Pro-Poor Tourism Info-Sheets

Sheet No. 10: International tour operators: roles, practices and implications for developing countries

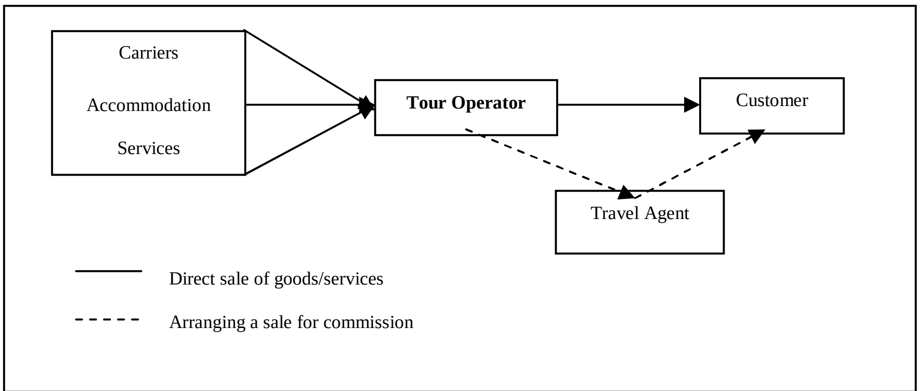
Tour operators based in the major originating markets affect the nature of tourism development and the impacts that this development has on 'poor' people. It is essential to understand the role of tour operators and the changing structure of the tourism industry in the *North*, to improve our knowledge of how pro-poor tourism strategies can be successfully implemented in developing countries. The aim of this PPT information sheet is to explain what tour operators are and how they operate. This, we hope, will help those based in Southern destinations that need to deal with them but are not familiar with the industry and its operating practices[1]. Further explanation of some industry terms is in Sheet No. 11.

What does a tour-operator do?

Tour operators are businesses that combine two or more travel services (e.g. transport, accommodation, catering, entertainment, sightseeing) and sell them through travel agencies or directly to final consumers as a single product. A tour operator is thus a crucial link in the distribution chain, representing the central connection between customers and providers of tourism services, and thus has the power to influence both the demand and the supply side.

The product that a tour operator sells to customers is the 'package tour', i.e. the packaged combination of transport, accommodation and services. Due to bulk-buying the tour operator is able to offer this package at a cheaper price than the customer would have been able to achieve dealing directly with individual suppliers. This package is distributed to the customer either directly (e.g. via direct sell, internet) or via a 'middleman' (the travel agent) who arranges the sale of the package for commission, usually 10% of the retail price (see figure 1).

Figure 1: The role of the tour operator in the distribution chain



The importance of tour operators for the sale of holidays

The four main tourist-generating countries are - in order of size - the United States, Germany, Japan and the United Kingdom. Europe generates the most international tourists, and accounts for 12.5% of arrivals in developing countries (WTO 2001). Although there is a growing trend towards independently arranged travel, significant numbers of tourists still use the services of a tour operator to book their holidays. In the UK, for example, 28% of travel to developing countries (out of a total of 4 million UK tourists) was booked through tour operators in 2000 (Mintel 2001).

[1] for a more detailed discussion see Meyer, 'The UK Outbound Tour Operating Industry and Implications for Pro-Poor Tourism', PPT Working Paper No. 17, 2003

Characteristics of the tour operating industry

Two major trends characterise the tour operating industry in the UK:

