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Alaska Marine Highway System Marketing and Pricing Study

Volume 1: Summary Report of Key Findings And Recommendations

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The Nature of the Alaska Marine Highway System

The Alaska Marine Highway System (AMHS) is a far more complex system than the casual observer might assume. In fact, the system operates nine vessels serving 36 communities in two countries along two thousand miles of coastline. It offers multiple products (passage, cabins, vehicle, freight and food) in hundreds of possible combinations to a wide variety of markets. The AMHS is logistically more complex than major cruise operations, which have simple itineraries and just a handful of product combinations.

The challenge of marketing and pricing the AMHS is just as complex. The system has over 1000 individual tariffs that may be purchased in nearly infinite combination. The process of selling the system's products to customers is not simple. In this modern age in the travel industry of fast service, packaging, and product simplicity, AMHS has a formidable challenge.

To compound this challenge, in nearly forty years of operation, the AMHS has had little market research to guide decision-making. Such a system must have detailed knowledge of its customers in order to provide appropriate service and to maximize revenue.

The Business Mandate

Having received a legislative mandate – through reduced funding – to operate more as a business entity and less as a subsidized public service, management of the system is focused on learning about existing and potential markets. The current AMHS situation is economically and politically unsustainable, with operating losses continuing to increase over time. In 1999, the system required $35 million in state funding toward its total operating costs of about $70 million.

Generating more business and increasing prices are two solutions – hence this AMHS Marketing and Pricing Study. More business cannot be generated without additional marketing, and more revenue cannot be generated from the current market without increasing prices. The market intelligence generated by this study becomes the foundation for making significant changes in marketing practices and pricing policies to increase revenue and decrease public subsidy.

A third solution — shuttle ferries for at least part of the system — is expected to lower operating costs once the capital investment in new equipment and facilities has been made. However, without substantial investment in marketing and a change in pricing policies, shuttle ferries also will remain underutilized. Thus, marketing and pricing must change in order to stimulate use and revenue regardless of the particular technology, itineraries, equipment, and speed of future AMHS operations.

High Customer Satisfaction but Declining Market Share

The system is currently in a paradoxical situation. Current AMHS customers assign high ratings to the experience of traveling the system. On a 1 (poor) to 7 (excellent) scale, the average AMHS rating is 6.2 (very good to excellent), an exceptional mark equivalent to Alaska cruise passenger satisfaction. Further, customers give AMHS personnel in all areas of operation – shipboard and shore-side – high marks as well.

Conversely, the number of customers has declined significantly since the peak years of 1992 and 1993. There is no question the AMHS delivers a quality product and the past decade has seen an unprecedented boom in travel to Alaska during the best of economic times. Why then has AMHS traffic declined?

Additional research evidence points out the declining market presence for the AMHS and some difficulties it experiences in selling its product.

- In research conducted by the Alaska Tourism Marketing Council (ATMC) in 1996, only 4% of Alaska visitors and 0% of their High Potential Prospects (for future Alaska travel) report ferry as a travel mode of choice.
- While 17% of ATMC inquirers express interest in ferry travel, research in this report (see *Volume 2*) shows only 17% of those convert into ferry users. This is a conversion rate of less than 3% in 1999 from the state's "hottest" list of prospective visitors.
- Seeing beautiful scenery and wildlife are the most important experiences to Alaska visitors and High Potential Prospects. The AMHS provides both experiences in comfortable, casual cruising style but does not market either appeal effectively, nor does it have the assets to do so.
- The major AMHS marketing effort is inclusion in *North! To Alaska*, an Alaska/Western Canada generic destination area marketing publication. According to focus group research conducted in this study, this program is ineffective as a primary sales strategy. Focus group participants said the program stimulated interest in travel to the general destination area. However, its breadth makes it an ineffective vehicle for actually stimulating the sale of AMHS products.

  The Tourism North program is beneficial overall to the system. The study team recommends expanded AMHS participation. However, it has been a mistake for the AMHS to depend exclusively on any generic, wide-ranging, multi-purpose program to sell its specific, unique product. AMHS lost not only individual targeted market presence but also considerable advertising revenue when it stopped publishing its own collateral piece several years ago.

  AMHS marketing materials must include ship plans; photos of cabins and public areas; maps of pier-to-town relationships and transportation options; simple and easily interpreted mini-schedules and tariffs for the most popular routes; and strong sales appeals focused on cruising coastal Alaska, viewing the scenery and wildlife in a relaxing, casual onboard ambience. The current brochure does none of these.
- Hold times on the telephone reservations system are often lengthy and well above industry standards. The result in 1999 was that 25% of phone calls from people who contacted the AMHS for information went unanswered and were abandoned. Hold times and termination rates are improving in 2000 with recent improvement to the system, but continue to lag well behind industry standards.

- Past research reveals that ferry visitors plan further in advance than visitors using other modes of transportation. This puts a premium on having schedules, tariffs, and marketing materials available in the market place early (meaning fall of the preceding year).
- AMHS customers are heavy users of guide books, the Internet, travel agents, and local and state tourism offices. The AMHS information provided to these sources needs to have stronger sales impact and information content.

AMHS Attracts Economically Desirable Customers Who Travel Throughout Alaska

The AMHS serves economically desirable customers who travel throughout Alaska. The dominant summer visitor market using the AMHS (estimated at about 150,000 in summer 1999) to travel to, from and within the state stays longer, spends more and travels to more Alaska places than most other visitor markets. *Anchorage is the #2 most-visited community in Alaska by AMHS summer visitors, second only to Juneau*. Nearly one-half (46%) of summer AMHS visitors spend time in Anchorage on their Alaska trip. In total, five locations not on these Southeast AMHS system rank in the top ten most-visited communities by AMHS visitors. These include #6 Interior/Denali region (26% of AMHS visitors), #7 Fairbanks (24%), #8 Valdez (22%), and #9 Kenai Penninsula (19%).

Positive Alaska Visitor Market Outlook

The demographics and emerging travel preferences of Alaska's major markets foretell significant visitor growth over the next decade and beyond. Members of the Baby Boom generation are coming into their prime travel years (age 45+ years) and national and international travel preferences are for unique experiences. This combination means more visitors are looking for something special to do. In addition, enormous cruise industry investment in new, larger ships means that "cruising in Alaska with spectacular scenery and wildlife viewing" will be a theme that receives tens of millions of dollars annually in advertising support for the foreseeable future. The AMHS must position itself in the marketplace as the independent, informal, flexible, small-ship way to have this experience. Finally, in spite of insufficient marketing, the AMHS has special appeal to European, Canadian, and Australia/New Zealand markets because they are all familiar with AMHS-style ferry travel in their own countries. The AMHS non-resident, or visitor market, is almost 20% from overseas.

Historical Marketing and Pricing Policies

A review of past marketing and pricing policies is essential to put into context the current fiscal situation of the AMHS. Past policies have been politically based (as they should be, to some extent, since the AMHS is a public agency). The operation of the AMHS has – and may always be – complicated by the conflicting dual mandate of providing public transportation service while being held accountable for bottom-line financial performance. These politically determined policies have had devastating economic and market consequences to a system that should have been experiencing increased traffic, revenue growth, and a declining deficit during the booming travel market of the 1990s.

The Marketing Deficit

Remarkably, for a business of its size, only about $150,000 of the ferry system's $70 million budget is available for marketing – specifically, advertising and the design, printing, and distribution of marketing materials. Further, only $50,000 is actually spent on promoting the system to its prime visitor market. This is done through a generic regional destination marketing program that research shows dilutes the AMHS sales message. Such a budget is more commonly associated with "mom-and-pop" tourism businesses that are a small fraction of the size of the AMHS. A cruise line with operations comparable in size to AMHS would expect to spend approximately $2 to $4 million on marketing. Cruise companies anticipate about $30 of revenue for every $1 invested in marketing.

A recent McDowell Group survey of Alaska visitor industry businesses shows that nearly one-half of them spent from 6% to 25% of their income on marketing. Travel industry rules-of-thumb place marketing at 5% to 10% of gross revenue. By any standard the AMHS marketing budget needs to be in the millions rather than the thousands in order to generate the business to close the subsidy gap.

Instead, the system has been hamstrung by overall budget cuts, selective line-item cutting, and rising costs. As a result, the system has been deprived of two essential nutrients, and the absence of them is fatal. First, since marketing money is minimal, it no longer has the ability to generate increased revenue for itself. Without marketing money, the system cannot be held accountable for increasing business or even for stemming the decline of customers and revenue. Second, without the ability to efficiently serve prospective customers who do want to buy, the system cannot survive. Reservations staff shortages combined with technical shortcomings meant that 25% of all telephone inquiries to AMHS in 1999 ended in an unanswered call and lost revenue. Again, the system cannot be held entirely accountable. On a positive note, efficiency measures and technology changes are reducing hold times in 2000.

The Cost of Past Pricing Policies

Pricing policies in recent years have resulted in almost no fare increases. Meanwhile, most travel-related services in America and Alaska adjust prices annually, at least at the rate of inflation. Consumers generally expect gradual price increases over time to cover cost increases. AMHS pricing policies had no relationship to the economic realities of rising fuel, maintenance, personnel, and other operating costs of the system. The disregard for the bottom-line effects of this "no raising prices" policy is a form of economic suicide.

Pricing policies must capitalize on very favorable market factors that could bring in additional millions at no additional cost. Research in this study reveals that most customers consider AMHS a *very good* bargain for the money, especially when it comes to passage fares. The market, particularly the dominant summer visitor market, appears willing to pay more. Unlike the AMHS, nearly all travel products nationwide – and certainly in Alaska – charge significantly more in peak season.

Study Purpose

The objective of the ***Alaska Marine Highway System Marketing and Pricing Study*** is to develop recommendations for how AMHS can enhance revenue and decrease subsidy through improved marketing and pricing practices.

To do this, the study undertook five tasks:

- Assessment of ferry system markets, including the first comprehensive profiling of system passengers.
- Analysis of the competitive environment.
- Analysis of the political and financial environments.
- Development of an information system and tariff/revenue model.
- Development of a marketing and pricing strategy.

Interim results from these tasks have been prepared for internal use by AMHS management during the course of the study. A total of four interim reports were created. Interim results were also summarized in several presentations to ferry system administrative staff, a presentation to ferry system vessel captains, and a presentation to the Southeast Conference of Mayors.

Final Study Products

Final documents developed as a result of the study include the following:

- ***Volume 1: Summary of Key Findings and Recommendations*** (this overview document).
- ***Volume 2: Customer Research Findings and Recommendations.***
- ***Volume 3: Marketing and Pricing Strategy.***

Volume 1: Summary of Key Findings and Recommendations

This document functions as an executive summary of the one-year study. It describes the following key elements of the study:

- The Alaska Marine Highway System's current situation and the effects of the political, financial, and market environment on ferry system market performance.
- Alaska Marine Highway System current customers and potential customers: their travel patterns and attitudes toward the ferry system and its competitive alternatives.
- The key marketing challenges the Alaska Marine Highway System must overcome.
- How AMHS must respond to those challenges to be successful — the marketing and pricing strategy.

Volume 2: Customer Research Findings and Recommendations

The summary of customer research profiles three main seasonal markets served by AMHS: summer, winter and spring travelers. It describes their wants, needs and priorities. It also describes potential AMHS customers both in Alaska and elsewhere and what AMHS must do to get them to purchase ferry travel. The document covers three areas of primary research performed for this study:

- Onboard Surveys – summer, winter and spring seasons.
- Telephone Surveys (three) with potential customers.
- Focus Group Research.

Onboard Surveys. The bulk of these surveys were conducted onboard AMHS vessels during the key summer season, when more than half of all ferry traffic and the majority of all system revenue is generated. These were face-to-face interviews with more than 1,700 randomly selected passengers on selected ferry runs during the summer of 1999. An additional 800 surveys were conducted between October 1999 and June 2000. The surveys documented a wide range of customer behaviors and attitudes. These included travel itineraries, trip purpose, passenger information, passenger preferences, and satisfaction levels. Together, the summer, winter and spring season onboard surveys represent the first comprehensive effort to understand AMHS passenger wants and needs since the first "Blue Canoe" was launched in the early 1960s.

Telephone Surveys. Surveys were conducted with 650 potential AMHS customers outside Alaska drawn from AMHS and ATMC lists, and 400 Alaska residents in communities served by the system. From this research, AMHS managers, for the first time, have market intelligence on which to base marketing and pricing decisions that will increase system revenue.

Focus Group Research. Two focus groups were held in Portland, Oregon in March 2000. The groups were chosen from a list of individuals from the Portland area who had contacted the AMHS and the ATMC for information about ferry travel. The main objective of the focus groups was to provide additional insight into how the AMHS can convert potential riders into actual customers. One area of particular interest was the role and effectiveness of the AMHS's only major marketing tool, the *North! To Alaska* brochure.

Volume 3: Marketing and Pricing Strategy

This volume provides supplementary recommendations and supporting information for the marketing and pricing strategies discussed in *Volume 1*. Specific marketing and promotional activities are described along with time frames for implementation. The volume also presents further pricing recommendations and discussion based on analysis by the study team's Tariff and Revenue Model.

Ridership Information System Documentation

Also included with the study reports, but under separate cover, is the technical documentation for a ***Ridership Information System*** that consolidates all ferry system ridership and ticketing information since 1983 into a seamless data system to support management decisions and strategy. Developed for the AMHS by McDowell Group associates Dr. Tom Gaylord and Sophie Ducharme of GDA Research, Inc., the system allows analysis by ferry management not only of historical data, but also of current operating results. The data warehouse may be automatically updated as soon as information is recorded in the AMHS reservation system.

System Challenges

The current situation is untenable.

The AMHS's current financial situation is untenable, and will become acute in just a few years unless dramatic steps are taken to improve marketing support and bottom-line management orientation. To accomplish this, the AMHS must have a clear mandate to operate as a revenue-oriented business.

The AMHS marketing budget is inadequate.

Of roughly $2 million in expenditures denominated as "marketing" by the Alaska Marine Highway System, nearly all is used to cover the costs of reservations personnel and computer system maintenance. The discretionary marketing budget of approximately $150,000 is inadequate for a transportation and visitor industry business with an operating budget of $70 million. The primary marketing piece employed by the AMHS –– *North! To Alaska* — is designed as a generic promotion of Alaska/Western Canada regional travel. Alone, it is not an effective sales tool for the AMHS. Declining ridership is a direct result of lack of marketing.

The AMHS is not accessible to purchasers.

Ready access to the system is the single biggest barrier to increased sales. In spite of important recent improvements, the reservations system is seriously overloaded. It lags far behind industry standards for call-response times and booking flexibility. Prospective ferry passengers tend to value highly the process of researching and planning their trips. Access to information is very important to them. The inability to find needed information may lead them to change their plans.

There is no follow-up marketing to interested potential customers.

The single biggest weakness in the AMHS marketing program is with follow-up marketing to people who have already expressed an interest in ferry travel – by calling, e-mailing or writing – and converting them into purchasers. More than 80,000 potential travelers expressed interest specifically in AMHS travel in 1999. However, the lack of market exposure and detailed AMHS-specific information, as well as difficulty in accessing the system, have resulted in declining summer traffic. This has occurred even though demand is substantial.

System operating information is not available for decision making.

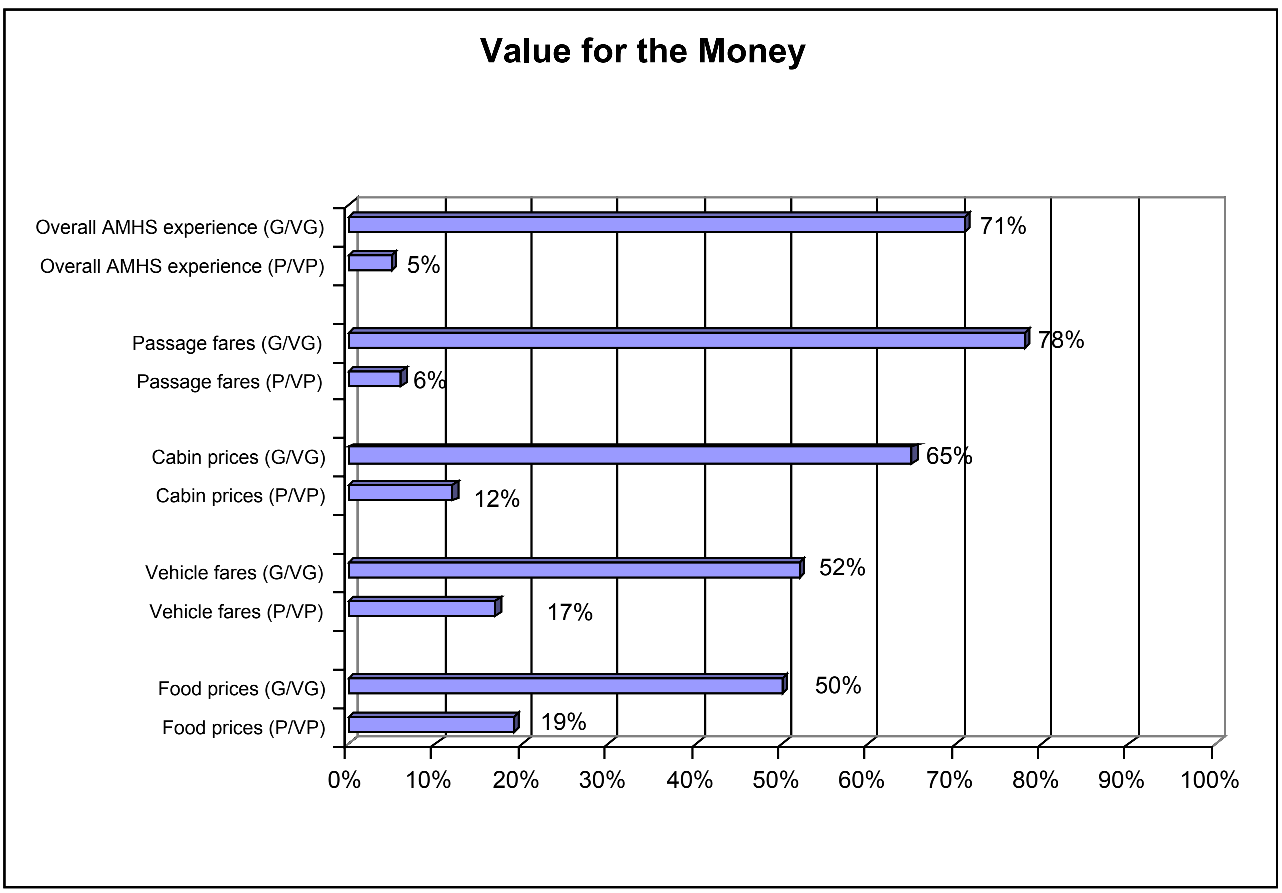
In the travel industry, where every unsold seat or cabin is a lost opportunity, strategic use of timely operating information is key to success. The AMHS must know quickly and accurately what space is selling and what requires additional promotion. Similarly, it must be able to track the results of marketing and promotional efforts. Until the study team designed a new Ridership Information System that allows analysis of the full range of reservations and ridership data at any time, this information was compiled by AMHS just once a year, mainly by hand.

