YONG CHEN

ECONOMICS OF TOURISM AND HOSPITALITY

A Micro Approach





ECONOMICS OF TOURISM AND HOSPITALITY

This book offers students an accessible and applied introduction to microeconomics in tourism and hospitality through a comprehensive analysis of the market mechanism, demand and supply, firm behavior and strategy, and transaction and institution.

This book not only helps students to master core microeconomic theories that are essential for understanding the tourism and hospitality industry, but more importantly, it guides students to analyze consumer behavior and firm strategy specific to the industry. Throughout the book, readers are guided to develop an economic analysis of tourism and hospitality that progresses from economic intuition and graphical representation to mathematical quantification. Carefully corralled case studies showcase the applications of key microeconomic theories in solving a wide range of real-world problems, including Uber's surge pricing, Airbnb's supply adjustment, and McDonald's and Burger King vying for prime locations. This book is written in an accessible style, illustrated with exquisite diagrams, and enriched with a range of other features, such as chapter summaries, review questions, and further reading to aid readers' in-depth understanding.

By reading this book, students will be able to develop an economist's way of thinking, which will enable them to analyze tourism and hospitality businesses in a rigorous and critical manner. This book is essential reading for all tourism and hospitality students and teachers.

Yong Chen, Ph.D., is an Associate Professor at the Ecole hôtelière de Lausanne (EHL), Switzerland, where he lectures on the economics of tourism and hospitality. Prior to joining EHL in 2014, he was a Postdoctoral Fellow in the School of Hotel and Tourism Management at The Hong Kong Polytechnic University, where he also obtained his Ph.D. in 2012. Dr. Chen's research interests include tourist behavior, tourism demand, the sharing economy, and Chinese outbound tourism. Dr. Chen's research has been published in a diverse range of reputable journals, and his opinions have also appeared in CNN, CGTN, *South China Morning Post*, Sixth Tone, and EHL Hospitality Insights.

"This book represents a massive step forward in the understanding and teaching of tourism economics, being a pioneer in entirely focusing on the microeconomics behind tourism and hospitality. Students, teachers, and practitioners will appreciate the author's ability in effectively explaining real-world phenomena with rigorous theoretical analysis. It is a fascinating narrative of tourism and hospitality through the austere language of economics."

— Paolo Figini, Associate Professor of Economics, University of Bologna, Italy

"This book is a timely addition to the existing economics texts. The author has taken a balanced approach in integrating economic theories with tourism and hospitality practices. The coverage of the book is comprehensive and the contents are easily accessible by both undergraduate and postgraduate students studying tourism and hospitality programs. The book is also a very useful reference for academics who have research interests in tourist and firm behaviors."

— Haiyan Song, Professor of Tourism, The Hong Kong Polytechnic University, Hong Kong, China

"Professor Chen presents an insightful integration of modern microeconomic theory and the competitive dynamics of the tourism and hospitality industry. His analysis of the prevailing models and explanations are expertly framed and explicated using examples from a wide-array of industry segments and settings, and he contextualizes the implications in a cogent, comprehensive, and accessible manner that will appeal to students, scholars, and practitioners alike."

— J. Bruce Tracey, Professor of Management, Cornell University, USA

"This book introduces a theoretic overview of microeconomics and provides practical applications to the tourism and hospitality industries. This is a unique reference for students and industry practitioners in tourism and hospitality who are seeking an insight into rapidly changing global markets and customer behaviors. This book is clearly at the top of my recommended reading list."

— SooCheong (Shawn) Jang, Ph.D., Professor of Hospitality and Tourism Management, Purdue University, USA

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Contents

List of figures xv
List of tables xix
List of acronyms xx
List of symbols xxii
Preface xxiii
Instruction to readers xxv
Acknowledgments xxvii

MODULE 1 The market **1**

1 Economic approach to tourism and hospitality 3
1.1 Tourism and hospitality 3
1.1.1 The making of modern tourism 3
1.1.2 The essence of hospitality 5
1.1.3 Tourism versus hospitality 6
1.2 Breadth and depth of tourism and hospitality 6
1.2.1 Breadth of the tourism industry 8
1.2.2 Depth of the tourism industry 8
1.2.3 Supply expansion in tourism and hospitality 9
1.3 The tourist and the tourist economy 10
1.3.1 Tourism and the tourist 10
1.3.2 Tourism consumption 13
1.3.3 Global tourism growth and distribution 15
1.4 Economic significance of tourism 17
Summary 20
Review questions 21
Problem solving 22
Bibliography 23

