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Travel, Logistics and Infrastructure

Viking Cruises founder Torstein Hagen: How tailoring experiences for Chinese tourists drives growth

Torstein Hagen's belief that Chinese and American cruisegoers fundamentally desire the same things — the comforts and language of home — has led to exponential growth in Chinese passenger numbers on Viking's European river cruises.

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Introduction

A little over two decades ago, Torstein Hagen founded Viking Cruises as a four-vessel river cruise operation carrying passengers from Moscow to St. Petersburg. Hagen's company has since grown to become the world's largest river cruise line, sailing as far afield as the Nile and the Yangtze, and operating more than 70 vessels, including six ocean ships.

In the early 2000s, the Norwegian spotted a gap in the US market for premium European cruises. He deduced that American customers poorly served by bus tour operators would appreciate a more comfortable way to visit the old continent; a single place of lodging rather than half a dozen hotels; and an experience that reminded them of home, at least until they stepped ashore.

Viking now accounts for half the American passenger cruise market in Europe. Its vessels eschew casinos, race tracks, and high-energy activities in favor of minimalist décor, live classical music, and destinations featuring cultural excursions, guest lectures, and cooking lessons.

Seeking to tap the world's largest outbound tourism market, Viking opened its first China office in 2016, promoting a single cruise, before expanding services that led to triple-digit annual passenger growth. Customers appreciated the model of understated elegance to the extent that they returned an industry-leading net promoter score of 78, and at the start of 2020, Viking was on track to serve 30,000 Chinese passengers across six European river cruise liners designed and staffed specifically for Mandarin speakers. As the year closed, it announced joint-venture plans for the world's first ocean cruise line dedicated to the China market.

However, the outbreak of COVID-19 has cast a pall over the industry. Bookings are down amid reports of cruise ships being turned away from ports. The Asia market, which hosts capacity for more than 4 million cruise passengers annually across almost 40 brands, is suffering particularly acutely. Viking has temporarily cancelled sailings in all markets it operates in.

Against this difficult backdrop, Hagen sat down in his capacity as Viking's chief executive officer to discuss company strategy with Steve Saxon, McKinsey Partner in Shenzhen, and Jackey Yu, Associate Partner in Hong Kong. He suggests Viking will press on with marketing in China throughout the virus outbreak, while explaining how Viking tailors its European cruise program for Chinese customers, and why price and product integrity stand out in the China market.

McKinsey: *How has your outbound Chinese tourist business evolved since you launched European river cruises?*

Torstein Hagen: We launched in 2016 with one cruise and 16 passengers, and last year served 20,000 Chinese passengers in Europe. The best case amid the virus outbreak is we'll host 15,000 passengers in 2020, and rebound next year to nearly 40,000. Our goal is 150,000 by 2025. Chinese passengers average about 10 nights per trip – three or four nights longer than regular cruisegoers. Average sale per customer is about 3,000 RMB per night. We've also increased our yield materially, and were on pace to have a retention rate across three or four years of over 30 percent, compared with an industry average in China of under 5 percent.

McKinsey: *What was the rationale behind launching your China-focused proposition in Europe?*

Hagen: China is the world's largest travel market, so we ought to be there. We came in believing there was a product opportunity; that pricing would come over time as Chinese were willing to spend more on experiences. People, whether Chinese or American, are not so different. This wasn't about reinventing Viking for China, it was about taking what we already did and making it Chinese: the language, the food, and the experience.

This year, we aim to operate six ships for the Chinese market on the Rhine and the Danube, each hosting 175 to 190 guests. They function as Mandarin-only hotels, with all the signage and excursions in Chinese, and the food cooked by Chinese chefs. We made a unique commitment that customer-facing crew from the hotel side had to speak Chinese, and recruited them from the best hotels in China.

McKinsey: *Why did you commit to making the vessels Mandarin-only?*

Hagen: Two decades ago, we bought Germany-based KD River Cruises. They marketed across Europe and the world, so there were a host of nationalities on board. Our experience showed multiple languages are an unattractive proposition for the consumer; it's a better product with only one group. It's also operationally troublesome having menus and excursions in multiple languages. We doubled-down on the English-speaking market, largely Americans, and have applied the same philosophy to China. There was also a gap in the market because Chinese consumers searching for better products are not properly served by their domestic travel companies, and the international travel landscape largely fails to cater to their tastes.