Pricing policies forego available revenue.

Seasonal pricing and more restrictive deposit and pre-payment requirements are standard in the travel industry and necessary to improve system financial performance. Research shows that many passengers are willing to pay more for AMHS routes and services. Further, price promotions would garner additional revenue at little expense by filling currently unsold space. However, price changes are not a substitute for effective marketing. A sustained marketing effort will enhance the perceived value of the AMHS experience. This will assist acceptance of future price increases and help AMHS target the most promising market niches. Long-term price increases without supporting marketing could lead to a loss of customers.

Summer Customer Value for the Money Ratings

1 (very poor value) to 5 (very good value) scale
Poor/very poor percentages = 1+2 ratings.
Good/very good percentages = 4+5 ratings



AMHS is not fulfilling its potential as a travel partner.

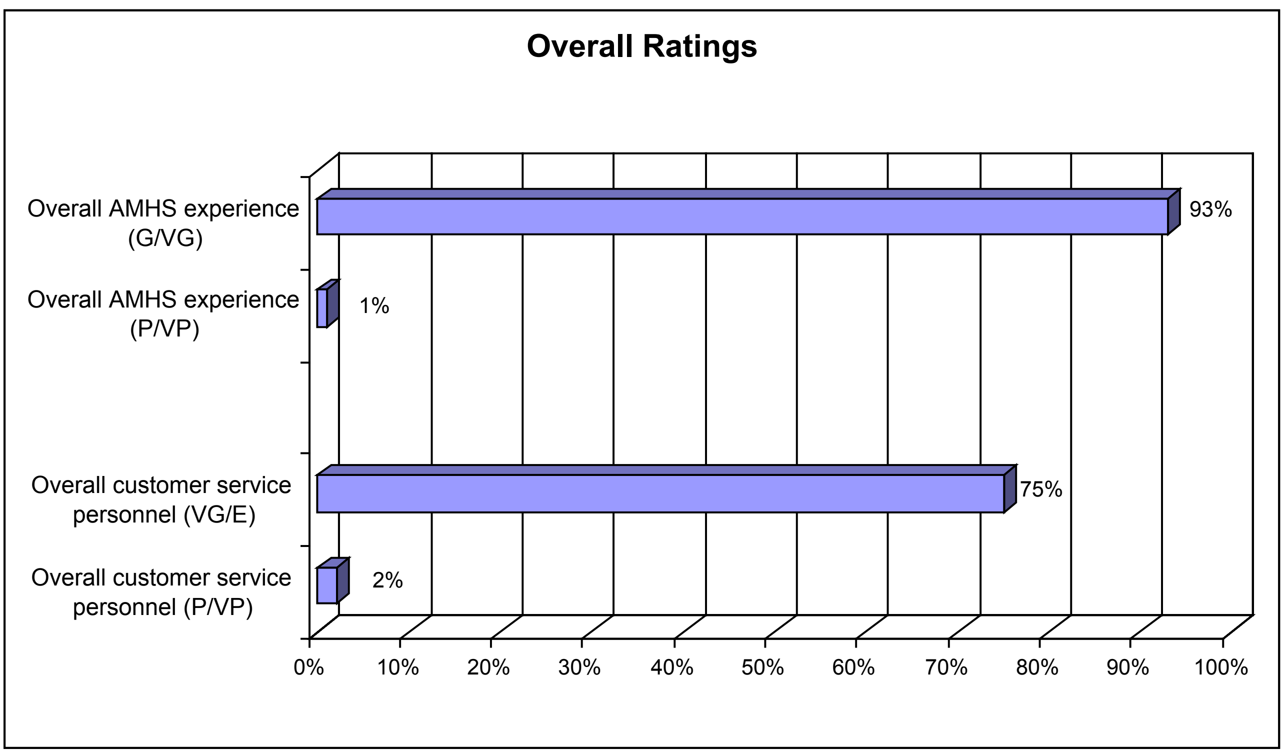
The AMHS could better serve residents and visitors alike, as well as enhance its role in the state's economic infrastructure, by working more closely with the rest of the travel industry. The object is to develop and support new products, promotions, and local and regional marketing strategies. This would benefit communities, as well as result in increased ridership and revenues for the system. Inconsistent marketing and administrative resources have been the main barrier to forming industry relationships.

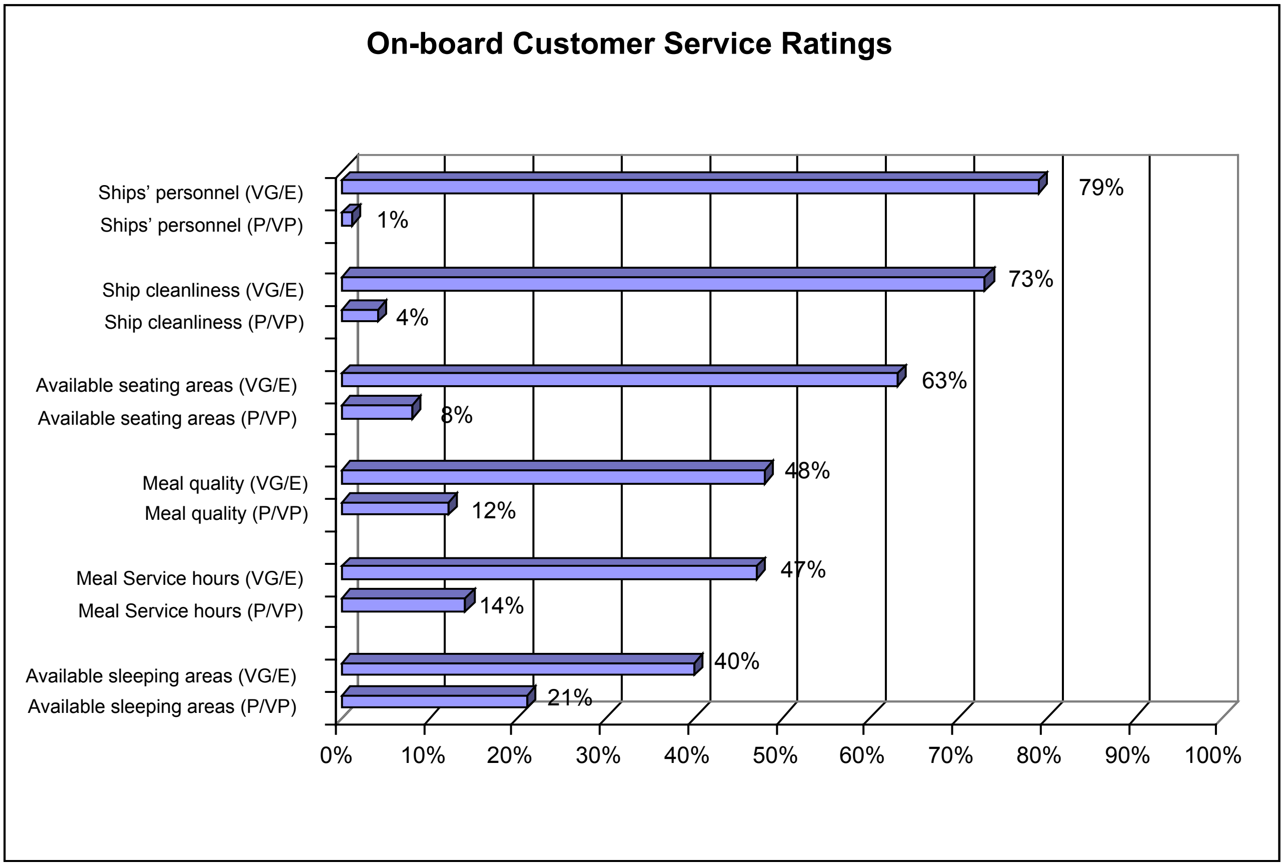
System Opportunities

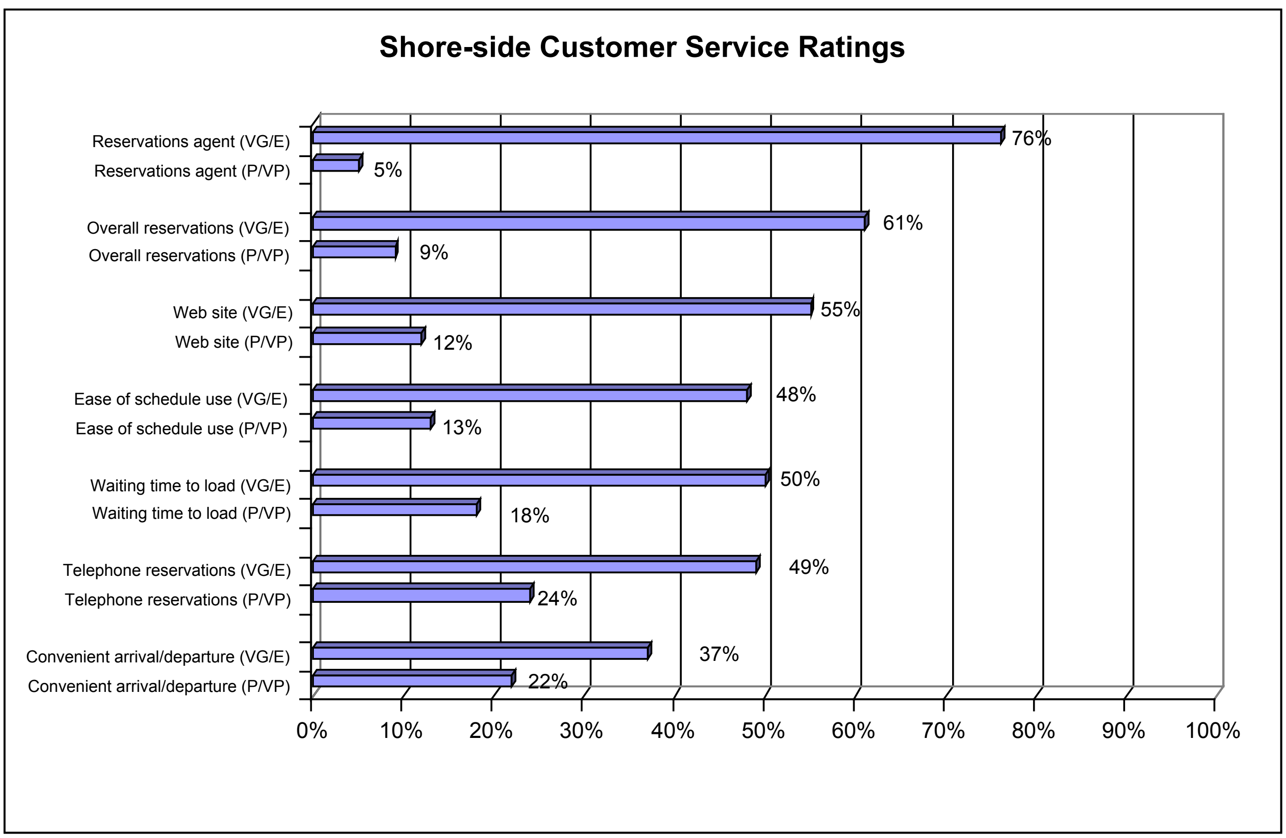
Customer satisfaction is high.

AMHS customers value highly the quality of experience they receive, particularly the cruising, scenic viewing, relaxation, and treatment by ferry system personnel. The average customer rating of the overall AMHS experience is 6.2 (on a 1=poor to 7=excellent scale). Further, customers perceive their AMHS experience as a very good value for the money. Passage fares are considered an excellent value; vehicle fares are considered moderately good. Complaints center on on-shore issues such as reservations access, inconvenient departure times, and long loading times.

AMHS Summer Customer Satisfaction Rating
Selected Indicators
Ratings on 1 (very poor) to 7 (excellent) scale
Very good/excellent = 6+7 ratings
Poor/very poor = 1+2+3 ratings
(Except Overall AMHS experience rating on 1 to 5 scale)




On-board Customer Service Ratings
Ships' personnel (VG/E)
Ships' personnel (P/VP)
Ship cleanliness (VG/E)
Ship cleanliness (P/VP)
Available seating areas (VG/E)
Available seating areas (P/VP)
Meal quality (VG/E)
Meal quality (P/VP)
Meal Service hours (VG/E)
Meal Service hours (P/VP)
Available sleeping areas (VG/E)
Available sleeping areas (P/VP)
79%
1%
73%
4%
63%
8%
48%
12%
47%
14%
40%
21%
0%
10%
20%
30%
40%
50%
60%
70%
80%
90%
100%


Shore-side Customer Service Ratings
Reservations agent (VG/E)
Reservations agent (P/VP)
Overall reservations (VG/E)
Overall reservations (P/VP)
Web site (VG/E)
Web site (P/VP)
Ease of schedule use (VG/E)
Ease of schedule use (P/VP)
Waiting time to load (VG/E)
Waiting time to load (P/VP)
Telephone reservations (VG/E)
Telephone reservations (P/VP)
Convenient arrival/departure (VG/E)
Convenient arrival/departure (P/VP)
76%
5%
61%
9%
55%
12%
48%
13%
50%
18%
49%
24%
37%
22%
0%
10%
20%
30%
40%
50%
60%
70%
80%
90%
100%

Visitors using the AMHS travel widely and bring benefits throughout Alaska

AMHS customers are important to economies throughout Alaska in spite of the lack of a meaningful marketing program. These independent-oriented travelers are likely to respond well to additional marketing. Because they travel and spend widely throughout the state, a reasonable AMHS marketing budget will translate into substantial additional economic benefits statewide.

Anchorage is the second most visited Alaska city by summer visitors who use the AMHS. Nearly one-half (46%) or about 70,000 AMHS visitors spent an average of 2.1 days in this city in summer 1999. Only Juneau (55%) hosts more. A total of five Alaska locations not even on the Southeast system rank in the top ten most-visited by summer visitors using the AMHS – Anchorage (#2), Interior/Denali (#6), Fairbanks (#7), Valdez (#8) and Kenai Peninsula (#9). Alaskans using the AMHS also visit numerous off-system communities but not to the extent that visitors do.

The only available expenditure data (McDowell, 1993) on Alaska visitors indicates nearly $10 million in AMHS visitor spending for Anchorage in summer 1999. However, this amount is declining in recent years due to reductions in AMHS marketing and resulting losses in passenger volume. Other estimated economic impacts range from about $11 million for Fairbanks (5 day average stay) and the Kenai Penninsula to $7 million for Valdez (1993 data applied to 1999 volumes).

Top Ten Alaska Locations Visited By Summer 1999 Visitors Using the AMHS

Location	Percent Visiting	Length of Stay
		(mean/median days)
1. Juneau	55%	8.6/3.0
2. Anchorage	46	2.1/1.0
3. Skagway	42	5.9/3.0
4. Haines	29	3.2/3.0
5. Ketchikan	27	3.9/2.0
6. Interior/Denali	26	1.3/1.0
7. Fairbanks	24	5.0/3.0
8. Valdez	22	3.1/2.0
9. Kenai Penninsula	19	5.6/4.0
10. Sitka	11	9.2/5.0

Alaska visitor market outlook is positive.

A large, enthusiastic summer market exists for the AMHS. Over 80,000 potential traveling parties expressed interest specifically in AMHS travel in 1999. However, the lack of market exposure and inadequate access to detailed AMHS-specific information, as well as difficulty in accessing the system, have resulted in declining summer traffic, when demand is substantial.

Further, the study shows that most Alaska residents also ride the ferries for pleasure. This means that residents, as well as visitors, are likely to respond to marketing messages materials, and products aimed at pleasure travelers in general.

AMHS has no significant competition.

The AMHS has virtually no competition for most of its market. Two thirds of AMHS summer passengers do not consider an alternative method of travel when deciding whether to take a ferry voyage. Most passengers — residents and visitors throughout the year — are interested primarily in an enjoyable experience and consider ferry travel unique.

Airlines and large cruise companies, in turn, have little to fear from expanded AMHS marketing. Research reveals scant cross-over between those expressing interest in travel by air and cruise and those traveling on the ferry system.

The nature of the AMHS experience, the time involved, the variety of options, and the price are so different from apparent competitors that the issue for the AMHS is not competition, but the system's ability to convert the substantial existing demand. It also must increase the demand through effective marketing.

Role of Marketing

Results from all phases of this year-long study underscore the need for the Alaska Marine Highway System to market itself effectively. The ferry system has been hamstrung by not having the staff and resources appropriate to a $70 million transportation system. Less marketing simply means less business. Lack of an effective program has cost the State of Alaska millions of dollars in lost revenue in the past decade.

By contrast, over the same period, cruise lines operating in Alaska have more than doubled their market by spending $30 million to $40 million in marketing their Alaska product. This has resulted in an annual return of about $1 billion, generating about $30 in revenue for every $1 in marketing. Bergen Line, a ferry system in Scandinavia, has found the same profitable return on marketing dollars. Once an ailing system, Bergen Line's aggressive marketing program has generated many times the revenue for every dollar spent.

Had even moderate assets been allocated to marketing during the past seven years, the AMHS likely would have enjoyed significant growth in tourism traffic and revenue during the booming 1990s. It would have an operating deficit many millions of dollars less than current levels. The absence of a substantial, additional subsidy and the inability of the AMHS to generate business for itself means service cuts and further system deterioration. Continuing the current policies and funding mechanisms will assure this outcome.

Role of Pricing

Since its last major price adjustment in the early 1990s, the failure to increase prices regularly in response to rising expenses has cost the AMHS significant revenue. This alone is justification for increasing prices by roughly 20%. Further, this study shows that many ferry products are under priced when measured by the value that customers place on them. Both of these facts are good reason for raising prices.

However, it is vital to recognize that simply increasing prices will not resolve the financial challenges facing the AMHS. While increasing prices is a reasonable and overdue strategy, only an effective, sustained marketing campaign will allow the AMHS to tap potentially large pools of new customers. The purpose of marketing is to raise the perceived value of a product in the eyes of the marketplace. Pricing may then be adjusted to take advantage of the new value perception. Currently, the AMHS is in an opportune position. Study results show that the majority of the market perceives ferry services to be an excellent value for the money.

Role of Reservations

Commensurate with an increase in marketing, the AMHS reservations system must continue to improve its efficiency and capacity to handle additional customer inquiries and convert them to sales. Our detailed recommendations include methods for minimizing lost sales by reducing telephone hold times, providing effective conversion information, upgrading technology, and improving inventory management. Implementing strict cancellation policies is a simple, but important, first step. The Ridership Information System discussed later in this report revealed that a significant percentage of reservations are not used or are changed. By reducing this percentage, reservations staff will have more capacity to deal with revenue-generating reservations.

Improving the existing reservations processes is only the beginning. Leading travel companies have redefined the role of the reservations department. They no longer think of it as a means simply of booking space for customers. Reservations has become ***inventory management***. The booking process represents an unparalleled opportunity for companies to influence customer purchases to the benefit of both the company and the purchaser. Small or large changes in itineraries, schedules, shore-based excursions, accommodations, and a host of other travel details can make the difference between a profitable and unprofitable sale and an enjoyable or less enjoyable travel experience.