- *Concentration and integration:* The package holiday market is dominated by a very small number of internationally operating tour operators. In the UK, for example, four tour operators (TUI UK, MyTravel, Thomas Cook and First Choice) control over 67% of all outbound package tours. The main trends in the industry are *economies of scale, horizontal and vertical integration*. Through these strategies, tour-operators can achieve considerable buying power and control over their suppliers, as well as the distribution of their products. Horizontal integration refers to a situation when companies join together with the aim to remove competition, to increase economies of scale, and to increase purchasing power. Horizontal integration comprises mergers at the same level in the tourism distribution or supply chain, i.e. mergers between different tour operating companies. Vertical integration implies the take-over or formation of businesses at different levels of the supply or distribution chain. For a tour operator this means investment into either suppliers through backward integration (e.g. accommodation, transport) and/or forward integration (e.g. travel agents). The main advantages are control over supplies in terms of quality, availability, access and price, and the ability to reach consumers. Vertical integration is a significant feature among the leading tour operators and has drastically increased in recent years. The four largest UK operators all own charter airlines, accommodation, ground-handlers and travel agents.
- Specialisation: Intense integration practices have also led to increased specialisation and the development of niche operators and niche products. Small and medium size operators have to compete with larger, integrated companies. As vertically integrated operators capture a large proportion of mainstream package holidays, independent operators (also sometimes vertically integrated) increasingly focus on specialisation. Independent tour operators compete by providing high quality, specialist and tailor-made services, which is responding to the trend that holidaymakers are becoming more discerning about the holidays that they take. They often specialise in geographical areas or activities. Table 1 summarises the differences between "mainstream" and "niche" operators.

Table 1: Mainstream and niche (or independent) tour operators

Mainstream tour operators	Independent tour operators
• Carry high volumes of tourists. • Have now adopted formerly 'off the beaten track' destinations. More destinations in developing countries are available to more customers. • Apply their marketing powers to destinations where they operate. • Generally operate on low margins and high volumes. Any swings in consumer demand can lead to capacities being cut with devastating effects for destinations. • Continue to sell mainly on price. Thus loyalty to specific tour operators or to destinations is very low. • Serve customers that are highly price-sensitive and low spending. The bottom end of the market is the first to fall off should a price increase in the host country occur. In recent years all-inclusive developments, and thus the manageability and predictability of holiday expenditure, have become increasingly attractive to this segment. • Tend to channel their clients and market their destinations through travel agents that they own. High Street travel agents remain the first choice for consumers seeking package holidays. • Focus on a relatively standardised and basic product (sun, sand and sea), with little interest in destination specific products and attributes. • Carry large volumes and have thus considerable power in tourism destinations dependent on them for visitors. • Are now introducing less standardised and more tailor-made holiday options, reflecting changing consumer demands and offering possibilities for local suppliers. • Are in full control over their demand and supply structures due to vertical integration, leaving little influence to destinations themselves. • Are frequently preferred trading partners for local suppliers because of the volumes they provide.	•Carry relatively small volumes •Often serve 'of-the-beaten-track' destinations to a fast growing consumer segment that desires tailor-made and high quality tourism products. • Are increasing their specialisation and have adopted niche products in order to distinguish themselves from inexpensive mainstream operators. •Serve consumers that are less price-sensitive, and higher spending customers. Interest in ethical products is growing and customers interested in ethical tourism are often the better-off, sophisticated travellers, using independent and niche tour operators rather than mainstream. •Generally do not use integrated High Street travel agents, but independent agents and direct-sell. Technological advances, in particular the internet, are expected to have largely advantageous impacts on niche operators. •Are highly dependent on local supplies, to the point that this is often their unique selling proposition. They provide a more complex and less standardised product, one that goes beyond simply providing accommodation and transport, by focusing on destination characteristics and inputs. •Tend to have established long tern relationships with their suppliers in the destinations and to adopt a partnership approach. •Generally pay higher prices to local suppliers due to the low volumes they purchase.

As for any company, the commercial objective of tour operators is profit maximisation. A key feature of the mainstream operators are very low profit margins (on average 2-3% of the total revenue after all expenditures are paid), and thus the large companies focus on increasing market-share, i.e. increasing the volume of passengers carried, by selling on price and serving an extremely price sensitive market. Mainstream tour operators seek to maximise profits in three ways:

Minimise costs of the packages that they put together through bulk buying, owning suppliers, providing a basic product, i.e. accommodation and transport, while additional services are being sold as add-ons (e.g. excursions), and extremely tight yield-management

- *Maximise revenue* by maximising the volume of sales to make up for low profit margins and price-sensitivity of the mainstream market. Given the relatively fixed costs of operating in a destination and a perishable product, avoiding being left with unsold packages is essential, even if this means selling under cost price – i.e. a concentration on bums-on-seats.
- *Pricing strategies* are an essential tool for tour operators in the UK but price increases can only be used in a very limited way, within this very competitive and price sensitive market. Pricing strategies, i.e. discounts, are used to lure consumers into shops and to persuade them to buy early, thus allowing tour operators to get rid of excess capacity as early as possible and to earn interest on deposits made on holidays to be taken months later.