2 Demand, supply, and the market 24
2.1 Economic thinking 24
2.2 Equilibrium analysis 26
2.2.1 Laws of demand and supply 26
2.2.2 Market equilibrium 28
2.2.3 Demand and supply versus quantity demanded and supplied 29
2.3 Economic surplus and market efficiency 31
2.3.1 Consumer surplus, producer surplus, and social surplus 31

2.3.2 Price controls and deadweight loss 32
2.3.3 Market efficiency 34
2.4 Determinants of demand and supply 34
2.4.1 Push factors versus pull factors 34
2.4.2 Demand drives supply 37
2.4.3 Supply creates demand 40
Summary 41
Review questions 42
Problem solving 45
Bibliography 47

3 Uber's surge pricing and market efficiency 48
3.1 What is a surge in demand? 48
3.2 How does surge pricing work? 49
3.2.1 Riders, drivers, and surge multipliers 49
3.2.2 Surge pricing works 50
3.2.3 Surge pricing fails 52
3.3 Welfare analysis of surge pricing 54
3.3.1 Economic surplus 54
3.3.2 Empirical evidence 56
3.4 Information, price signal, and market efficiency 57
3.4.1 Surge multiplier as the price signal 57
3.4.2 "The use of knowledge in society" 58
Summary 59
Problem solving 60
Bibliography 61

MODULE 2 Demand 63

4 Consumer choice and demand 65
4.1 The economic problem 65
4.2 Utility, preference, and indifference curve 67
4.2.1 Utility and diminishing marginal utility 67
4.2.2 Consumption bundle and preference relation 68
4.2.3 Indifference curve 69
4.3 Budget constraint and consumer optimization 72
4.3.1 Budget line 72
4.3.2 Consumer optimization 74
4.3.3 Equalization of marginal utility per dollar 75
4.4 Derivation of the demand curve 76
4.4.1 Consumer optimization and the demand curve 76
4.4.2 Properties of the demand curve 77
4.4.3 Demand functions 77
4.5 The work–leisure tradeoff 78
4.5.1 Substitution effect 78
4.5.2 Income effect 80
4.5.3 Opportunity cost of leisure 80
Summary 83

Review questions 84
Problem solving 87
Bibliography 89

5 Elasticity of consumer demand 90
5.1 The responsiveness of demand 90
5.2 Defining and calculating elasticity 92
5.2.1 Arc elasticity 93
5.2.2 Midpoint elasticity 95
5.2.3 Point elasticity 95
5.3 Interpretation of elasticity 97
5.3.1 Nature of the effect 97
5.3.2 Magnitude of the effect 97
5.4 Major elasticities of demand 98
5.4.1 Price elasticity of demand 99
5.4.2 Income elasticity of demand 100
5.4.3 Cross-price elasticity of demand 104
5.5 Price elasticity and firm revenue 106
5.5.1 Price elasticity of linear demand 106
5.5.2 Price elasticity and firm revenue 107
Summary 110
Review questions 111
Problem solving 113
Bibliography 115

6 Network effects in market demand 116
6.1 Individual demand versus market demand 116
6.1.1 Additivity in market demand 117
6.1.2 Demand interdependence and non-additivity 118
6.1.3 Network externality and network effects 120
6.2 Network effects and market demand 121
6.2.1 Bandwagon effect 121
6.2.2 Snob effect 123
6.2.3 Veblen effect 124
6.3 Nonfunctional demand and utility 128
6.3.1 Functional demand versus nonfunctional demand 128
6.3.2 Functional utility versus nonfunctional utility 129
6.4 Consumer belief and information cues 131
Summary 132
Review questions 133
Problem solving 136
Bibliography 137

7 Demand for Pinot Noir versus Merlot: The Sideways effect 138
7.1 Sideways and the wines 139
7.2 *Sideways* on wine consumption 140
7.2.1 Standardization and comparisons 140
7.2.2 The Sideways effect on quantity 141
7.2.3 The Sideways effect on price 142

7.3 Decomposing price and the Sideways effect 144
7.3.1 Change in price or quantity 144
7.3.2 Changes in both price and quantity 145
7.4 Consumer knowledge and the Sideways effect 147
7.4.1 Consumer knowledge and wine consumption 147
7.4.2 Heterogeneity of the Sideways effect 147
Summary 150
Problem solving 151
Bibliography 151