Expanded training of reservations personnel and a well-designed, flexible booking system are the key elements for turning a passive booking operation into a pro-active, sales-oriented inventory management strategy. Current AMHS reservations staff appear well-trained for their functions as they are now defined, and they get generally high marks from callers. Developing the capacity to do effective inventory management, however, will require new approaches, skills, training and electronic systems.

AMHS Staff Capacity

Even if substantial funding for additional marketing activities were immediately available, the AMHS lacks the staff capacity, expertise, and business systems necessary to conduct effective marketing at a level appropriate to its operations. To succeed, the system needs the expertise available to comparable-sized travel businesses. Further, it needs this expertise quickly.

The financial condition of the ferry system requires immediate marketing attention. The study team has developed many recommendations that will improve business performance. Effective implementation means that the AMHS must obtain qualified marketing staff without delay or contract with outside marketing expertise, or both.

Although speed is essential, marketing is also a cumulative endeavor. It is imperative that the AMHS arrange for long-term access to the resources and skills necessary to conduct a consistent, first-class marketing campaign.

Contract agents are not the solution to reservations staffing issues. While adding reservations capacity and creatively marketing on their own, contract agents do not have the marketing capacity to generate substantial new ferry business. Instead, contract agents have shared with the central reservations office slices of a shrinking pie at a cost of 10% (commissions) to the system. The system should not abdicate its marketing, information, and sales (reservations) responsibilities to entities unable to stimulate significant increases in total traffic.

Overall Marketing Program Goals

The study team recommends the AMHS develop a substantial marketing program that increases ridership an average of at least 5% and revenue 10% annually through 2005. This must be an integrated program that develops marketing, sales (i.e., reservations), pricing policy, and product enhancement in a coordinated manner. Each of these four elements is part of the overall marketing program and none can stand alone without concurrent development of the other three.

- Reservations must be capable of handling existing demand without customer loss as well as new demand stimulated by marketing efforts.
- Marketing must enhance the perceived value of the AMHS product so that price increases will be viewed as good value for the money by future markets. Marketing must also direct new demand to available inventory that is in turn sold by reservations.
- Pricing policy must maximize revenue from existing and new markets without losing customers generated by marketing and sold by reservations.
- Finally, the product as it is delivered on the ships, though highly rated by current customers, must be enhanced to meet expectations generated by marketing efforts and pricing policies.

Following are study team recommendations for pricing, marketing, reservations, and product enhancement. We also include brief summaries of short, intermediate, and long term action items. These are all covered in greater detail in *Volume 2* and *Volume 3* of this report.

AMHS needs a marketing function that has the staff, expertise and resources to:

- Design, package, and promote multiple travel products aimed at a variety of market niches.
- Analyze effectiveness of advertising and marketing activities.
- Work closely with other travel and tour providers to co-develop and co-market products.
- Market shipping services proactively to potential customers, including negotiation of special rates to fill available space.
- Sell and promote travel products on board AMHS vessels.
- Establish and manage concession contracts for food, gift shop and other onboard and terminal services.

AMHS needs an information/reservations system that:

- Maintains records by voyage and for every port pair within each voyage in enough detail to profile the important demand segments for each port pair, season and date, arrival and departure time, trip purpose, accommodation, etc.
- Allows for multiple pricing structures that can vary by time of reservation, by voyage, port pair, season, arrival and departure time, accommodation package, etc.

AMHS needs a reservations staff that is trained and equipped to:

- Respond strategically to individual purchase inquiries by promoting particular voyages, products, and packages.
- Implement price promotions at the right times and of the proper scale to fill available space during the entire booking phase for each voyage while also maximizing revenue return on that space.

Overall Pricing Strategy

- Adopt a market-based pricing policy characterized by significant peak, shoulder, and winter season differentials that match each market's ability and willingness to pay.
- Make immediate adjustments in prices of passage, cabins, and vehicles to reflect the market's perception of value of these items.
- Since northbound and southbound traffic have different peak seasons, institute directional peak and shoulder season fares.
- Manage inventory by using pricing policies and promotions to encourage ridership on underutilized runs and in off seasons.

Route Groups and Reference Voyages

The study team determined that a systematic method of analyzing prices could be based on eight "route groups." The team developed a Tariff/Revenue Model to help analyze the effects of various pricing options. The model is described in detail in *Volume 3* of the study report. The model is a simplified representation of the whole Marine Highway System. It divides the ferry system into eight geographic and business segments called "route groups." Transportation, price, and availability alternatives were compiled for reference voyages for each of the eight route groups.

Pricing Recommendations

Summer Tariffs in 2001

Increase summer 2001 tariffs by an average of 14% over current rates. This is accomplished by increasing passage by 30%, cabins, 20%, and vehicles, 5% above current tariffs. Research results indicate these specific increases will be accepted by most of the summer market. Further, pricing sensitivity modeling show this will result in little loss of customers and at least a 10% increase in summer revenue. A 10% overall increase is also recommended for summer 2002, pending analysis of summer 2000 sales.

For 2001, add an additional 10% "cruise premium" to passage and cabins to the Ketchikan–Bellingham route. This is the highest demand link on the system and cabins sell out for the summer in a matter of hours – an obvious case of under valued inventory. Competitive pricing analysis shows this route's passage and cabins to be particularly under priced. Excess demand can be channeled to other Bellingham sailings or to the Prince Rupert route group.

In areas such as Haines/Skagway and Prince William Sound, where the system can be perceived to compete with private tour operators (though the products, speed, service levels, and vessel types are not closely comparable), raise tariffs to near private sector levels, in season, to increase revenue. This will also reduce any perception of unfair price competition.

Rationale: The AMHS must develop a market-driven pricing policy. The AMHS has had a policy that resulted in virtually no price increases for several years while prices of most all other travel products have increased. Its price now lags far behind its value in the eyes of the market place. The study team believes that the AMHS is significantly under priced system wide. AMHS customers rate the AMHS experience as an excellent buy for the money, in particular the passage fares. The lucrative summer visitor market is especially appreciative of the value for the money.

Long-Run Summer Tariff Pricing

Over time, move toward a price structure with a significant differential between summer and winter tariffs. Continue to increase prices each summer by at least 5% overall until price resistance is clearly evident to the point where the pricing sensitivity model begins to approach negative returns. The Ridership Information System may be used to track customer response to price changes with precision.

Rationale: The system has catching up to do in terms of a market-based pricing policy with its legislative mandate to become business-oriented. Summer is the time to maximize revenue from the dominant visitor vacation market.

Peak Season Summer Tariffs

In 2002, implement a split pricing policy for peak and shoulder portions of the summer season. This is universal travel industry practice and helps manage inventory.

Rationale: The peak season for the Alaska market is approximately June 20 to August 20. Cruise lines, hotels, airlines, rental vehicle companies and tour companies all charge premium prices for travel during this period when demand is the greatest. Shoulder season (May 1 to June 19 and August 21 to September 30) rates are moderately lower than the peak season rate but significantly higher than winter rates. The purpose is to induce price sensitive travelers into taking available inventory on either side of peak season.

Direction Tariff Differentials

Beginning in 2002, develop directional fare differentials on mainline, high revenue routes. Start peak fares earlier northbound and later southbound. Peak season prices could be instituted northbound from approximately June 1 to August 5, and for southbound, from July 1 to through Labor Day. This will not only help fill available inventory but is likely to encourage additional use of the system by existing customers and new customers.

Rationale: No single route – including most sailings on the popular Bellingham route – is full in both directions at the same time. Heavy early season northbound flows are common and heavy late-season flows are common. The ships are underutilized in the opposite direction on most sailings except for a limited time in mid-summer. Shoulder season fares would encourage earlier northbound and later southbound travel, spreading the directional markets out to match available capacity on the most popular high-revenue routes.

Winter Seasons Tariffs

Increase winter season tariffs by at least 2% every year indefinitely as a general policy to cover cost inflation. Increase passage prices by 10%, cabins by 5% and vehicles by just 2% in winter 2000/2001. This will generate an estimated additional 3% revenue from October through April.

Rationale: While the dominant winter resident market is more price sensitive than the visitor market, customers still perceive the value for the money of the AMHS experience as good. The same relative formula (passage gets the highest increase, followed by cabins, then vehicles) used for summer increases should be applied to winter fares. Winter customers, like summer customers, think passage fares are a bargain and that cabins are a good buy. They are more sensitive to vehicle fares, but approximately 40% of both visitors and residents rate them a good buy.

Economy Travel Policies

Price discrimination by area of residence is not possible due to federal transportation funding requirements and other legal considerations. However, the study team recommends a program aimed at economical AMHS travel that would include such economy-travel opportunities as winter season multi-trip passes, space available discounts, directional discounts, and rate differentials in low volume route groups like the Southeast Village route group.

Reservations Payment, Cancellation, and Change Policies

These will help bring in revenue and, more importantly, reduce the load on the reservations system created by the large percentage of ticket cancellations and reissues. Ridership Information System (RIS) data show about one-half of all reservations booked are either unused or changed, most of them without penalty. Significantly stricter cancellation, change and payment policies comparable to those of Alaska cruise lines and airlines will increase revenue and will dramatically increase the revenue efficiency of the reservations staff.

Vehicle Tariff Structure

AMHS customers show the most price sensitivity toward vehicle prices. The study team recommends that price increases for vehicles be moderate and applied gradually. In addition, the team recommends a simpler vehicle price structure similar to that used by BC Ferries. The structure would replace AMHS' current practice of charging by individual vehicle length with one that places most vehicles into 5 or 6 basic pricing categories.

A simpler vehicle tariff will speed reservations and ease reporting burdens. Some customers may resist having their vehicles categorized with others that are not precisely the same size, but this practice is common, and most drivers will not object.

Marketing Recommendations

Market Positioning

Establish a new image of the AMHS as the way to experience the "real Alaska" by cruising the Inside Passage (and other spectacular Alaska coastal areas). This mode of cruising allows for premium scenic and wildlife viewing (emphasize closeness and show examples), relaxation and casual onboard ambience.

Rationale: Research shows that customers and potential customers see the AMHS as unique, as a chance to see the "real Alaska." They view this as being unlike either air travel or the large cruise ship experience. The two most important needs of visitors – spectacular scenery and wildlife viewing – are AMHS strong points. It is vital to understand that the product AMHS customers are purchasing is not passage, cabins, car deck space, and food. It is the intangible experience of immersion in the Alaska mystique that happens to be facilitated by passage, cabins, car deck space, and food.

Product Simplification

Develop a simplified means of presenting the AMHS product based on the eight natural route groups. Follow this with a simplified presentation of the AMHS product in brochures, schedule, packaging and marketing approach. The system breaks down into eight logical route groups. Most markets are only interested in one or two of them for purposes of planning their trip. Each route group is served by a limited number of vessels.

Recommended route groups that can be defined as products are:

- Bellingham Mainline (normally the Columbia).
- Southeast Major Ports (Matanuska, Taku and Kennicott via Prince Rupert).
- Northern Lynn Canal (Malaspina and Kennicott, primarily).
- Southeast Villages (Aurora and LeConte).
- Cross-Gulf Intertie (Kennicott).
- Prince William Sound (Bartlett and Tustumena).
- Southwest (Homer-Kodiak) (Tustumena).
- Aleutian Chain (Tustumena).

Rationale: Modern, successful, travel marketing practices demand that the AMHS product be simple to research and easy to buy. The current means of AMHS presentation is to give the prospective customer an overwhelming catalogue of hundreds of items. The current schedule and tariff format forces the potential customer to wade through pages of routing lines to find the one or two of interest to their trip. The customer must then contact an agent to work it all out. Simply separating the schedule into the eight groups listed above would significantly improve the ease of making a purchase decision.

These route groups then become the operational basis for a variety of targeted marketing initiatives. With this simple change, the AMHS becomes just eight products rather than the hundreds of possibilities presented in current brochure material – a common complaint by customers, high potential prospects, and focus group participants.

Product Enhancement

Although AMHS customer satisfaction is generally high, research pointed to some areas where improvement of the onboard experience should be considered. Passengers identified the following areas as the most important for AMHS to improve in its current vessel operations:

- More convenient arrival and departure times.
- More convenient hours of food service.
- Quality and selection of food items.
- Availability of seating for viewing.
- Availability of sleeping areas (public spaces, not cabins).

Product Packaging

The study group recommends featuring one to three popular itineraries for each route group. While all routing alternatives remain available, this would make it easy to plan and buy for most prospects. Each of these route groups are very special, with their own unique attractions within the overall appeal of seeing the real Alaska via the AMHS.

Rationale: Such a program reduces the initial presentation of the ferry product to a couple of variations of just eight basic products. This not only simplifies the purchasing process for the customer, it also allows the AMHS to target their marketing to available inventory that has the highest revenue potential.

Timing

Enter the market earlier with marketing material, advertising, schedules, tariffs, itineraries, and packages by September 1 each year for the upcoming summer season. Schedule and brochure availability and being open for booking by September 1 are mandatory. Telephone, Internet, mail and fax reservations systems must be programmed and adequately staffed by September 1 each year.

Stay in the market throughout the late selling season with marketing activity, because a significant proportion of independent Alaska visitors are short (one week to 3-month) trip planners.

Rationale: AMHS customers plan with a longer lead time than customers of any other mode. Longer-term trip planners are more likely to have a vehicle, so they have higher revenue potential. Early entry will also cut down hold times as the backlog of demand that normally clogs the phone lines after December 1 will be dissipated over an additional 90 days. Further, Alaska's primary marketing programs (ATIA, SATC, Tourism North) and cruise lines all place heavy marketing emphasis on the September-December period.

Focus

The period of primary marketing emphasis should be May 1 through September 30 with expansion into April as well.

Rationale: Summer has by far the highest potential for additional business. It will be the most tolerant market for significant price increases, since the market is three-fourths visitors who view AMHS prices as a high value for the money.

Brochure and Schedule Development

Develop a stand-alone AMHS marketing brochure. It should help prospects research all relevant AMHS products, make the decision and implement their purchase. It should include:

- Clear focus on central themes: cruising the "real Alaska," premium viewing of scenery and wildlife, and relaxation with casual onboard ambience.
- Simplified presentation of the product in the recommended eight route groups, similar to the way cruise lines feature each type of itinerary in a single spread.
- Dominant pictures showing vessels in close proximity to spectacular scenery and marine wildlife (whales preferred).
- Pictures of cabins and public areas.
- Ship plans.
- Maps showing (and explaining) how easy it is to reach key ports by highway from U.S. and Canada. It should focus on access to Prince Rupert, Haines, and Skagway.
- Maps showing terminals in relation to towns with information on terminal-town access.
- Itineraries of selected high value (to the AMHS) trips (i.e., to and from Prince Rupert) that enhance the perceived value of the AMHS experience and fill potentially high-revenue routes.
- Simplified mini-schedules and tariffs of popular routes that AMHS wants to emphasize.

Develop simplified mini-brochures and schedules featuring the AMHS product by the eight route groups. Route group brochures would include:

- Repeat of the image message: cruising/viewing/relaxation/casual/Alaska style/close up.
- Specific appeals of itinerary (whales, small community, specific ship(s), etc.)
- Simplified schedules and tariffs for each route group.
- One to three examples of itineraries using a single route group.
- A single price for vehicle of a certain size, cabin, and passage for two for each itinerary. Adjustments can be made at time of sale.
- Suggestions of on-shore attractions at ports of call.
- Print mini-schedules for each route group.

Rationale: The current brochure is inadequate for generating sales because, according to focus group participants, it lacks key information and a central sales theme to make them eager to buy. Further, the information is not in easy-to-use formats. Finally, AMHS material is buried in the middle of a 128-page generic destination marketing piece.

The route group brochures overcome three marketing problems with the AMHS. First, they will define the AMHS product in terms of a manageable number of alternatives, focusing on the best the AMHS has to offer. Second, they will speed up the reservations function, making it simpler and faster for prospects to buy the most popular products. Third, they allow for inventory management through targeted promotion of route groups and the most marketable itineraries.

Fulfillment

According to ATIA research, brochures should be sent to AMHS direct inquirers and to ATIA inquirers who are high potential ferry customers. Check ATIA Send brochures to all Tourism North prospects not included in the ATIA list. It is understood that Tourism North mails to ATIA prospects.

Rationale: Even without follow-up and access to an effective free-standing AMHS brochure, as suggested above, AMHS inquirers convert to AMHS customers at a 35% rate. ATIA respondents interested in ferry travel convert at 17%, and ATIA prospects interested in highway travel convert at 15%. Scarcely any air or cruise prospects convert to AMHS customers. Even a modest increase in conversion rates means millions of dollars to the AMHS bottom line.

Advertising

Develop colorful, large ads to increase AMHS awareness and present recommended market image. Again, the ads should show ships in close proximity to spectacular scenery and marine wildlife. For the cover of the main AMHS brochure, photography must communicate the central marketing messages. One possibility is a photo by Peter Metcalf of a whale jumping in front of the bow of a mainline vessel with mountains in the background.

Rationale: Rapid growth in the number of Alaska cruise alternatives has created a torrent of marketing materials. It is harder and harder for individual materials to stand out. As a result, photography and layout must be first rate. The need for graphic design to support the main marketing messages cannot be overstated.

Guidebooks and Travel Planners

Place full-page ads in the most obvious publications – *Alaska Travel Planner*, *North! To Alaska* (cover position, preferably back cover), *The Milepost* and the *AAA Guide*. Work with guidebooks and destination marketing programs to develop copy to present the new AMHS market position along with information to support booking.

Develop an ad campaign based on analysis of all available research, selecting the most effective and efficient media vehicles. The ATMC (now ATIA) has conducted numerous studies of conversion rates of high potential prospects.

Rationale: Again, proliferation of marketing materials and public relations campaigns by all manner of travel industry participants requires that copy, layout, and placement be chosen with the greatest care.

Internet Presence

Develop a state-of-the-art Internet presence that showcases the new image, information, and booking capability. All that applies to brochures and advertising applies to the AMHS Web site.

Rationale: The Internet is the present and the future for the AMHS. It alleviates pressure on the phone reservations system and allows customers to research the product at their own pace. The Internet has quickly become the leading source of information for visitors using the AMHS. Spring 2000 customers said they used it more than the printed AMHS schedule.

Promotion

Follow-up fulfillment with a booking reminder suggesting travel that will fill open, high-value space. Use route group package promotions. Automatically clean inquirer lists at 60 days from inquiry by removing booked inquirers.

Define later season availability 120 days out and test promotional mailings to non-booked inquirers.

Rationale: Maximizing conversion of the best prospects – direct inquirers – is the first priority of marketing. They are the most interested and the AMHS has the ability to contact them immediately.

Public Relations

Develop a travel writer invitation program.

Develop a press release plan to the year beginning with the schedule announcement.

Cooperative Marketing Program Participation

The study team enthusiastically endorses AMHS participation in cooperative marketing programs of Tourism North, ATIA and the SATC. Also, we recommend participating with major Convention and Visitors Bureaus (CVBs) in their programs.