McKinsey: *Do you feel the proposition scales up to 1,000-passenger ocean ships?*

Hagen: We decided to scale-up gradually on river ships and then add ocean liners when we have the scale. Chinese people don't necessarily recognize river cruise destinations like Rüdesheim, or Heidelberg, so that proved a challenge. When we launch ocean trips in a couple of years, we'll run our "In Search of the Northern Lights" cruise in northern Norway, which Chinese people will recognize and enjoy.

McKinsey: *Strategically, how do you view the rise of Chinese outbound tourism?*

Hagen: The strategy is similar to when we launched our US business: We compete against bus tour operators. A river cruise is a better product; more relaxing, and easier to manage. In catering to Chinese customers, we can leverage our existing prime docking stations in key European cities, and other fundamental advantages we hold from operating in the region since 1997. Most bus tours and the majority of our competitors have about one Chinese-speaker for every 40 guests. Viking has one Chinese speaker for every 3.5 guests, and we carry our own guides, matching around one guide per 16 to 20 people, augmented by a local guide office. We offer an unrivalled level of service and attention.

Torstein Hagen

Age:
77 (Born: 1943)

Education:
Holds a degree in physics from the Norwegian Institute of Technology, where he completed his Master's Thesis related to artificial intelligence and machine learning.

Earned a Master of Business Administration from Harvard University.

Studied computers at Wesleyan University on a Fulbright Scholarship.

Career Highlights:
Leads the world's most successful river cruise line as Chairman, and manages operations across an ocean fleet of six ships.

Secured a joint venture partnership with China Merchants Shekou & Group ahead of launching a dedicated Chinese ocean cruise line.

Launched European river cruises for Chinese customers in 2016, expanding the business to 20,000 customers a year in 2019.

Purchased KD River Lines in 2000 to expand Viking's European river cruise portfolio, ahead of entering the American market.

Founded Viking Cruises in 1997 with the purchase of four river vessels in Russia.

Helmed Royal Viking Line as CEO from 1980 to 1984, before losing control to Norwegian Caribbean Lines.

Served as a member of the board of directors for Holland America Line and Kloster Cruise Ltd.

Led Bergen Steamship Co. as CEO from 1976.

Advised cruise companies on their strategy as a Partner in McKinsey & Company's European offices.

McKinsey: *Do Chinese tourists have any specific traits that make them standout as customers?*

Hagen: The biggest difference is WeChat, which is an incredibly powerful tool but difficult to work with for marketers, and the complexity and uniqueness of China's social media environment. From a customer perspective, the US and China markets are almost identical, with one big difference: The appetite for foreign travel is much greater in China, and there's a larger gap between a lot of products and expectations.

McKinsey: *How do you engage with Chinese customers across ecosystems that use very different social media and marketing tools?*

Hagen: There is a greater trust differential compared with the US: People have to believe you're a real brand, especially if you're asking for 50-60,000 RMB per cabin. Our marketing strategy is clear: fill social media with content, make sure people know who we are, and allow as many people as possible to give honest feedback. Real success, as in the US, will depend on brand advocacy from travelers. If you have a net promoter score in the high 70s, it means people are spreading the word. In combination with the very social environment in China, that's a powerful tool.

McKinsey: *Travel brands find direct marketing a challenge in China, but you've had strong success. What's the secret?*

Hagen: We have a good partner who allows us to develop a one-on-one customer relationship, and use our brand as the messaging tool versus forcing their brand forward. Our success is also driven by declining trust in travel agents in China. As much as we police it, agencies still rebate commissions and try to manage their products independently. If you look at our competitors on Online Travel Agency platforms, they normally sell 12 nights, 10 days. How can you have a 12-night, 10-day travel experience? You sleep on the plane. When we tell you 10 days, it's 10 days in Europe and nine nights. Price transparency, product transparency, and integrity is how you build long-term brand value. Our travel partners support that philosophy.

