- Tourism Australia does not choose its overall level of funding but instead works within a fixed budget determined through the Commonwealth Budget process. The community interests will be best served when it uses this fixed budget to maximise the visitor expenditure its marketing induces. A net benefit assessment is therefore not appropriate at this level.
- The requirement for a CBA to be undertaken both ex-ante and ex-post is burdensome and unlikely to significantly change decisions or increase transparency.
- Tourism Australia already has the incentive, knowledge and accountability to drive the efficient use of its funds. It is not clear that the requirement to undertake CBAs of its spending decisions would improve outcomes. However, the costs it would generate are unambiguous and non-negligible.

In addition to these considerations, the analysis presented in this document suggests that the Commission's final report could usefully consider clarifying the following points:

- Whether it considers that draft recommendation 8.1 should in fact apply equally to major events and destination marketing and in what ways, if any, the recommendation would differ between the two;
- The level of detail required and methodology used when undertaking a CBA of a destination marketing campaign; and
- The report could distinguish between the activity and funding of Tourism Australia and that of the various state and territory tourism organisations and how this may impact on its recommendations.

Limitation of our work

General use restriction

This report is prepared solely for the internal use of Tourism Australia. This report is not intended to and should not be used or relied upon by anyone else and we accept no duty of care to any other person or entity. The report has been prepared for the purpose of providing Tourism Australia with our views on selected features of the Productivity Commission's Draft Report on Services Exports. You should not refer to or use our name or the advice for any other purpose.

Contact us

Deloitte Access Economics
ACN: 149 633 116

Level 1
9 Sydney Avenue
Barton ACT 2600
PO Box 6334
Kingston ACT 2604 Australia

Tel: +61 2 6175 2000
Fax: +61 2 6175 2001

www.deloitteaccesseconomics.com.au

Deloitte Access Economics is Australia's pre-eminent economics advisory practice and a member of Deloitte's global economics group. For more information, please visit our website www.deloitteaccesseconomics.com.au

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte's approximately 200,000 professionals are committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 6,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at www.deloitte.com.au.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

© 2015 Deloitte Access Economics Pty Ltd