Rationale: Research shows that CVBs are a major source of information for AMHS customers. The new AMHS message, image, and purchasing opportunities need to be included in these programs. Alaska tourism marketing is based on cooperative programs and the AMHS has the opportunity to participate and influence them in a positive way. None of these programs can do AMHS' marketing for the system, but through these programs, AMHS can identify prospects to convert with their own marketing efforts.

Marketing Partnerships

Develop marketing partnerships with carriers, destinations and other operators that can extend the marketing reach of the system. Focus on route groups with the highest potential yield for the AMHS since they will also have the highest potential for major marketing partners.

Short-Term Implementation

To reap the crucial cumulative benefits of consistent marketing, the AMHS must address a range of issues. The most important of these are summarized below:

Continue to improve reservations functions.

Significantly increase ease and speed of access for AMHS customers and business partners. This is vital to take advantage of existing market demand and to handle additional demand generated by new marketing initiatives.

- Engage the supplying contractor of the reservations system to improve the system's response time. Upgrade to Oracle 8 to gain significant speed.
- Consider using an automated telephone response system to provide callers with as much information as possible before they speak to an operator to make a booking.
- Begin training reservations agents to shift from order-taking and information-providing mentality to a sales orientation. This means guiding prospects to available inventory targeted by the AMHS, placing extra emphasis on vehicle prospects, suggesting itineraries, and emphasizing the "real Alaska" attractions of the AMHS.
- Continue daily tracking of hold and talk times, terminations and sales by individual agents.
- Improve the Web site, not only by the addition of online booking but by making it a more effective trip-planning resource. Provide more information and planned itineraries on the Web. This will help reduce demand on telephone operators and at the same time increase sales. Specifically, the "Tour Alaska's Coast" Web page needs to be vastly expanded. See <bergenline.com> for an effective approach to ferry-cruise marketing on the Web. <BCFerries.com> also has excellent trip-planning materials.
- Add a segment at the opening of the "Schedules and Reservations" page that informs people of when and where space is limited at any given time, and that promotes dates and runs that are under booked. Also, add a segment that tells people precisely the information they will need to book a voyage, e.g., vehicle length.

Hire a senior-level Marketing Manager.

In order to implement these and other project marketing recommendations, it is imperative that AMHS hire a senior-level business development manager with substantial marketing experience in the travel industry, including Alaska. This individual must have the skills to structure, promote, manage and evaluate a broad range of travel products in conjunction with industry partner companies. This individual must be able to provide knowledge critical to successful implementation of many project recommendations. She/he will be crucial in coordinating and tracking new marketing initiatives for maximum effectiveness and follow-through.

Implement a "Prime Prospects Program."

Since current administrative staff are fully occupied with regular duties, in order to implement these programs, AMHS will need to contract for project management assistance. The program should have oversight by the Marketing Manager recommended by the study team.

This is the most important step AMHS can take to increase revenues in the short run. AMHS must maximize conversion of high-potential ferry prospects, namely, individuals who have already expressed an interest in using the system. The program involves developing a flyer, researching past inquirer lists for prospects not yet converted, and conducting a mass mailing to prime prospects.

The two target groups are:

- Direct inquirers to AMHS.
- ATMC inquirers who have indicated an interest in travel by ferry.

Publish schedule and be open for bookings on September 1, 2000.

It is vital to complete the 2001 summer schedule by June 2000, so it can be released in time for bookings to open in September 1999.

This will significantly increase bookings for 2001 and will also accelerate cash flow in 2000. In addition, it will make an important statement to the travel industry that AMHS is determined to meet industry standards for customer and business-to-business services. This will set the stage for developing new relationships and products.

Prepare stand-alone AMHS brochure by September 1, 2000.

It is critically important to have the stand-alone AMHS promotional brochure available as a companion piece to the schedule by September 1999. It will increase conversion rates, bring in cash in advance and let the industry know the AMHS wants new business.

Develop three or four simple new package products for 2001 brochure.

These should be simple ferry itineraries of popular experiences on routes with available inventory and high-revenue for the AMHS. Top priority would be Prince Rupert and Major Southeast Port itineraries. These could also include packages developed with marketing partners such as hotels, railroads, and other land-based operators, and air carriers.

The study team anticipates that this primarily will be the responsibility of the new business development manager.

Long-Term Recommendations

To reap the cumulative benefits of consistent marketing, the AMHS must address a range of issues. The most important of these are described below.

Integration of New Management Tools

Two new management information tools were developed by the study team in the course of this project. We recommend AMHS personnel gain expertise in the use of these systems for the critical long-run functions of inventory management and pricing policy development. Every time a ferry leaves port with empty cabin, cardeck or passenger space, the system foregoes an opportunity to earn additional revenue. Targeted marketing and pricing will minimize this loss. Analysis of operating data is key to this process.

Integrate the Ridership Information System (RIS).

Inadequate data processing staff and systems have created a crisis. Fundamental marketing intelligence is not tracked nor analyzed. Worse, system performance information is not available to inform basic, vital management decision-making. As this document is being written in July of 2000, operating statistics from 1999 have not yet been compiled.

Current operating statistics are essential to successful marketing and pricing of ferry travel. Ridership information must be timely, accurate and easy to obtain and analyze. Information systems must provide immediate access to booking status and feedback on how passengers respond to price changes. The McDowell Group team has developed a system that makes this possible.

The sophisticated information system developed by McDowell Group partner company GDA Research and Information Systems, Inc. consists of a comprehensive Oracle data warehouse and an easy-to-use, easy-to-modify Brio analysis interface. With it, managers can instantly recall every ship, voyage, reservation, port, vehicle and passenger, and conduct time-series analyses simultaneously. Marketing and pricing decisions are easier to make with the instant access to this information. AMHS managers now have the entire database available in easily accessible format for management use and for inventory control while marketing. The system is designed for virtually automatic updates directly from reservation system software.

Refine the Tariff/Revenue Model.

The tariff/revenue model was developed to study the effects on revenue of pricing changes. Price sensitivity factors were developed from data generated by the study team's market research and by other pricing sensitivity models. The model is a spreadsheet that allows manipulation of variables to create any number of "what if" pricing scenarios. The model should be updated by actual sales results in reaction to actual price changes beginning in summer 2001. A price elasticity study would improve the accuracy of model pricing parameters.

The model is not intended to predict such future events as market demand for a second Bellingham vessel, or market demand for new high-speed shuttle ferries on selected routes. Original market demand research is essential prior to any modeling of these future events. The market research results would then be loaded into the model, just as the results of this project's research are used to test pricing scenarios in the present system.

Participation in Cooperative Destination Marketing Programs

While an AMHS-specific marketing program is the essential first priority, the study team recommends full participation in cooperative destination marketing programs.

The Tourism North program is effective and deserves the system's continued participation, but no commercial enterprise should rely solely on a destination marketing program as its primary means of converting sales. Expanded participation in Tourism North should include major advertising purchase of one of the covers, significant upgrade of sales copy, simplified schedules, and direct mail follow-up by AMHS.

The Southeast Alaska Tourism Council (SATC) program is limited, but the AMHS should play a significant role in this organization, which targets AMHS' primary region of operation.

The new statewide Alaska Travel Industry Association (ATIA) is in the formative stages. This is an opportunity for the AMHS – one of Alaska's primary tourism attractions and a major carrier of visitor traffic – to have an influence and drive some benefits to the system. The study team recommends the AMHS become a strong participant in this program with significant advertising investment and a direct mail program using lists generated by ATIA, cross-referenced with ATIA lists used by the Tourism North program. Further, the industry relationships available through these programs can enhance AMHS marketing reach through marketing partnerships and packages.

Market Research Recommendations

The AMHS should continue the market research program that underlies the results of this study. The purpose of the research will be to track and measure the impacts of marketing, pricing, sales and product development on AMHS revenue and market demand. Continuing research should be conducted for:

Track customer satisfaction.

Continue to measure satisfaction with both onboard and shore-side services, particularly those the system is attempting to change such as meal quality and service hours, waiting times for loading, and reservations system response times. Food service improvements require more detailed research. Meeting customer needs will require the proper onboard equipment, procurement policies, and staff training.

Study pricing sensitivity.

Continue the measurement of customer perception of value of the components of the AMHS product – passage, cabins, vehicle fares, food, and the AMHS experience overall. Consider more sophisticated research methods of estimating price elasticity.

Measure reservations and sales effectiveness.

Track important indicators of performance and efficiency. These include hold times, termination rates, talk times, conversion of AMHS inquirers, and sales per agent.

Set goals and track potential customer conversions.

Track the conversion rates of ATIA, Tourism North and SATC prospects as well as the rates of prospects brought to the system by specific promotion and advertising efforts. Pay particular attention to conversion rates for those interested in ferry and highway travel. Track closely the information sources used by both customers and prospects.

Onboard Tour Sales

Add an onboard tour desk on each vessel and market local tours, transportation and accommodations for commission fees as well as available AMHS inventory. While there may be some resistance to this concept, the legislative and executive mandate requires that the AMHS generate additional revenue to shrink the subsidy. Onboard tour sales are a major means of generating additional revenue at little cost. Gift shops and/or Pursers' desks could easily become tour sales desks.

Contract Agent Performance Evaluation

Develop and implement a plan to evaluate contract agent performance and re-structure if necessary. This will be a key early project for the new business development manager. Analyze bookings for 1998, 1999 and 2000 year-to-date to determine source of booking: AMHS; Kodiak; etc. Use this along with an analysis of cost-per-booking information and telephone reservations performance data, as the basis for developing a strategy for either increasing AMHS reservations staffing or outsourcing more of the reservations function.

Define contract agent role for the future

Once AMHS has done some analysis of its contract agent relationships, discussions with the agents should focus on the future role of these agents with the system. What will be their role in packaging and selling products? Will there be other tiers of agents with differing responsibilities and commission rates? How will agent performance be tracked and evaluated in the future?

Travel Agent Utilization

Develop a plan for utilizing travel agents generally to AMHS's best advantage. If, as recommended, AMHS markets itself as a travel product and as a component in other travel products, it will be important to work more closely with travel agents.

Food Service Evaluation

Define more precisely the scope of AMHS food service challenges and potential responses. Food quality, selection and operations were clearly areas of customer concern and should be a target for significant improvement. This is an area for more detailed research as noted above.

AMHS Trademark

The study team believes it makes sense to register the AMHS name and logo as a trademark. However, trademarks must be defended vigorously against infringement. This will entail some expense from time to time. The advice of an attorney who specializes in trademark law is recommended.

A Marketing Model to Consider

The fundamental marketing issue is a structural one. Past history has proven that political and operational priorities within state government have shoved the marketing function to the bottom of the barrel, ironically increasing the need for public subsidy. Even in the best of budget times the AMHS marketing budget was a fraction of any comparable transportation operation. Can a dramatic increase in marketing activity ever occur within the current structure?

Norwegian Coastal Voyages/Bergen Line, a ferry system in Scandinavia, found itself facing a similar problem. It's answer was to split into two organizations: one to operate the vessels and a second, independent company, to execute the marketing. Once an ailing system, Bergen Line's aggressive marketing program has led to substantial expansion of services. Their website, www.bergenline.com, exemplifies a number of the marketing techniques recommended in this study.

The Bergen Line success is based on the rationale that vessel operations and marketing, particularly visitor marketing, require very different organizational cultures and competencies. Operations stayed with the original ferry company while marketing is now handled by private enterprise focusing on the leisure discretionary travel market. This allows the operation to provide basic transportation services to residents while maximizing the revenue from the remaining inventory by strong marketing to high-yield leisure markets. Bergen's revenue and volume have increased significantly as a result of this arrangement.

The Alaska Marine Highway System has a long and proud tradition of serving communities in coastal Alaska. Its local constituencies see the system as basic transportation for Southeast and Southwest Alaska. The system functions literally as a highway where, in large measure, none other exists. As such, it provides a fundamental transportation and shipping service to residents and businesses in these regions.

At the same time, the system is a tourism business serving both resident and non-resident markets. It competes with multinational companies for international, domestic and in-state vacationers. This tourism enterprise serves local communities by enhancing the visitor industry, thereby improving local economies.

The system is undergoing substantial change. It is operating in an era of declining state revenues and increasingly intensive marketing by large travel companies. Moreover, the state is about to implement a new transportation plan for Southeast Alaska that will dramatically change the system's operations. Each of these issues has implications for the system's future.

The Marketing and Pricing Study team looked at the external factors affecting AMHS operations, and analyzed current AMHS finances, including sources of revenue and objects of expenditure. The picture is not a pleasant one. The current political and financial environment places the system in difficult circumstances. Following are the major factors affecting future operations.

Key Findings

Significant change is needed.

Interviews and analysis for this study indicate that incremental changes are not likely to mitigate the fundamental causes of the AMHS' financial situation. The system's current financial course is not sustainable in the near future. Absent a significant shift in direction, the Alaska Marine Highway System will be unable to meet either of its primary mission goals.

Increased earned revenue is key.

The system's finances cannot come into balance solely through cost reductions. Accomplishing this will require a focus on revenue generation that is at least on a scale with the system's efforts at cost control. This means that in addition to staffing vessels, terminals, maintenance and other operating departments, the system needs adequate administrative staff or contractors to plan, direct and market a $70+ million dollar business.

Most ferry runs cannot operate without subsidy.

The dual nature of AMHS's mission must be explicitly addressed. Market research undertaken for this report clearly indicates that few AMHS routes have potential for positive net revenues. In the past, only the Columbia's run from Bellingham has achieved this. Routes and services that exist solely or primarily (by virtue of the system's role as regional transportation infrastructure) may not reasonably be expected to generate substantial revenues. Other economic and social functions may or may not justify those routes and services. In any case, they are public services, and they require public funds.

Increased revenues are not possible without additional marketing and management capacity.

This study clearly indicates that the AMHS has routes and services capable of providing substantially greater revenues. However, this potential may be realized only if the system has resources and expertise comparable to the private sector firms it must emulate to be successful. While price increases are warranted for many AMHS products, price increases alone are not enough. If it is not politically or organizationally feasible to provide that additional skill and capacity within the AMHS, then it must be obtained by partnering or contracting with the private sector.

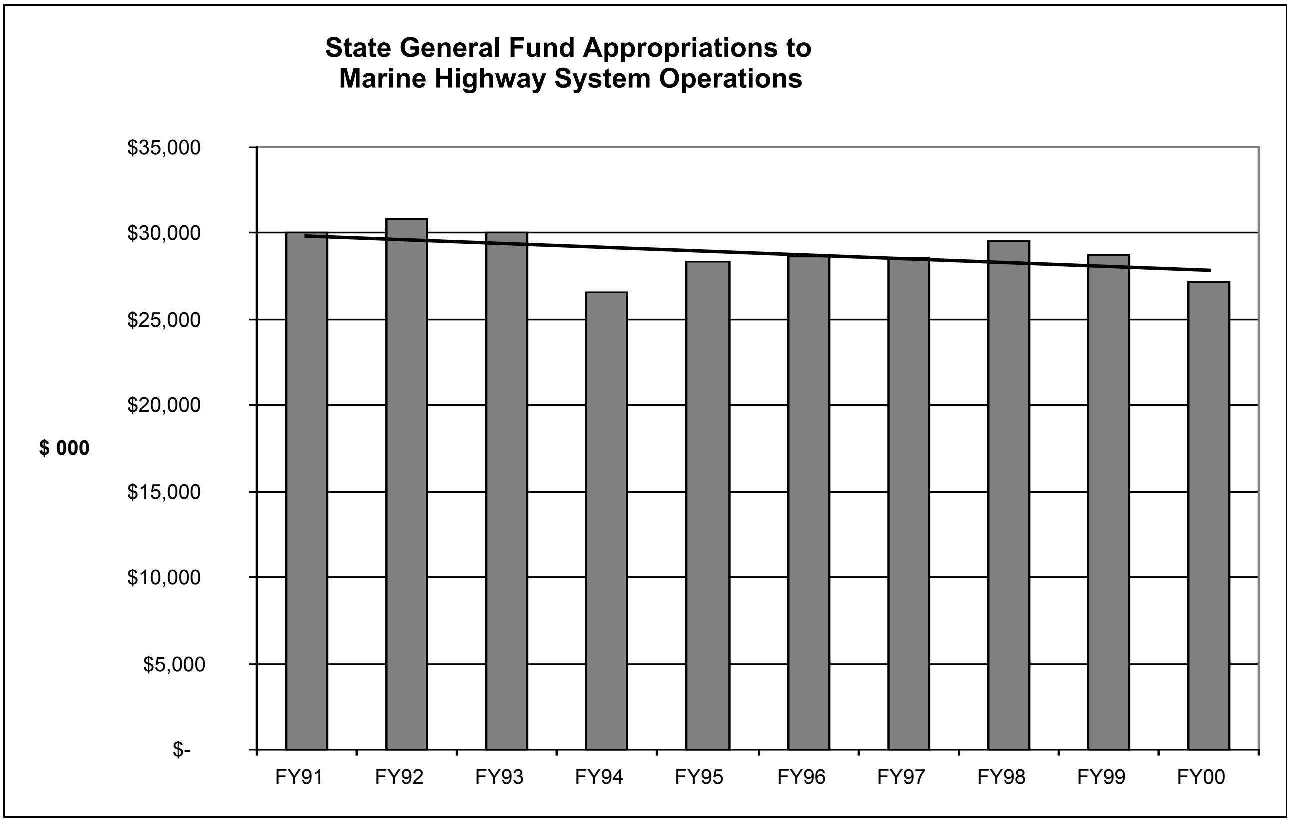
Historical Financial Performance

The system's annual expenditures exceed its revenues by an amount larger than the annual general fund support for the system. Legislators from outside the core areas served by the AMHS appear to be less willing to provide sufficient general fund support to cover the difference between annual system revenues and expenditures.

System net revenues have declined by nearly $5 million in the last decade. Gross revenues have been essentially flat, while expenditures have increased. This has resulted in a net effect of a nearly $2 million gap. At the same time, appropriations from the state general fund have declined by nearly $3 million.

Over the last decade, annual state appropriations for support of the system have fluctuated from $27 to $31 million. Currently, three-year and ten-year trends are both declining.

Failure to raise tariffs as operating costs increased also contributed to the AMHS' financial problems. In large part, AMHS has bowed to political pressure to keep tariffs low. The graph below compares an average of three representative passenger fares with the rate of inflation during the 1990s. Most AMHS tariffs have not changed appreciably in the past eight years.