McKinsey: *Did you enter China seeking to emulate the direct model that has proved successful in the US and UK, or was it a separate decision process?*

Hagen: We are not direct sellers, we are direct marketers. Nobody should get between us and the guest when it comes to what we sell, in terms of the package and the price. We need to have a direct conversation with consumers; and own our product, delivery, pricing, and yield. We are not concerned whether customers buy with travel agents, which have always been an important component of our businesses, but we do care that they buy a Viking product. There was considerable pushback from agents, with multiple cancelled bookings when we refused requests for extra commission or special requirements. We do not allow agents or other intermediaries to repackage under their brand.

McKinsey: *What is your advice to foreign companies on choosing and working with a local Chinese partner?*

Hagen: Understand what your needs are, be very clear about what you expect, and make sure it's a mutual win. Don't worry about short-term cost versus long-term benefit. If you're worried about the short term, you're going to find it very difficult in China.

McKinsey: *How does Viking drive the China agenda, while balancing control from headquarters with flexibility from the local team?*

Hagen: China is our top strategic initiative for the next decade. We run strategy accordingly with close oversight from the center in terms of choosing partners and capital allocation. At the same time, we clearly instil our brand values in the China team, and have people there who understand our brand. We allow them to localize operations and control how messaging and creative works in China, as long as it's brand appropriate. If something goes out that is not brand appropriate, then we have a clear and open dialogue about how to learn from that mistake.

McKinsey: *How do you balance the freedom to design messaging in China with the sales organization and brand team being in the US?*

Hagen: The US will always be, certainly until China becomes bigger, the foundational decision-maker of what our brand represents. Then we allow flexibility for China to interpret that. For example, in the US, we've taken a position that our customer is aged 18 and over. In China, everybody wants to travel in July and August with their grandchildren. We adapted and said it was eight and over in China, and designed art programs to culturally enrich and entertain the kids.

McKinsey: *What do you see as the biggest challenge to continuing the growth momentum of Chinese outbound tourism?*

Hagen: The biggest global challenge is that Chinese travelers are generally treated poorly, and that lack of respect may eventually lead them to vote with their wallets. There is also a risk that the more presence we have as a brand, the more motivated travel agencies, tour operators, and others are going to be to have their own ships and capacity, and we end up in a price-based fight for market share. But consumers are smart, so they'll distinguish between the real thing and a copycat. In the US, we started off with 25 percent market share 10 years ago but by spending money on messaging through tough times we now have 50 percent. I can't see why we shouldn't have 50 percent share of Chinese travelers in Europe.

McKinsey: *Assuming the coronavirus virus outbreak subsides, what are your plans for the future in China?*

Hagen: We have announced our partnership with China Merchants Group, which should form a basis to create a large domestic Chinese cruise line. That's our focus.

McKinsey: *How do you think the virus outbreak crisis will evolve, and what will be the impact on the cruise market?*

Hagen: It's hard to tell. Fortunately, we have taken precautions. Our ships are small, so the likelihood of getting infected with us is much smaller. But that's probably not a big consolation; it's going to be difficult for the whole market.

McKinsey: *Do you think the issues with other cruise ships, which have hosted significant coronavirus outbreaks, have damaged the image of cruising as a whole, and if so, will it bounce back?*

Hagen: Yes, and yes. They, and the cruise industry, received a lot of advertising they did not need, and the crisis management challenge was very difficult, but history says it will be cyclical. The affected cruise lines were in a very difficult position managing sick people in a closed environment, and it was the authorities' decision to impose and implement quarantine. It will have a real impact on the China cruise industry for the next year.

McKinsey: *How did you look after Chinese customers with existing bookings through the COVID-19 crisis?*

Hagen: We hadn't started the season yet, so we didn't have Chinese who were already abroad. The first thing we did is send a message reassuring our customers that we would look after them. We canceled the first-half schedule, and returned all payments. We also offered a program for customers to leave money on account and receive a loyalty bonus. No matter what happens with COVID-19, we need at least six to eight weeks of quiet before we bring Chinese back to Europe. Rushing them back will lead to misery for travel brands. Fortunately, we are in a very strong financial position, so we can focus solely on our customers.

Steve Saxon is a partner in McKinsey & Company's Shenzhen office. **Jackey Yu** is an associate partner in the Hong Kong office.