Influence of large tour operators

By the nature of their role and the sheer volume of their operation, large tour operators influence many aspects of tourism development and impact:

Image creation: Given the fact that selling a tourism product depends largely on imagery, the marketing and distribution channels that bring customers and suppliers together play a crucial role. The image of the product is created by the tour operators' promotional activity at home in generating areas, frequently with very limited destination input.

Customer demand: tour operators have direct access to the clientele. As the bulk of package holidays are sold through travel agents belonging to vertically integrated tour operators, they are providing the images, information and options upon which customer awareness, demand, and buying behaviour are based. This enables them to open new destinations and grow them rapidly.

Product price: With many destinations offering a similar product and being marketed in a similar way, price is a major decision making factor for consumers. Package holidays are often deliberately priced low in order to generate high demand.

Size, path and type of tourism: The major benefit provided by mainstream tour operators to developing countries is that they can significantly increase the volume of tourist arrivals, ideally leading to employment generation, export earnings and economic development. However, this also affects the nature of the destination. High volumes are achieved by providing low cost holidays through economies of scale, bulk-buying, and low input prices. The first element, high volumes, does not go without the other, low prices, and vice versa. However, there are trade-offs. High volumes of price-sensitive, low spending customer groups are not always the most appropriate. If tourism is developed to meet the needs of mainstream customers, it makes it more difficult to invest in more diverse areas and products, which may have greater involvement of poor and small-scale producers.

Government strategy in destination. Governments may rely on multinational companies to develop tourism in a particular destination, and in return offer financial incentives, assistance in terms of marketing, access to slots and routes for airlines, or commitments to fund infrastructure investments. Eagerness to attract investors and operators can conflict with a government's adoption of measures that encourage pro-poor behaviour by companies and which may make the destination less attractive to smaller operators and other market segments which may be more pro-poor.

Contractual arrangements with suppliers: Tour operators are able to offer highly competitive prices to their customers because of their ability to bulk-buy supplies at low cost. For local suppliers (e.g. hoteliers, excursion-providers), the high volume and relative security of contracts from tour operators is attractive. However, the need to secure these contracts and operate at low prices can make it difficult for local providers to invest in a differentiated product or allocate extra resources to pro-poor commitments. The reliance of the larger operators and their local staff on earnings from excursion programmes can create conflict with other suppliers – often poor producers – of sightseeing and activities.

Linkages and market opportunities for locally-provided services: there is little incentive for large tour operators to expand access for local entrepreneurs, where they are selling a standardised product in which security and familiarity are more important to the customer than local flavour. The EU Package Travel Directive further encourages operators to encourage their clients to use the operators' own excursions and to stay within the confines of the products over which the originating market operators have control. Furthermore, tour operators often earn important revenue from their own sale of excursions, which would be undercut by promoting services sold by local businesses.

Leakage of expenditure: 'Leakage' refers to tourism payments that never reach the destination - because they pay for services of companies in the originating or other off-shore country – or that leave the destination to pay for imported goods. A general consensus has been that leakages are higher if integrated Northern tour-operators are involved rather than locally-owned enterprises. This relates to the fact that integrated companies frequently own the main elements of the package holiday, i.e. transport and accommodation. However, this does secure higher levels of FDI for poor countries.

Small operators have a less dramatic influence on tourism volumes, but can still significantly affect the path of development by putting a new area or new type of product on the map. Part of their product appeal is frequently a destination focus and the inclusion of local products, and they are less likely to own downstream operations. Thus independent operators rely more on destination inputs and can provide important markets for local products. They are more focused on enhancing product quality rather than price competition, and can also often have a more balanced relationship with suppliers due to the product characteristics and volumes generated.