State General Fund Appropriations to
Marine Highway System Operations
$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
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$ 000
FY91
FY92
FY93
FY94
FY95
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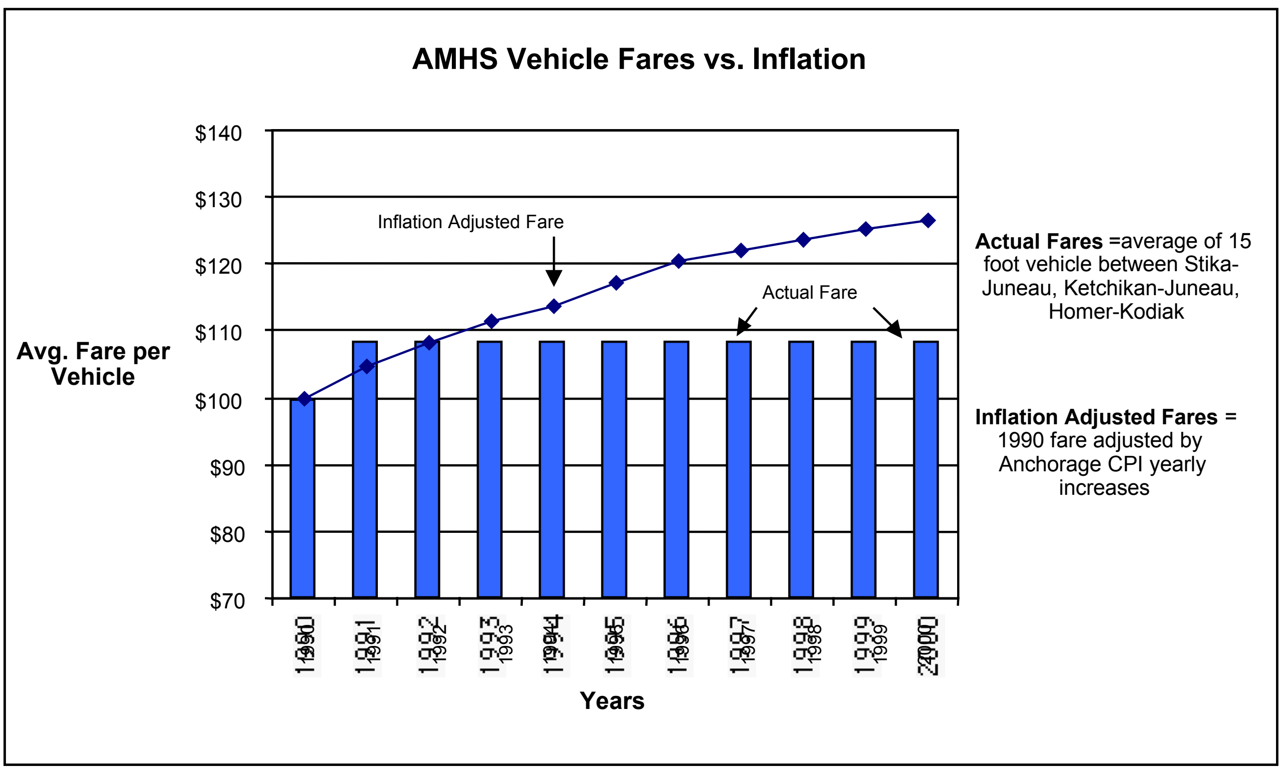
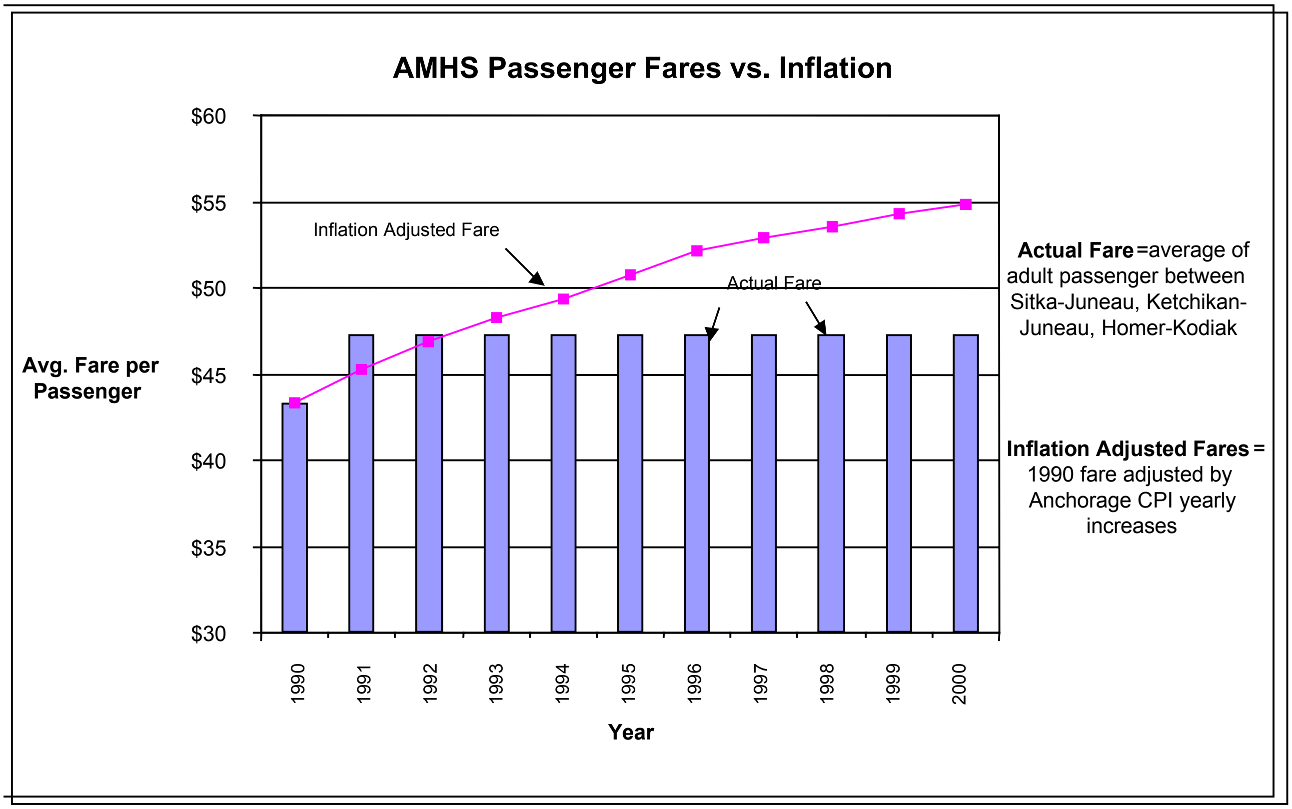
FY97
FY98
FY99
FY00


AMHS Vehicle Fares vs. Inflation
$140
$130
$120
$110
$100
$90
$80
$70
Avg. Fare per Vehicle
Inflation Adjusted Fare
Actual Fare
Years
Actual Fares =average of 15 foot vehicle between Stika-Juneau, Ketchikan-Juneau, Homer-Kodiak
Inflation Adjusted Fares = 1990 fare adjusted by Anchorage CPI yearly increases

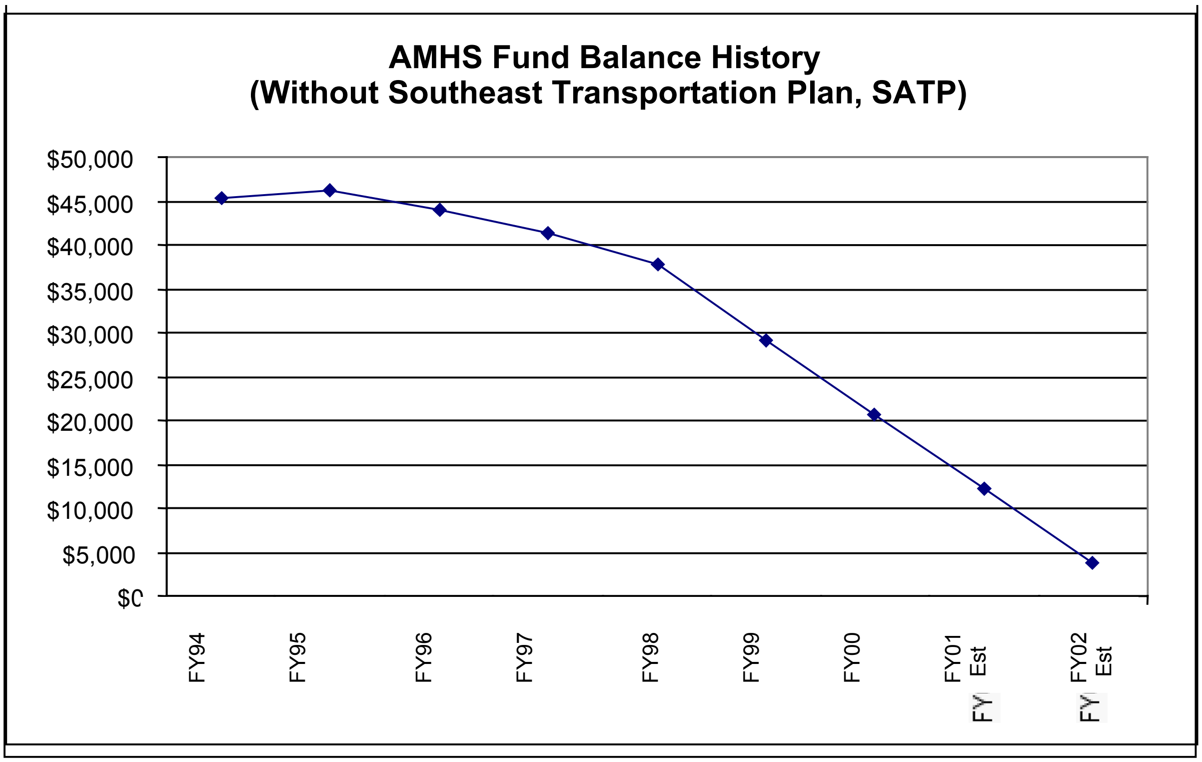

AMHS Passenger Fares vs. Inflation
$60
$55
$50
$45
$40
$35
$30
Avg. Fare per Passenger
Inflation Adjusted Fare
Actual Fare
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
Year
Actual Fare =average of adult passenger between Sitka-Juneau, Ketchikan-Juneau, Homer-Kodiak
Inflation Adjusted Fares = 1990 fare adjusted by Anchorage CPI yearly increases

Alaska Marine Highway System Fund

The Alaska Marine Highway System Fund was established in 1990 to provide fiscal stability to the system. Its fund balance has declined for the last five fiscal years, and will be gone in seven years at current draw-down rates. Absent significant appropriations to assist the system in its transition to the Southeast Alaska Transportation Plan, the fund balance decline could be even faster.

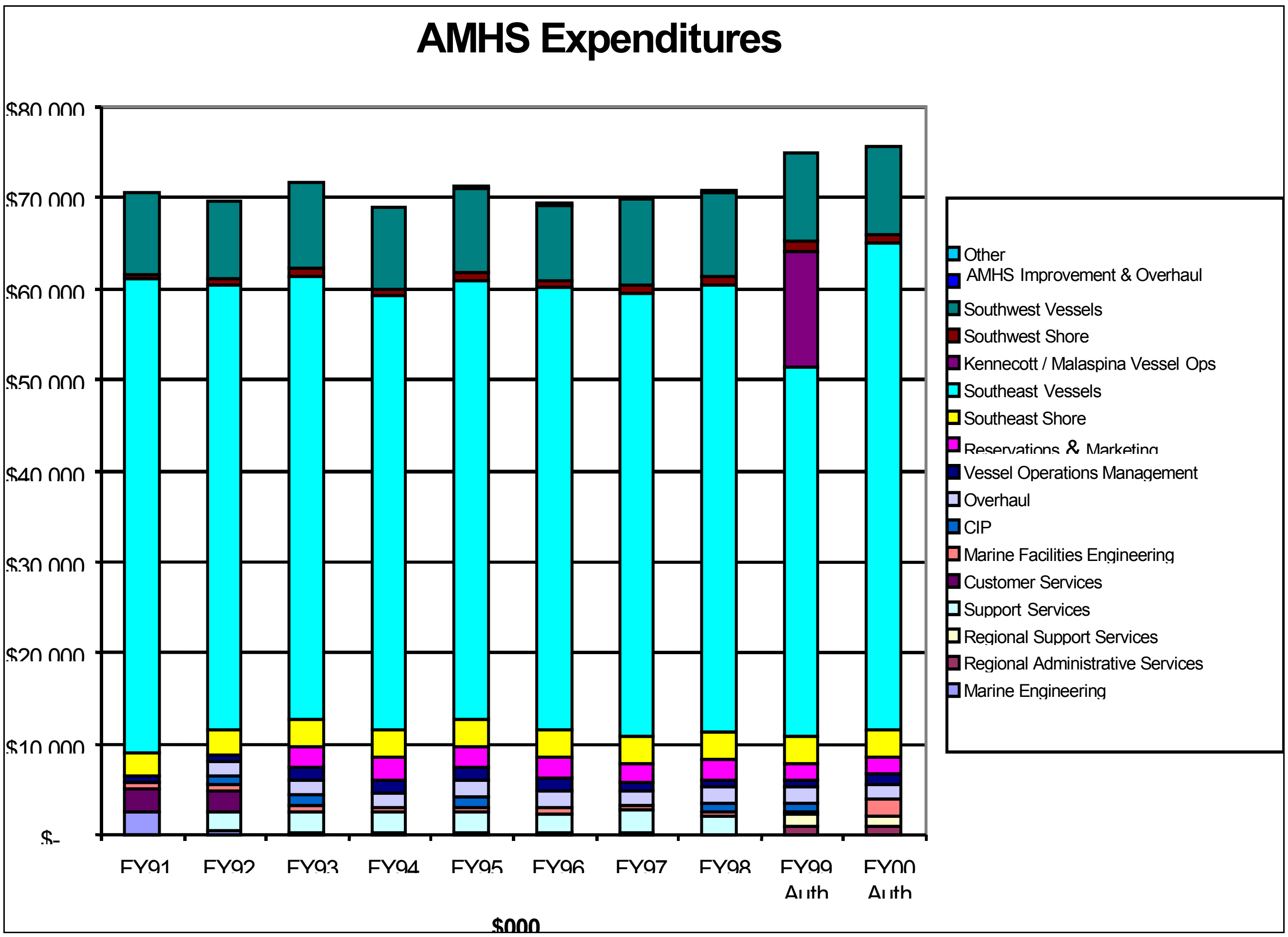
The Fund has largely fulfilled its original purpose, that of providing stability to system operations. Its presence means that the system can weather short-term revenue declines (caused by events such as the Canadian blockade or labor disputes) or short-term fluctuations in fuel prices. However, consistent failure to replenish the fund indicates that it is not functioning as an operating reserve, but rather as a budget supplement. It seems that the ability of the system to draw down the fund balance is allowing the state to ignore long-term structural problems in either the revenue or expenditure picture.

The decline in the fund balance over the past five years is alarming, and accelerating. Absent significant change in the system's revenues – either by increasing state appropriations or operating revenues, the structural deficit of $3 to $5 million annually will have to be made up by draconian expenditure reductions when the fund balance is gone.



The State of Alaska's sources of general fund revenue are themselves declining. Alaska's political leadership understands the effect of the gap between recurring state revenues and current rates of state expenditures. There is not, however, a political consensus on what to do about this gap. The magnitude of public rejection of a proposed fiscal plan in September 1999 underscores the size of the political problem in solving overall state fiscal issues. Attempting to predict the solution to these issues is pure conjecture, but assessing the impact of these issues on the AMHS is clearer. In short, a significant increase in state general fund support for AMHS operations is unlikely in this environment. What this means is that the system must address its shortfall through increased operating revenues or through significant curtailment of operations.

The system has made significant strides in holding the growth of expenditures through the 1990s. Nonetheless, cuts have hit heavily at administrative support and marketing – the areas where increases are almost certainly required if the system is to achieve operating revenue growth. Operating expenses are projected to grow again in FY00.



Changes in the AMHS Operating Environment

Southeast Alaska Transportation Plan

The *Southeast Alaska Transportation Plan* requires substantial capital investment in the marine highway system. Implementation of this plan will require a complex operating transition and further impact the system's revenues and expenditures.

The plan envisions a mix of long-haul mainline ferries with "fast ferries" operating between local communities. It requires construction of three new vessels, training of new staff for operations and maintenance, and changes in the way passengers move through the system.

Analysis of how implementation of the *Southeast Alaska Transportation Plan* will impact the AMHS is beyond the scope of this study. However, several issues identified by the research will affect system revenues and expenses and will require planning and marketing to avoid disruption to the system. These include:

- <u>Capital costs.</u> The system will need significant capital appropriations in FY01 to FY04 to pay the costs of construction of the new vessels. While the majority of funding should come through federal appropriations, the state will need to provide sufficient general funding to match the federal funds. The ferries are a new concept for Alaska, and may have unanticipated design or construction problems. In addition, new docking and ground facilities will need to be constructed.

- <u>Transition costs.</u> The new ferries will not all come on line at the same time. Significant work will be required to prepare a transition plan that sequences changes and ensures that all parts of the plan are completed in a manner that allows the plan to be carried out.

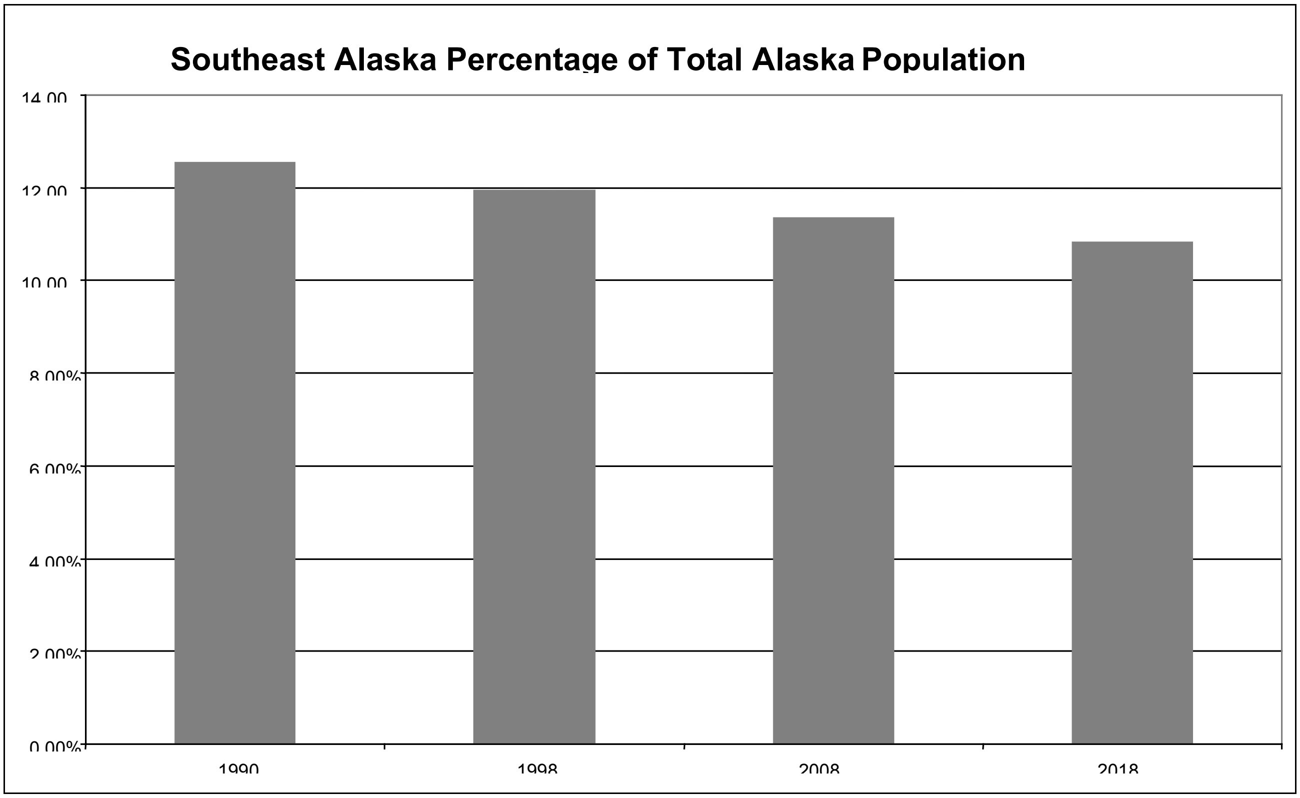
- <u>Overnight accommodations.</u> The new "fast ferry" plan anticipates that through passengers will overnight in port, rather than on the ferry. These changes may require that the system ensure the shore services for through passengers are adequate. Some experienced system staff are concerned that the system will lose passengers who do not want to overnight on shore.

- <u>En-route vessel change.</u> Under the current system, passengers from Bellingham to Skagway or Haines stay on a single vessel for the entire voyage. Under the new plan, many will be required to change vessels en route. The current reservations system will need to be modified to allow through fares. There is concern that there will be passenger resistance to the new system. If there is such resistance, additional marketing efforts will be required to ensure no loss of revenues occurs. Similarly, the new system may provide new marketing opportunities. Without an effective marketing effort, these may go unrealized.

- <u>Fleet maintenance.</u> The current ferries carry maintenance staff and repair parts on board. For the planned new ferries, primary maintenance and support will be on shore. This change has implications for system safety and reliability, and requires careful planning to deal with any vessel breakdown that may occur away from port. The changes may require modifications to the system's labor agreements.

State Demographics

The communities served by the AMHS are a declining proportion of the total population of the State of Alaska. This change in relative population levels affects the region's political power, and ultimately the political support for the region's core transportation system. Current projections by the state demographer show the proportion of the state's population resident in Southeast Alaska will continue a slow decline over the next two decades.



Business Practices

The Alaska Marine Highway System is caught between two sometimes-contradictory imperatives – providing basic transportation services to communities and operating as a bottom-line-oriented business. It receives inconsistent messages from state and community political leaders, and is tugged back and forth between the two imperatives.

The result is that the system is overly politicized. System administrators attempt to be responsive to concerns expressed by legislators, but sometimes find themselves pulled and pushed in directions that may not be optimum for overall system performance. Communities demand better service at reasonable prices, while legislators demand better bottom-line performance.

One effect of this constant pulling back and forth between competing demands is staff demoralization. System veterans have seen changing legislatures and changing administrations try to emphasize different aspects of system performance, sometimes at the same time. Under changing directives, the safest course for a public employee is to avoid dramatic change, and especially change fundamental enough to threaten the status quo.

Unfortunately, the issues we have seen in this study show the status quo is not sustainable. Fundamental change will be necessary. Even with ardent support, however, significant change to public agencies is extremely difficult without sufficient high-level administrative staffing to plan and effect its major components.

The system operates with insufficient shore-side support staffing. Marketing expenditures have been cut below the level that would allow the system to use market opportunities to improve its revenues. Administrative and planning staff have been reduced and, in some cases, combined with other regional transportation staff. The bottom line is that there is currently insufficient staff to develop and implement major changes to the system.

This highlights the fact that, while cost control is important, it is not the answer to AMHS' situation. The study team compared revenues and expenditures per staff member between the Alaska Marine Highway System and the British Columbia Ferry Corporation (BCFC). BC Ferries has an operating budget roughly three times that of the AMHS. It operates 40 vessels and 43 terminals serving 26 routes. It has permanent staff of 2,800 and another 1,800 in seasonal help.

While the systems are clearly not identical, we found that BCFC expenditures per staff member were approximately 17% lower, while revenues per staff member were 37% higher. Given the higher cost of living in Alaska, the cost per staff does not appear unreasonable. The data points to revenue growth as the most important area for Alaska system improvement.

A cursory examination of BCFC staffing indicated a substantially larger administrative support component, including more than a dozen employees working on information systems development and a similar component in system marketing. Even adjusting for the larger size of the BC Ferry system, it is clear the Alaska Marine Highway System is understaffed in these core areas.

Summary of Findings

In most cases the Marine Highway System has no direct competition for its services. There exists considerable means besides the Alaska Marine Highway System (AMHS) to transport people, vehicles, and other freight in Southeast and Southcentral Alaska, however, these "alternatives" do not constitute direct competition for AMHS. Onboard ferry interviews conclusively showed that the large majority of passengers do not give serious attention to arranging their transport on other available services. For this reason, information on alternative services may serve as a useful point of reference in pricing analyses, but is of less importance to AMHS for strategic purposes.

As a result, the competitive analysis for this study was performed primarily with respect to creation of a Tariff/Revenue Model. This Model is described below, and in detail in *Volume 3* of the Study Reports.

Goals of Competitive Analysis

Business consultants and practitioners have given a great deal of attention in recent years to competitive response as a business strategy. For many organizations, competitive response has joined the traditional focus areas of cost control and revenue management to form a kind of "strategy triumvirate."

For the Alaska Marine Highway System, however, the importance of competitive strategy pales in comparison to the need to execute fundamental marketing activities directed at readily identified potential customers. There are two main reasons why competition is not an important concern for AMHS. The first is that AMHS provides a unique set of products that have little direct competition in most markets. This is discussed in detail below.

Secondly, the AMHS has very little capacity to respond to competition, regardless. AMHS is limited by operating restrictions that, in most cases, preclude or severely limit effective competitive response. These include political operating mandates, geographic operating demands, Coast Guard regulations, vessel limitations, funding restrictions, labor considerations and other factors. Many of these are inherent in AMHS' dual role as public servant and business.

AMHS is severely limited in its ability to alter its products — for example, schedules, accommodations, passenger and freight services, and other service elements — in order to respond to the actions of competitors. Moreover, its control over prices is also limited, as discussed in the section below on pricing. Given this situation, there is little reason for AMHS to dwell on the services and products provided by other transportation businesses.

The key competitive conclusion is:

> The Alaska Marine Highway system has no significant direct competition for most of its markets. This applies to all seasons. It applies to residents and visitors alike. It includes most foot passengers, vehicle travelers and freight shippers.

The most prominent motive customers have for selecting the Marine Highway System is cruising the Inside Passage with its scenic marine views in a relaxing atmosphere. This is true for both visitor and resident markets. Neither mainline cruise companies nor commuter air carriers offer a remotely similar product. Few people find flying particularly relaxing, and the onboard experience of the booming luxury cruise market is dramatically different from that of the AMHS. In fact, among those surveyed for this study, only two percent of people interested in cruising ended up taking the ferry, and only 7 percent of people taking the ferry even considered taking a cruise ship before making their decision. While cruise and ferry passengers purchase very different experiences, both value them highly, rating them approximately 6.3 on a 7-point scale.

This lack of competition has profound pricing implications. The market values ferry service primarily for the experience rather than as transportation from one point to another. They do not view the air or cruise ship experience as an alternative way to obtain a similar experience.

The differences in type of experience, speed, scheduling, time commitment, and price are so substantial that the system experiences little direct competition from air carriers, freight lines, large cruise ships, small cruise ships or short, custom marine tour operators.

Marketing Implication

The marketing implication of this competitive situation is extremely positive. If the system accepts the recommendations of this report and increases its marketing, improves access through reservations, upgrades its information and raises prices, it will attract the significant unmet demand that is oriented toward the AMHS product. Other travel industry providers are unlikely to suffer, and many will benefit from increased use of the Marine Highway System.

Summary of AMHS "Competitors"

Overviews of businesses providing travel and shipping products roughly comparable to those of the AMHS are provided below in order of decreasing importance to AMHS. This report focuses mainly on businesses serving the pleasure and adventure travel markets, because that is where the main potential for additional ridership and revenue lies.

Worldwide Adventure Travel

Most relevant to AMHS is the indirect competition resulting from the full range of other independent travel opportunities, both in North America and worldwide. These are the choices potential travelers consider when planning a substantial pleasure trip. If they are to choose AMHS, they need clear, readily accessible information, not just about the ferry system, but about all the key elements that go into developing an independent itinerary. These include information about lodging, food, shore transportation, and shore excursions. They also include information about the natural and cultural environment. These are areas of great interest for prospective ferry travelers.

The existence of this broad range of adventure travel options dictates the type of marketing message AMHS must use. AMHS' challenge is to differentiate itself in this crowded field of pleasure-travel opportunities. Similarly, it is important for AMHS to distribute materials and information that are designed to "close the sale." This is the great shortcoming of *North! To Alaska* with respect to AMHS. It presents AMHS in the context of many other travel options. Because it provides this breadth of information, *North! To Alaska* is not effective at precipitating an actual purchase of AMHS product.

Fortunately, the task of differentiating AMHS is not difficult. As noted, those who know about it already view the Alaska Ferry System as a unique product. Recommendations in *Volume 2*, *Customer Research* and the "Marketing Strategy" section of this volume address the specific messages AMHS must convey.

Cruise Ships

The organization that represents the cruise ship industry — Cruise Lines International Association (CLIA) — is optimistic about the future North American cruise market. In a recent publication, CLIA reported:

> The cruise industry is young. Since 1970, an estimated 76 million passengers have taken a deep-water cruise (2+days). Of this number, 60% of the total passengers have been generated in the past 10 years. Thirty-three percent of total passengers have been generated in the past five years alone. Of those who have cruised in the past five years, the average number of cruises per person has been 2.4 in this same time frame or one every two years.
>
> The cruise market potential is huge. Over the next five years, the cumulative market potential for the cruise industry is $54-$97 billion. By year-end 2000, we project that approximately 6.5 million passengers per year will cruise on an annual basis. Taking a cruise is a dream of 56% of all adults with the highest interest being exhibited by the emerging baby-boomer category. To date, only 11% of the US population has ever cruised.[1]

It is assumed that the trend nationally applies to the Alaska market also. The Alaska destination has a high level of awareness among potential cruise passengers. Further, port content, glaciers and scenic cruising will remain priorities of the cruise lines. While the industry has not reported any forecasting of their markets in 2010 and 2020, it is assumed that the potential for growth remains dependent on its expanded capacity and

[1] *Cruise Industry Overview*, Marketing Edition, February 2000, Cruise Lines International Association.

price competitiveness. Limiting growth factors will include crowding of ships (docking options), over-crowding of people, and political resistance.

Comparison of Cruise Ship and Ferry Tariffs
Inside Passage Routes

Vendor	Travel Dates	# Nights	Trip Price Inside Berth	per person dbl occ Outside Berth	Cost per Night Inside Berth	per person dbl occ Outside Berth
AMHS Bel. To Bel.	Jul	7	$850	$871	$121	$124
Small Ship	May	10	2,780	3,780	278	378
Small Ship	Jul	8	3,230	4,140	404	517
Small Ship	Jul	7	2,180	2,780	311	397
Small Ship	Jun-Jul	8	3,055	3,545	382	443
Large Ship	Jul	14	2,095	3,145	150	225
Large Ship	Jun	7	1,099	1,399	157	200

Small-Ship Cruising

Small-ship cruising is, at least superficially, the closest pleasure travel product to the AMHS. Similarities include an “up-close and personal” way of seeing the Inside Passage, a casual on-board ambiance, and the opportunity to mix with other passengers in a smaller, more intimate setting.

However, there are significant differences between small-ship cruising and ferry travel that keep them from being closely competitive. The vessel size of ferries means that several hundred passengers are on board at any one time, compared to between 20 and 100 passengers on these small, specialized cruise ships. Size alone makes the experiences different. Perhaps more importantly, virtually all small-ship cruising is sold in all-inclusive packages where schedules and itineraries are determined in advance. In contrast, the AMHS experience may be purchased in a variety of ways.

Finally, small-ship cruising may be a good way to meet Alaska visitors, but it is not well suited to meeting Alaska residents in their home environment. Focus groups indicate that this is an important goal for at least some of the independent travelers attracted to the AMHS.

Per diem costs for the most popular small-ship cruises of the Inside Passage range from $300 to $450 per person, including food and accommodations. Day cruise costs vary substantially, as shown in the tables.

In specific locations, marine shuttles and short cruises compete directly with AMHS for both locals and summer visitors. In general AMHS is priced below comparable passage on one of these competitors. Sometimes the difference is substantial. The AMHS is certainly an economical way to see Prince William Sound, for example.

Transportation Alternatives between Haines and Skagway (one way)

AMHS	$17
Water 1	20
Water 2	21
Bus	116
Car rental	178
Motor home rental	619

Prince William Sound Cruise Options

	Price	Duration
AMHS	$58	6.75 hours
Cruise 1	69	6 hours
Cruise 2	99	4 hours
Cruise 3	122	4.5 hours
Cruise 4	64	4 hours

Seward Tour Options

	Price	Duration
AMHS	$30	11 hours
Cruise 1	99	6 hours
Cruise 2	99	8 hours
Cruise 3	139	9.5 hours
AK Railroad	92	3 hours

Only in the case of the Haines-Skagway shuttle is the AMHS product comparable to the competition. In this market, the private sector competitors run at twice the speed of the ferries and have much more expedient loading and unloading procedures. Further, they provide multiple trips per day, allowing visits to either town with a return the same day.

In short, the AMHS product is not comparable in terms of speed, efficiency or frequency. Only by extreme under pricing would the ferry lure passengers from private sector providers, and few at that.

In Prince William Sound there are a number of private sector cruise options. While the AMHS may cover the general area and provide a pleasurable experience, the speed, efficiency, interpretive services and the nature of the vessels make the tour operator product entirely different.

As a result of these differences, AMHS can raise prices close to those of the competition and still retain all or most of its market. Further, doing this avoids any semblance of unfair competition with the private sector.

Large-Ship Cruising

The primary service in demand for most of the AMHS market is pleasure travel that is not time-sensitive. This service involves a variety of option mixes: passage, cabins, vehicles, food, etc. While this description might also be applied to large-ship cruising, potential ferry passengers are clear that this is not an attractive option for them. Significant price increases for Alaska Marine Highway cruising products is not likely to steer potential customers to the large cruise ship experience, because the products are not viewed as directly competitive.

For the most part, ferry travel is an inexpensive alternative to taking a cruise. Only the heavily discounted "positioning" and other shoulder season cruises tend to be competitive with AMHS on a cost per night basis.

Further, study research shows that potential ferry vacationers are not particularly interested in cruise ships. Only 7% of AMHS users considered cruise ships as an alternative prior to selecting the AMHS. Rather, they want the unique experience afforded by ferry travel. Some have visited Alaska before by cruise ship and have returned by ferry in order to see more of the "real" Alaska.

The cruise industry in Alaska is large and continues to grow. The table following demonstrates the rapid growth over the last ten years of tourists and residents that enter Alaska by cruise ship as compared to the AMHS alternative. For all travelers entering Alaska, the AMHS ridership has an average annual decline of 3.2% each year, while the cruise industry has an average annual growth rate of 11.9%. As demonstrated in the chart below, the growth in the cruise industry is a result of its marketing ability to attract both new and repeat customers and its increased capacity. Survey data suggests that the visitor choosing the ferry did not consider a cruise ship mode. Therefore, the decline in AMHS use is not directly related to the success of the cruise industry. The decline in use of the AMHS may be related to the availability of other modes of entry such as air and highway.

Ferry and Cruise Arrivals in Alaska (1989 – 1999)

Year	AMHS	% Change	Cruise	% Change
1989	40,999		152,200	
1990	37,272	-9%	187,331	23%
1991	39,162	5	194,018	4
1992	35,973	-8	211,970	9
1993	40,005	11	246,967	17
1994	45,169	13	285,095	15
1995	36,554	-19	283,461	-1
1996	39,671	9	337,519	19
1997	25,961	-35	392,163	16
1998	29,482	14	403,404	3
1999	25,816	-12	457,106	13
Cumulative % Change 1989 to 1999		-37%		+200%
Cumulative % Change 1994 to 1999		-43%		+60%

Source: McDowell Group, Inc., various Alaska Visitor Statistics Program and Visitor Arrival reports

As the size of the market has changed, so to has the type of client. Thirty years ago, cruises were for the affluent elderly – known as the "Cadillac market." The average age of cruise passengers is said to be in the mid-40s.[2] The industry has diversified into several different products based on embarkation port, length of cruise, itinerary, onboard services, size of ships, and price. Sales and marketing have become highly sophisticated. The tendency of the large ship cruise industry is to fill the ships at any cost through aggressive promotion and discounting, even in the softest years.

Passenger Profiles

Five cruise lines operate in Alaska: Princess, Holland America (HAL), Norwegian, Royal Caribbean (RCI), and Celebrity (Celebrity is owned by Royal Caribbean). Together, they account for 92% of all cruise passengers to Alaska in 2000. These companies have brought on new ships, increased their capacity, and enlivened the luxury segment of the Alaska marketplace.

Princess Cruises: With its diverse fleet and wide variety of itineraries and duration of cruises, princess passengers are difficult to characterize. Their age and income vary with the ships, seasons, and the destinations. Overall, passengers average 55 years of age with an annual income of $40,000 and over. Typically, they are experienced travelers who cruise frequently and are looking for Princess's mainstream type vacation, but they can range widely in characteristics and attitudes.

[2] *Cruise Industry News Annual 2000*, Cruise Lines International Association

Holland America: Passengers are mature, experienced travelers and families who seek comfort and consistency and who appreciate quality and a high level of service. Many are retired or semi-retired business owners with some college education, executives, and professionals. The range is from young nurses and secretaries on their first cruise to affluent seniors who cruise often, to honeymooners, young families, and some handicapped travelers. The average age is younger than 55. More than 55% are couples; 50% travel with groups.

Norwegian Cruise Line: Passengers, mostly from the US and Canada, represent a very broad segment of people from all walks of life. They have an estimated $35,000+ average income per person. They are often attracted by NCL's highly acclaimed shipboard entertainment, theme and special interest cruises, and sports programs. They are a diverse group and include young professionals, families, special interest groups, and incentive winners.

Royal Caribbean: This line's passengers tend to be moderately upscale couples and singles from their mid-30s to mid-50s and family vacationers with a household income of $40,000+. They are active fun-seekers looking for a wide variety of shipboard activities and destinations. The average age is early 40s, but slightly lower in three- and four-night cruises and slightly higher on ten-night or longer trips. In summer, the median age also drops due to the large number of families traveling with children. Less than 25% are 60 or older and they are likely to be on cruises of longer than nine nights. About half of the passengers have taken at least one cruise and a quarter has sailed with RCCL.