Implications for implementing Pro-Poor Tourism (PPT) in developing countries

A boost to growth? The expanding range of developing countries featured in tour operator packages has potential to boost tourism growth rates in poor countries.

Implementation of PPT by destination stakeholders: the behaviour of a destination government and local suppliers will be influenced by their need to attract or maintain tour operators. If this need is high, this may then constrain their interest or ability to invest in PPT measures

Adoption of PPT by tour operators themselves: One of the reasons why it is often difficult for tour operators to implement PPT strategies themselves, is that they operate through the 'supply chain' and thus have limited direct control over PPT activities or initiatives undertaken by local companies that could have the potential to benefit the poor. The extent to which a tour operator has the options to implement PPT strategies within a developing country depends on what they own and do. A tour operator that owns accommodation, transport and ground handling services is much more able to adapt core business practice than one who only purchases from other suppliers. Similarly, practices of a mainstream operator will be quite different from those of a niche operator, given their product appeal and market position. In discussions with mainstream tour operators, three reasons are often given for their reluctance to encourage pro-poor practice by their suppliers: (1) their lack of responsibility for poverty reduction in destinations; (2) the EU package travel directive requiring strict compliance with consumer protection laws; and (3) the competitive environment in which they operate. Smaller and speciality operators often have partner style relationships with their suppliers and see that they have more to gain by positive engagement.

Corporate Social Responsibility (CSR) and ethical issues have until recently largely been neglected by tour operators. Although there are now a number of initiatives and many tour operators, pride themselves with having adopted sustainable tourism principles, the tour operating sector lags behind other components of the tourism industry – for example the corporate hotel sector. The reason for this is the role of tour operators as mediators. Apart from the mainstream operators very few tour operators actually own suppliers and they do not recognise any direct responsibility for the sustainability of the product in the destination, this is seen as the responsibility of the government in the destination.

Summary

Tourism development at the destination level is strongly influenced by tour operators. Tour operators create the image for a destination that is used in promotional activities at home. They can put a destination onto the map or divert tourists to elsewhere. The big difference in the market position and operating behaviour of mainstream and independent tour operators makes it difficult to generalise about the impact of these structures on developing countries.

Mainstream operators are crucially important for a large number of destinations, simply because of the volumes they bring and business that they generate. They have considerable influence over the whole tourism experience due to their economies of scale and volume planning, image creation, destination contracting, types of excursion offered, nationality of overseas staff and pricing policy. Independent operators often provide a far less significant economic contribution, but, as has been argued, they are often more amenable to PPT measures.

There are several constraints to the implementation of Pro-Poor Tourism:

- Image creation for a destination is done in generating countries often with limited destination input. The holiday product is designed and distributed by tour operators in generating countries.
- Mainstream products are sold on price and only a very small price increase might lead to customers looking for alternative products. Because mainstream operators sell a product, rather than a destination, destinations become interchangeable.
- Developing countries with a high volume of tourists supplied via a small number of mainstream tour operators are highly dependent on these operators. Maintaining these relationships can become a dominant policy objective that constrains other developmental objectives.
- Similarly, suppliers in the South are often dependent on tour operators that can offer large-scale, relatively secure contracts. This can limit opportunities for other forms of tourism development based on independent travellers or smaller specialist operators.

On the other hand, the structure of the tour operating industry also offers great potential for more encouragement of PPT practices.

- Tour operators have great potential to influence both their customers as well as suppliers and host destination governments to adopt PPT practices – this potential should be built up through continuous engagement with the private sector.
- The current interest of mainstream tour operators in sustainable tourism practices offers potential to introduce industry-wide best PPT practice.
- The increasing specialisation of niche operators offers potential for local economic development and positive poverty impacts to be used as a product enhancement, similar to sustainable and responsible tourism initiatives in the past few years.

References:

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