Celebrity Cruises: The profile passenger is moderately affluent, late 30s to 60s in high season; ages lower in off-season. The typical passenger is 48 years old, married and has a household income of $50,000+. They tend to be educated, experienced travelers who own a house in a relatively affluent suburb and have college-age children. Fifty percent have taken a cruise before, and of this group, 20-30 percent are repeat customers for Celebrity.

Carnival Cruise Lines: Carnival attracts a broad spectrum from all walks of life. The cruises lend themselves to families with or without kids, honeymooners, married couples, singles, and seniors. The average age is 43. On a typical cruise, 40% are 35-55; 30% under 35 (including 130,000 kids annually); 30% over 55. Seventy percent are first-time cruisers. Income levels are average for cruise passengers.

Current Cruise Capacity and Traffic

Current capacity and market share for Alaska's cruise industry is found in the table below.

Alaska Cruise Capacity and Market Share (2000)

Cruise Line	Ships	# Berths	Market Share
Princess	6	183,780	29.0%
HAL	6	167,990	26.5
NCL	2	82,000	12.9
RCI	2	78,000	12.3
Celebrity	2	72,150	11.4
Carnival	1	29,720	4.7
World Expedition	1	7,260	1.1
Crystal	1	5,640	0.9
Radisson	1	4,410	0.7
Special Expeditions	2	1,960	0.3
Clipper	1	600	0.1
Total	25	633,510	100%
Percent Change from 1999	+4%	+11%	

Source: CLIA

Juneau, Ketchikan and Skagway are the three largest ports of call for large cruise passengers, hosting 77% of cruise passenger traffic. The cruise industry is predominantly located in Southeast Alaska. Large cruise ship traffic to the Southcentral destinations of Anchorage, Valdez and Whittier is relatively small. Dutch Harbor's cruise market is quite small.

Future Cruise Capacity and Traffic

According to the Cruise Lines International Association (CLIA), major cruise lines plan to add eight new ships and approximately 17,000 new berths to the Alaska market during the next six years. This is a 35% increase in Alaska capacity. The number of cruises these ships will make to Alaska is still uncertain. However, if the number of passengers also increases by 35% it will mean more than 800,000 cruise visitors per year to the state.

Price Competitiveness

Costs per diem for most large-ship cruises (Summer 2000) range between \$250 and \$350. A few companies offer cruises in the \$150 – \$250 range and some cruises are priced at \$600 and more.

Air Travel

Commonly considered the main alternative to ferry travel, air travel in fact meets very different customer needs. Ferry travel is slow, enjoyable and relatively cheap. By comparison, air travel is fast, uncomfortable, and expensive. There are few situations where customers balance the two against each other. Passengers typically have more options for travel times than the ferry provides, however, the air carriers cannot offer a vehicle option and the ferry is more reliable in unfavorable weather conditions.

Study research shows that cost is not often the determining factor in the choice between air and ferry travel. Where speed is a dominant consideration, air travel will nearly always win out. Where relaxation and enjoyment are prime, the ferries are heavily favored. Particularly in winter, weather may dictate ferry travel in spite of customer preferences.

Within Alaska, air fares and Marine Highway passage fares are not closely comparable. Air fares tend to be two to three times higher than those for passage on the ferry system. Because the products are so different, most ferry fares may be increased significantly without losing customers to the air carriers.

Still, both for Alaska residents and visitors, the cost of air travel is the most important benchmark with respect to AMHS tariffs. This is simply because, for many AMHS ports, air travel is the only alternative to ferry passage. For this reason, air travel costs are the primary competitive factor used by the study team's Tariff/Revenue Model to estimate the financial impact of different ferry tariffs. See below for more details.

A five-year analysis of coastal communities served by both ferry and air (see table) shows that the proportions of people leaving by ferry as opposed to air varies considerably by community. Differences depend upon specific air and ferry options in both the departure and primary destination communities. Communities accessible by road — Seward, Haines and Skagway — for example, have a much higher percentage of people leaving by ferry, because many of them are traveling with a vehicle. Juneau, with the largest number of jet flights among Southeast Alaska communities and no road access, has a percentage of people leaving by air.

The five-year trend is relatively flat for most communities. This implies that demand for ferry service vs. air should remain relatively stable over time, unless there is a change in available service.

Percentage of People Leaving Selected Port Communities by Ferry as Compared with Air

Port	1998	1997	1996	1995	1994
Seward	279%	178%	315%	405%	202%
Haines	165	133	167	138	192
Skagway	109	99	118	103	163
Tenakee	105	122	112	66	53
Angoon	105	110	107	NA	103
Hyder	86	336	366	NA	NA
Pelican	61	88	85	113	92
Petersburg	56	60	63	64	81
Ketchikan	53	38	41	32	41
Wrangell	52	51	54	50	83
Metlakatla	32	25	29	29	32
Kake	27	39	33	35	33
Sitka	24	24	28	28	32
Juneau	19	18	18	19	21
Hollis	NA	755	1164	NA	NA

Air travel appears to be less important as an alternative to long-haul ferry passages. Research shows that passengers on long-haul ferry routes are primarily there for the experience, not for transportation. Longer air routes are more significant as a complement to ferry service – i.e. fly-sail vacations – than as a competitor.

A comparison of air travel vs. ferry travel on representative legs for the eight route groups shows AMHS with dramatically lower prices in every case except the Bellingham to Skagway leg. As noted, the air-ferry comparison is not particularly apt on most system legs. This is particularly true of the Bellingham to Skagway run. This run functions as an Inside Passage cruise for the vast majority of passengers, and not as transportation.

Cost of Air and Ferry Travel (Summer 2000)

Route Group	Reference Voyage	Air Fare One-way	AMHS One-way
Bellingham	BEL-SGY	$289	$252
Southeast Major Ports	YPR-HNS	327	122
Southeast Villages	PBG-KAE	56	22
North Lynn Canal	JNU-HNS	79	24
Southcentral	HOM-KOD	196	48
Prince William Sound	VDZ-WTR	charter only	58
Aleutian Chain	KOD-UNA	492	202
Cross-Gulf Intertie	JNU-VDZ	210	90

Hotels/Lodges

One may conceive of pleasure travelers seeking a relaxing weekend weighing the choice between ferry travel and a combination of air travel and a hotel stay. However, research on potential ferry customers did not reveal this as an issue for AMHS. In any event, the air/hotel option would be significantly more expensive and would be unlikely to provide the wildlife and scenery viewing opportunities available on the ferry. Adding a nature experience to the air/hotel product would, in most cases, place the cost far beyond that of a ferry trip of the same duration.

Barge Lines

For those types of freight for which it is appropriate, barge shipment provides important advantages over AMHS. AMHS accepts only wheeled vehicles. This means that the shipper must load and unload the van. This is not attractive to shippers who are accustomed to shipping vans by barge, where the barge company provides loading and unloading services.

The fact that AMHS vessels carry passengers restricts the types and sizes of freight that can be accommodated. For many freight shippers, it is more expedient to use barge services. Further, the amount of space available for freight is more constrained on ferries than on barges, particularly during the summer. Since the most profitable use of car-deck space is to provide a vehicle option for passengers, freight shipment by ferry tends to be expensive relative to barge lines.

On the other hand, for personal vehicles, barge shipment does not allow the driver to accompany the vehicle. For most customers, there is little point in sending one’s car by barge and flying to meet it when both the cost and the total elapsed time of a ferry trip are less. For the vacationer who is not interested in cruising the Inside Passage, it may be expedient to ship a car or camper to a road-accessible port and to fly there later to meet it. However, the key variable in this scenario is lack of interest in the Inside Passage, not cost.

Since the AMHS travels faster than barge service for most routes, it might be possible to induce some barge customers to switch to ferries by under cutting barge prices. However, this would invite criticism of the system for unfair competition. Such criticism might be minimized by limiting the low prices strictly to unreserved space as it is available.

Other Freight Services

While some smaller communities are very dependent on AMHS for shipping both inbound and out, in most towns AMHS freight addresses a narrow niche. It is faster and more expensive than barge service, slower and cheaper than air. This makes it the mode of choice for a relatively small range of shipping needs. For example, high-value fresh seafood is shipped by air, because the extra cost is less than the additional value obtained from short shipping times. Lower value fresh fish, such as Southeast Alaska chum salmon, is shipped by ferry because the profit margin per pound is not large enough to cover the cost of air freight. The example is especially instructive because it highlights the importance of other variables besides price.

Since shipping chum by ferry takes longer than air, it is vital that departures and road link connections are timed to create the fewest delays between when the fish leave the water and when they arrive at their destination. Reliability is a key factor for fresh shipments. AMHS is more reliable than air freight, since it is less weather-dependent. However, it is harder to schedule, since there are many fewer departures from most communities. For frozen and canned fish, naturally, time is less essential and barge service suffices.

In the past, AMHS has been a preferred shipper for fresh foods coming north. However, improved barge service has displaced the ferry in many communities. Attitudes by shippers toward AMHS freight service tend to reflect the fact that freight has not been a priority of the system. Perceptions are that AMHS can be inflexible and unresponsive regarding shipper needs. In part this undoubtedly reflects the strict regulations under which AMHS must operate as a passenger carrier. Lack of administrative staff also leads to decreased flexibility.

It is likely that the single most effective strategy for increasing freight revenue is simply to work harder selling the service. The most apparent shipping opportunity for AMHS is the winter season, when under used capacity could be offered at reduced rates. If this is seen as “unfair” competition with the private sector, a related strategy is to solicit aggressively any State of Alaska shipping business, particularly that which could be timed to coincide with the excess capacity. For example, there may be some flexibility in the timing of State shipments of vehicles and heavy equipment.

Highway Transportation

In a few areas, people have the option of driving their vehicles for all or part of the distance between port-pairs. Typically the route is longer than the direct route offered by AMHS. However, highway travel has the advantage of allowing travelers to chose their own speeds and times of departure, weather permitting.

Highway travel is expected to increase in popularity. For example, after four years of gradual decline, visitors arriving in Alaska by personal vehicle increased by 12% in summer 1998.

Introduction

The following analysis consists of selected highlights summarizing the differences and similarities among the three major seasonal markets served by the AMHS, as identified by the results of a comprehensive on-board survey. For purposes of this study, the market was divided into summer, winter and spring markets. The study team conducted over 2,500 on-board surveys of AMHS customers for the 12-month period ending June 2000.

Summer Market

Summer is clearly the current dominant market. It brings in most of the year's revenue and logs the majority of the system's vehicles and passengers. Summer is also the market that can yield the lion's share of increased revenue with the marketing and pricing strategies recommended by the study team. The system – with the exception of some voyages on the Bellingham run – has a significant amount of unused capacity even in peak summer season. The product is available to sell. Further, the summer market considers the AMHS an extremely good bargain, opening the door for substantial peak-season price increases over time.

Spring Market

The spring market (May and early June) is the market that has the most proportional growth potential. For years, the rest of the visitor industry has expanded heavily into the spring season, which is a much easier sell than Alaska's fall season. An added benefit is that spring appears to attract longer staying independent visitors to Alaska, who have the economic ability to buy the AMHS product and to bring substantial benefits to Alaska overall with their longer stays in the state.

Winter Market

Winter season has the least potential for additional revenue. Service is limited. The market is predominantly residents (who are more price sensitive and can inflict political consequences on the system), and the Alaska experience is most difficult to market to visitors from October through April. However, growth potential does exist for the winter season. A large percentage of winter visitors still use the AMHS for pleasure purposes and are attracted by the viewing/cruising/relaxation aspects of the experience.

Customer Satisfaction Ratings

This study confirms that AMHS customers in all seasons are quite satisfied with their overall AMHS experience, and with the customer service personnel in all parts of the system. Nineteen out of twenty customers rate their overall AMHS experience good or very good (4 or 5 on a 1-to-5 scale). Less than 3% of the total market (only 1% of the dominant summer market) gives poor ratings for their overall experience. AMHS customer service personnel ratings are equally as good. Three out of four give AMHS personnel a very good or excellent rating (6 or 7 on a 1-to-7 scale), and only 2% of the total market assigns a negative rating to AMHS customer service personnel. These are remarkable ratings by any standards, including those of the Alaska cruise industry, and they vary little by season.

AMHS customers do have some specific gripes that need to be addressed – phone reservations, reservations overall, waiting time for loading, inconvenient sailing times, available seating/sleeping accommodations, food quality, and meal service hours. Compared to other ratings, these are significantly lower and are negative for too many AMHS customers. Most deficiencies are off-ship issues in two categories – insufficient access to the absolutely critical information and reservations functions, and mechanics of scheduling and loading.

> **Marketing Implication:**
>
> The AMHS has a great on-board product to sell. Aggressive marketing will immediately boost traffic and revenue. Simply getting the word out about what the AMHS already offers will have significant positive impacts on revenue. Improving reservations and information functions to modern-day tourism industry standards will have a dramatic affect on sales.

Most-Liked and Least-Liked Aspects

By far the most popular aspect of the summer market's AMHS experience is the Alaska experience itself – scenery, sightseeing, views and mountains (which we will call the Alaska marine viewing experience). This is followed by another vacation aspect – relaxation. Dislikes centered on the off-ship experiences of inconvenient sailing times and long departure waits. Poor food was the leading on-board complaint.

Seasonal market differences exist. Over one-half of summer market customers mentioned the viewing experience as the most-liked aspect of their AMHS experience. Only half this percentage of winter customers mentioned the marine viewing experience. However, it is still the leading most-liked aspect for the winter market. Spring customers closely resembled summer customers in their likes. Winter customers did not complain about long waiting times.

> **Marketing Implication:**
>
> Getting up-close to the real Alaska in a relaxing setting should be the focus of the marketing message.

Customer Characteristics

Significant seasonal market differences exist in terms of resident/visitor composition, trip purpose, traveling party composition, vehicle lengths, and repeat usage of the system. Visitors dominate the summer market and Alaska residents dominate the winter market. But the leading trip purpose for all three seasonal markets is vacation/pleasure.

Most AMHS summer customers travel for vacation and pleasure purposes, while more than one in three winter customers do so. However, vacation/pleasure travel is still the most common trip purpose for the winter and spring markets. About one-half of spring customers are on a vacation/pleasure trip.

Visiting friends and relatives is an important purpose for all seasonal markets. Winter customers are the most likely to travel for personal reasons such as relocation, medical and shopping, and for business only.

Most summer and spring customers travel with their spouse/partner or friends and relatives. Winter customers most commonly travel individually. Group travel is a small portion of every seasonal market, although more common in summer.

The big money for large vehicles is in the summer. The proportion of vehicles 20 feet and over is triple in summer compared to winter and nearly double that of spring customers. Nine of ten winter vehicles are under 20 feet in length. The winter market is moderately more vehicle-oriented with 61% of all winter customers coming on board with a vehicle.

Customer Information Sources

AMHS customers like to do much of their own trip planning. Access to information about the AMHS and related travel products is very important to them.

AMHS customers use multiple information sources to plan their AMHS trip. The ferry brochure and schedule, friends and relatives, 800 number, and the Internet/web page are the dominant sources of information about ferry travel. *The Milepost* guidebook and travel agents are also important.

Use of the Internet and the AMHS Web site has doubled in spring 2000 compared to just nine months ago in summer 1999. One-half of AMHS spring customers used the Internet for AMHS trip planning. Internet use by spring customers now equals the ferry brochure/schedule as the leading source of information about the AMHS.

Customer Trip Patterns

Residents are repeat users.

The resident market in all seasons is almost entirely a repeat market, indicating strong habitual use by the current market, but also low recruitment of new resident customers. Lack of an in-state marketing effort and a resident difficulty with phone reservations access are likely reasons for the lack of new resident customers. Some in-state marketing will stimulate winter travel, but the study team's recommended priority is to invest almost all marketing money in the summer and spring visitor markets, in that order.

AMHS passengers are repeat Alaska visitors.

The AMHS attracts a higher percentage of repeat Alaska visitors than the tourism industry does overall. This is positive because it means that summer visitors who know about the system from previous trips are more likely to use it. Marketing programs to current Alaska visitors in general should stimulate business.

Winter and spring customers are far more likely to be repeat AMHS customers than are summer customers. More than one-half of them “keep coming back.” Marketing programs reaching the current winter market can increase traffic from repeaters.

Customers tend to favor through service over shuttle.

The market response to ending mainline voyages in Juneau and shuttling to Haines and Skagway (and vice-versa) was a net loss. All markets prefer mainline over shuttle service, though about a third prefer the shuttle option. The critical summer market was least adamant about their mainline preference. More customers in all seasons prefer mainline service all the way to the stop-and-shuttle alternative, though a quarter to a third of seasonal markets did prefer the shuttle option. All markets thought that the shuttle system discouraged rather than encouraged AMHS use. The long-run solution is to offer both alternatives.

AMHS visitors stay in Alaska longer.

AMHS visitors, especially those in spring and summer, stay in Alaska for significant periods. Summer AMHS visitors stay in Alaska much longer – a mean of 20 days and a median of 14 days – than the nine-day statewide visitor average. The mean is affected by long-stay RV users who spend weeks, and sometimes the entire summer, in the state. Spring AMHS visitors stay even longer (mean of 31 days, median, 16 days), as a portion of this market gets an early start on their long stay in Alaska. Not only will spring season marketing help fill the AMHS when lots of capacity is available, but the rest of Alaska will benefit from encouraging long-staying RV'ers who travel throughout the state.

Anchorage and Fairbanks are major beneficiaries of AMHS seasonal customer markets.

Anchorage and Fairbanks are major beneficiaries of AMHS' seasonal customer markets. This is true year-around and especially during the dominant summer season. Anchorage gets more summer AMHS customers (35% of the total) visiting the city than any port on the system except Juneau, the hub of the Southeast system. Not only do AMHS customers visit Anchorage, but they stay for an average of three days. Anchorage also gets 26% of spring AMHS traffic and 12% of the winter trade.

Fairbanks ranks seventh on the list of Alaska cities most frequently visited by AMHS summer customers, yet the nearest AMHS port is over 300 miles away. This Interior center hosts 16% of summer AMHS traffic and has the added benefit of longer-stay AHMS customers, who visit Fairbanks for an average of five days. Fairbanks gets 12% of the AMHS spring market and 4% of the system’s winter market.

Marketing Implication:

When the AMHS benefits economically from an increased commitment to marketing and revenue generation, Alaska in general benefits. When the AMHS markets its product, it also markets for the rest of the state, particularly areas such as Anchorage and Fairbanks that have substantial tourism

Transportation Alternatives

AMHS customers see the system as a unique one-of-a-kind product, very different from other transportation, touring or cruising options. As a result, the AMHS has no competition for two-thirds of each seasonal market – an enviable market position. Most AMHS customers simply want the AMHS experience, period. When it does compete, it is primarily for foot traffic with major airlines flying between major cities, and to a lesser degree, with small airlines flying between smaller communities. Only one in twenty summer and spring customers considered a cruise ship before choosing the AMHS.

Major airlines were considered least by the dominant summer market, most by the winter market. Probably because a spring start offers lots of summer time in Alaska, driving was considered least by the summer market and most by the spring market. Only one in twenty AMHS customers considered a cruise ship.

When the AMHS does compete for its critical summer market, the dominant deciding factor in the system's favor is the familiar theme of the Alaska marine viewing experience. The vehicle option is a major deciding factor in all three seasons, even more so in winter. Lower cost than other alternatives is the third major factor for choosing the AMHS over competitive alternatives.

Marketing Implication

The AMHS needs to concentrate only on selling its own highly rated, unique one-of-a-kind product to increase revenue substantially. Competition is not the issue, marketing is. Air travel, driving and large-ship cruising are not at all comparable to the AMHS experience. Emphasize the AMHS Alaska marine viewing, relaxation, cruising theme, and the unique features of this experience to all seasonal markets,

Ferry travel is a good value.

AMHS customers in all seasons perceive the AMHS experience a good buy for the money – especially passage fares and the overall AMHS cost. The winter market is the most price sensitive on cabins and vehicles, and the spring market is more price sensitive than the summer market. All markets assign the lowest ratings to vehicle fares and food, but even in these cases, good ratings exceed poor ratings by at least a two to one margin.

The key dominant summer market is most impressed with the value received. Overall value ratings (71% good/very good value vs. 5% poor/very poor value) are exceptional and the passage value rating is even higher. Even vehicle fares get a 52% good vs. 17% poor rating by the summer market.

AMHS passengers spend a significant amount.

AMHS traveling parties spend a significant amount on their AMHS experience. Each AMHS traveling party pays between $300 (summer resident market) and $1000 (spring vehicle market) to the system alone, not counting any other spending in Alaska. Even a summer foot passenger party generates $400 for the system and the dominant summer visitor market spends well over $700 each.

Marketing Implication:

Significant summer price increases will do little to discourage the summer market and will boost revenues immediately. Modest price increases in winter will have little affect on volume. Most fares on the system are under priced by any standard – AMHS customers are clear on that point. Raise prices in summer season. Raise them substantially for passage, moderately for cabins, and some for vehicles. Further, each customer is worth a significant amount so any increase in conversions, through better information and reservations service. will pay big dividends.

Customer Demographics

Seasonal markets differ demographically.

The summer visitor market comes from throughout the U.S. and the world, consists mostly of visitors, and is older and more affluent than other seasonal markets. Nearly one in three summer visitors on the AMHS are from overseas (mostly Europe) and Canada. All AMHS seasonal markets are significantly younger (under 50) than the overall Alaska visitor market.

The winter market is predominantly Alaska residents. Winter visitors are primarily Western U.S. residents, with some coming from overseas. The spring market is most like the summer market in terms of demographics.

Marketing Implication:

The AMHS has obvious appeal to both U.S. and foreign markets, even with minimal marketing of the system in either area. Marketing in prime U.S. regions, Western Canada, Europe, and Australia/New Zealand will stimulate additional volume and revenue from affluent markets willing to pay more than the system now charges.

Comparison of AMHS Seasonal Markets

The following tables compare survey results for the three major AMHS seasonal markets:

AMHS Passenger Survey
Seasonal Market Profiles
Summer 1999, Winter 1999-2000, Spring 2000

	Summer	Winter	Spring
Resident and Visitor Markets			
Residents	28%	73%	48%
Visitors	72	27	52
Customer Satisfaction Ratings			
Overall AMHS experience			
Good/very good	93%	87%	94%
Poor/very poor	1	5	4
Overall customer service rating			
Very good-excellent	75%	74%	77%
Poor/very poor	2	3	1
Timeliness of phone reservation service			
Very good-excellent	49%	43%	50%
Poor/very poor	24	27	23
Timeliness of Internet reservation service			
Very good-excellent	46%	41%	56%
Poor/very poor	14	15	8
Overall reservation service			
Very good-excellent	61%	60%	60%
Poor/very poor	9	11	8
Convenience of arrival/departure times			
Very good-excellent	37%	34%	47%
Poor/very poor	22	26	13
Ship cleanliness			
Very good-excellent	73%	80%	73%
Poor/very poor	4	1	4
Meal quality			
Very good-excellent	48%	44%	46%
Poor/very poor	12	11	8
Most liked aspect of ferry experience			
Scenery/sightseeing/views/ mountains	51%	26%	42%
Relaxation	17	22	14
Meeting/talking/gathering/new people	9	9	7
Least liked aspect of ferry experience			
Departure times/early loading/ late arrival	11%	14%	5%
Waiting time to depart	9	2	7
Food	8	7	4

AMHS Passenger Survey
Seasonal Market Profiles
Summer 1999, Winter 1999-2000, Spring 2000 (continued)

	Summer	Winter	Spring
AMHS Trip Characteristics			
Resident repeat AMHS users	90%	86%	79%
Visitor repeat AMHS users	16	60	39
Repeat Alaska visitors	36	54	37
Ferry trip information sources			
Ferry brochure/schedule	48%	55%	50%
Friends/family	35	24	36
Ferry system 800 number	26	29	37
Internet	24	23	46
Web page	19	19	37
Main reasons for trip (multiple choices allowed)			
Vacation/pleasure	74%	37%	57%
Visiting friends/relatives	22	25	23
Personal reasons	16	36	26
Business only	8	23	24
Business/pleasure	8	10	3
Length of Alaska trip (visitors only)			
Mean	20 days	35 days	31 days
Median	14 days	10 days	16 days
Passenger type			
On Foot	45%	39%	45%
With a Vehicle	55	61	55
Vehicle length			
Under 20 feet	69%	88%	82%
20 feet and over	31	12	18
Ferry option preference			
Prefer shuttle service	33%	31%	25%
Prefer main line service	43	57	65
Travel party			
With spouse/partner	36%	23%	36%
Individual traveler	24	50	32
With group	10	5	3
Alaska places visited/ median # days stayed (most visited cities in summer)			
Juneau	48% / 3 days	32% / 3 days	31% / 3 days
Anchorage	35/ 2	12/ 3	26/ 3
Skagway	29/ 3	15/ 2	31/ 1
Ketchikan	27/ 2	23/ 3	21/ 3
Haines	25/ 3	27/ 1	29/ 1
Valdez	17/ 2	3/ 2	10/ 2
Fairbanks	16/ 3	4/ 12	12/ 2
Average party size	2.5 people	2.2 people	2.2 people

AMHS Passenger Survey
Seasonal Market Profiles
Summer 1999, Winter 1999-2000, Spring 2000 (continued)

	Summer	Winter	Spring
Value for the Money Ratings and Spending on AMHS			
Perception of value for the money			
Passage (good value/poor value)	78% /6%	74%/ 8%	76%/ 6%
Cabin (good/poor)	65/ 12	50/ 25	55/ 15
Vehicle (good/poor)	52/ 17	39/ 31	38/ 21
Food (good/poor)	50/ 19	41/ 23	44/ 18
Overall (good/poor)	71/ 5	62/ 7	63/ 14
Average per party AMHS spending	$576	$653	$924
Visitor party	731	986	925
Resident party	301	537	924
Foot party	401	412	792
Vehicle party	701	761	1015
Competitive Considerations			
Other options considered			
None, only considered AMHS	64%	65%	68%
Major airline	11	18	14
Small plane	10	7	14
Driving	5	13	18
Large cruise ship	5	0	4
Reasons for choosing ferry system over other options			
Scenery/wildlife	32%	8%	20%
Vehicle option	29	43	25
Lower cost	26	27	16
Relaxation	23	14	17
Cruise Inside Passage	22	15	31
Demographics			
Origin: Alaska residents			
Juneau	22%	21%	16%
Ketchikan	18	10	9
Anchorage	7	6	10
Fairbanks	3	4	7
Origin: Visitors			
Western US	33%	52%	38%
Overseas	19	12	17
Midwest US	17	12	21
South US	14	17	9
Canada	8	8	4
East US	8	3	11
Average age (of respondent)	49 years	45 years	46 years
Average household income	$60,300	$52,200	$57,400

Market Analysis of Potential-Customers

The major market research task of this study was the on-board surveys of over 2,500 current AMHS customers summarized in the preceding section. These surveys identified the existing market and resulted in a number of marketing and pricing recommendations for increasing volume and revenue.

The next step was to conduct four major research efforts – three surveys plus a pair of focus groups – analyzing the most promising potential AMHS markets. Following this analysis are recommendations for successfully converting high potential markets into future AMHS customers.

The Best Prospects – AMHS Inquirers

The best prospects for AMHS travel are potential Alaska visitors who already inquired about it directly from the system through mail, e-mail, fax or telephone. These people have qualified themselves as the premium group of prospects by their direct expression of interest and by the effort they went to locating the AMHS reservation and information system. The number one marketing objective of the system is to maximize the conversion of inquiring prospects into customers. The study team surveyed a sample of 250 AMHS inquirers who are non-residents of Alaska.

The Next Best Prospects – High Potential Alaska Visitors

Much of Alaska tourism marketing is centered around the statewide tourism marketing program, formerly conducted by the Alaska Tourism Marketing Council, and now conducted by the new Alaska Travel Industry Association. This program – through advertising, public relations, and list fulfillment – generates several hundred thousand qualified names of people interested in travel to Alaska. The study team selected a sample of 400 high-potential Alaska visitors from these lists. The research determined conversion rates of potential Alaska visitors to becoming actual AMHS customers and studied how to increase the rate of conversions of this well-defined group of prospects.

Alaska Resident Market – Prospects at Home

Alaska residents are the dominant winter market and account for three of ten summer users. Four hundred Alaska households – both AMHS customers and non-customers – living in the 36 communities served by the system were surveyed. The research investigated how to increase current market use and stimulate conversion of non-customers.

High Potential AMHS Customer Focus Groups

Focus groups of potential AMHS riders were essential to evaluating the effectiveness of current marketing efforts. The system currently has virtually no targeted marketing program specifically selling the AMHS product. Instead, the system's single marketing and information effort is participation in a generic regional Alaska/Canada cooperative program called *North! To Alaska.* The system's product appeal and the effectiveness of the current program were evaluated in focus groups consisting of high potential Alaska and AMHS prospects. An independent research firm in one of Alaska's most important metropolitan markets conducted the focus group study.

The following summary of findings combines the results of the four research tasks under several topic headings. See *Alaska Marine Highway System Marketing and Pricing Study, Volume 2: Market Research Findings and Recommendations* for complete analyses and statistics on these four studies of potential customers.

Alaska Resident Market – Prospects at Home

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Conversion of High-Potential Markets

AMHS Inquirers

The AMHS converted 35% of its best prospects – potential Alaska visitors who inquire directly to the system through phone, mail, e-mail, and fax – into AMHS customers in 1999. This does not include discouraged prospects, the 25% of phone inquirers who terminated their calls after holding for service in 1999. Another 21% of AMHS inquirers came to Alaska in 1999 but did not use the system even after directly inquiring. Most inquirers who did not come to Alaska in 1999 expect to come in the near future. This means these people remain blue chip prospects for AMHS conversion and should be contacted.

Marketing Implication:

Even a modest improvement in the conversion rate of AMHS' best prospects would have a dramatic effect on gross revenue. A 10% (to 45%) increase in conversions could raise revenue by at least $5 million. Increased conversions of inquirers can be accomplished by:

- reducing terminations of prime prospects by cutting hold times to industry standards.
- improving reservations system technology, speed and procedure.
- training reservations specialists as sales agents instead of order-takers and providers of non-AMHS (i.e., non-revenue) information.
- developing a state-of-the-art Internet presence.
- developing a AMHS-specific brochure.
- following up on past inquirers.

High Potential Alaska Visitor Prospects

The conversion rate of high-potential Alaska visitors (names drawn from the ATMC program lists) *who also specified interest in the AMHS* was 17%, about one-half the conversion rate the AMHS gets from its own direct inquirers.

Competition for High Potential Alaska Visitor Conversions

Airlines and cruise companies have little to fear from the AMHS. Only 2% of those interested in air travel and 7% of those interested in cruise ship travel to Alaska converted into AMHS customers. The AMHS conversion rate for those first expressing interest in travel to Alaska by highway is better, 15%. The real competitive challenge for the AMHS is to convince vehicle owners of the benefits of AMHS travel.

On the other hand, the AMHS seems to have little to fear from airlines and cruise lines. Two-thirds of current customers do not consider any competitive alternative before choosing the AMHS.

Marketing Implication

The conversion rate of qualified high potential Alaska visitors whose names and addresses are immediately available to the AMHS is quite low. An increase of just 5% (to 22%) in the conversion rate of just those expressing interest in the AMHS would bring millions into AMHS coffers. Increased conversions of identified, qualified high potential Alaska visitors can be accomplished by;

- marketing to them (over 100,000 mentioned interest in the AMHS) in any way.
- sending them AMHS-specific information adequate for making the sale.
- participating in the statewide tourism marketing program, placing large advertisements in the most obvious places (i.e., *The Milepost*, *North! To Alaska* brochure, *Alaska Vacation Planner*).
- package the AMHS product in easy-to-buy itineraries.
- package the AMHS product with other tourism operators.
- increase the capacity and efficiency of the reservations system (all

Motives for AMHS Customer Conversion

Converts chose the system primarily to "cruise the Inside Passage" and for "relaxation." Overall, the marine viewing/cruising experience (usually expressed in terms of "cruise the Inside Passage") was by far the dominant motive for purchasing the AMHS product. This was evident in all potential AMHS customer research, including the summer *resident* market.

Focus groups of high potential AMHS customers further support this motive. Participants were enthusiastic about the AMHS experience because they want to "get up close and personal with Alaska in a way cruise ships can't." They see the AMHS as the only way to do that. This helps explain why most AMHS customers do not consider a competitive means of Alaska travel.

> **Marketing implication**
>
> The central message for making the AMHS sale is clear. Cruise Alaska the Alaskan way, experiencing scenery and wildlife up close with relaxing onboard ambiance.

Deterrents to AMHS Customer Conversion

Those who did not convert cited "inconvenient schedule" (which means both the time of departure and arrival and the fact they often couldn't book when they wanted to go) and "too expensive," a comment that applied mostly to vehicle costs**,** rather than to passage and cabin fares. Over one-third of prime prospects are traveling with a vehicle, but the majority of high potential prospects appear to be foot passengers. Not getting the requested information also appears to be a deterrent in making the sale.

Information and Marketing

Information Sources

The Internet and the AMHS brochure/schedule were the two leading sources for those who convert to AMHS customers. For high-potential ATMC prospects, friends and family and Alaska Convention and Visitors Bureaus are at the top of the list. Only one in nine specifically remembered using the *North! To Alaska* brochure for planning their AMHS trip. More than that likely used it because it was the only hard-copy source for schedule information. The Internet is quickly becoming the dominant information source, according to our most recent AMHS customer data.

> **Marketing Implication:**
>
> The Internet is the present and the future. A state-of-the-art Internet information, marketing, and reservations presence will increase conversion rates, attract additional markets, and relieve pressure on the phone and mail reservations systems, making them more efficient and productive in return.

Information Request Fulfillment

Unfulfilled requests appear to be a problem – one that likely contributes to lack of conversion of prime prospects. Some focus group participants, understandably, did not recognize the all-purpose *North! To Alaska* brochure as being the AMHS information they requested. Instead, they thought they hadn't received AMHS-specific information.

Ten percent of all inquirers said they did not receive the information they requested. More significantly, nearly twice as many (18%) non-converts said they did not get the information they requested compared to 4% of those who did convert to Alaska visitors.

Marketing Implication

Conversions can be increased by:

- improving fulfillment response to 100%,
- developing and sending out an AMHS-specific free-standing brochure that is recognized as the AMHS piece.

Effectiveness of Current AMHS Marketing Efforts

High potential AMHS prospects in the focus groups did not think the *North! To Alaska* brochure was sufficient to make an AMHS sale. They felt that it did not market the AMHS effectively. Independently conducted focus groups in a major West Coast market area identified the AMHS primary marketing program (*North! To Alaska* and the schedule included in the all-purpose regional brochure) as inadequate for converting high potential prospects into AMHS users.

Both high potential and actual AMHS customers in the groups said the *North! To Alaska* piece was useful for general overall trip planning to Western Canada and Alaska. In the opinion of the study team, the declining market presence of the AMHS is in part due to the obscuring and dilution of the AMHS sales message in the large destination brochure.

Marketing Implication

Every operator in the tourism industry world wide has their own marketing program and marketing sales piece. No other operator in the *North! To Alaska* program depends only on that program and collateral piece to make their sales. Fix this problem by;

- developing free-standing AMHS-specific marketing program and brochure, relying primarily on this piece to make the conversion.
- continuing participation in the *North! To Alaska* program as in the past but with two significant changes. Send the AMHS-specific free-standing brochure to every inquiry generated by the program; and take a full-page ad (preferably inside front cover or back cover) in the *North! To Alaska* brochure.

Demographics of high potential prospects

Prospects tend to be older and more from the Western U.S. than actual AMHS users. High-potential prospects have about the same level of affluence as actual AMHS customers.

Resident Market Considerations

Based on telephone surveys with 400 residents of coastal Alaska communities served by the AMHS, potential resident customers:

Are repeat riders, but not necessarily frequent ones.

Nine of ten residents interviewed have used the ferry system in the past, but not frequently. Only one in four used it at least five times in the last year. Resident use is not declining significantly. Most say they are using the AMHS about the same as in the past.

Obtain information mainly from the schedule.

The schedule is by far the dominant source of AMHS information for residents with only a small minority using the Internet or the 800 number.

Travel the ferries mostly for pleasure.

Residents' leading reason for using the AMHS is for vacation and pleasure (45%), followed distantly by business (24%).

Believe fares are reasonable.

Overall, residents think they are getting their money's worth, especially when it comes to passage fare. They rate vehicle fares as average in terms of value for the money and cabins as a pretty fair buy.

Are moderately interested in a pass for off-season travel.

Nearly four households in ten would consider buying a winter pass for $335, a possible promotion that could raise revenue when income is at the lowest. On average, they said they would take four trips with their pass.

Are deterred from ferry use mainly by the timing of departures and arrivals.

One-half of all residents did not use AMHS in the past year. The reasons were "inconvenient schedule" (24%), "no reason to use it (24%) and "wanted to fly" (20%). Cost was an issue with only one out of nine non-users. Cutting fares would stimulate virtually no use from one-half of the population and probably little additional travel by current users.

Marketing Implication

The major potential for increasing revenue from residents is based in the state's major urban markets and is vacation/pleasure, which is a discretionary expenditure. Residents' major use of the system is vacation/pleasure.

Most barriers to additional resident use are not really under AMHS control. Residents are unlikely to respond in sufficient numbers to reduced fares so discount programs would likely yield a net loss of revenue. Response to the winter pass was positive from a surprisingly high share of the market. Devote most marketing expenditures to outside markets where the potential for return is much higher. Then, increase revenue from residents by;

- Stressing vacation/pleasure uses of the system in major Alaska markets.
- Offering incentives available primarily to residents (season passes, for example) that could generate additional revenue.