MODULE 3 Supply **153**

8 Firm production and cost 155
8.1 Production function 155
8.1.1 Capital and labor 156
8.1.2 Diminishing marginal product 158
8.2 Derivation of cost curves 159
8.2.1 Cost structure 159
8.2.2 Cost concepts 160
8.2.3 Cost curves 162
8.3 Cost and short-run production 165
8.3.1 Revenue, cost, and profit 165
8.3.2 Breakeven point 166
8.3.3 Firm optimization 167
8.4 Cost and long-run production 167
8.4.1 Long-run average cost 167
8.4.2 Economies of scale 169
8.4.3 Why economies of scale arise 170
Summary 171
Review questions 172
Problem solving 175
Bibliography 177

9 Competition and market structure 178
9.1 Market structure in a nutshell 178
9.1.1 What is market structure 178
9.1.2 Market structures in tourism and hospitality 181
9.2 Perfect competition 181
9.2.1 Market demand versus firm demand 182
9.2.2 Positive profit, zero profit, and shutdown 183
9.2.3 Derivation of the supply curve 185
9.3 Monopoly 187
9.3.1 Downward-sloping demand curve 187
9.3.2 Marginal revenue curve 188
9.3.3 Output and price decision 189

9.4 Monopolistic competition 190
9.4.1 Product differentiation and demand 190
9.4.2 Monopolistic competition in the long run 192
9.5 Oligopoly 192
9.5.1 Strategic competition 192
9.5.2 Duopoly and Bertrand competition 193
9.5.3 Market efficiency 195
Summary 196
Review questions 197
Problem solving 200
Bibliography 202

10 Market concentration and market power 203
10.1 Market definition and market boundary 203
10.1.1 Market boundary by product 203
10.1.2 Market boundary by location 205
10.1.3 Market concentration and market power 205
10.2 Measuring market concentration 206
10.2.1 Four-firm concentration ratio 207
10.2.2 Herfindahl-Hirschman Index 209
10.2.3 Lorenz curve 211
10.3 Measuring market power 215
10.3.1 Lerner index and price elasticity of demand 215
10.3.2 Lerner index and demand substitutability 216
10.4 Industry versus sector 218
10.4.1 The complementary nature of the tourism industry 218
10.4.2 Market concentration in tourism and hospitality 219
Summary 221
Review questions 222
Problem solving 224
Bibliography 226

11 Airbnb versus hotels in supply adjustment 227
11.1 Performance metrics in the lodging industry 227
11.1.1 Supply and demand 227
11.1.2 Occupancy, ADR, and RevPAR 229
11.2 Discrepancy in market performance 230
11.2.1 Airbnb ADR and occupancy are stationary 230
11.2.2 Airbnb ADR and occupancy are lower 231
11.3 Demand seasonality and supply adjustment 234
11.3.1 Supply adjustment 234
11.3.2 Demand seasonality and market equilibrium 237
11.3.3 Cost and host behavior of Airbnb 239
11.4 Competition in the lodging industry 240
Summary 241
Problem solving 242
Bibliography 244

MODULE 4 Firm behavior and strategy 245

12 Monopoly and price discrimination 247
12.1 Price discrimination versus uniform pricing 247
12.1.1 Uniform pricing of a monopolist 247
12.1.2 What is price discrimination 248
12.2 Third-degree price discrimination 249
12.2.1 Demand heterogeneity by consumer segment 249
12.2.2 Pricing on consumer segments 250
12.2.3 Discontinuity in market demand 253
12.3 Second-degree price discrimination 253
12.3.1 Block selling and diminishing marginal utility 253
12.3.2 Pricing on sale blocks 254
12.3.3 Welfare analysis 255
12.4 First-degree price discrimination 257
12.4.1 Pricing on individuals 257
12.4.2 Social optimum and market efficiency 258
12.4.3 An example of first-degree price discrimination 259
12.5 Market imperfection, information, and price discrimination 260
12.5.1 Price discrimination and market efficiency 260
12.5.2 Information acquisition about demand 261
12.5.3 Economic discrimination versus social discrimination 262
Summary 263
Review questions 264
Problem solving 267
Bibliography 269

13 Starbucks pricing: Tall, Grande, and Venti 270
13.1 Receptacle size and price tag 270
13.2 Second-degree price discrimination 272
13.2.1 How does it work? 272
13.2.2 Why the Tall is the optimal single size 275
13.2.3 Optimal sizes and prices for Grande and Venti 276
13.3 Third-degree price discrimination 278
13.3.1 How does it work? 278
13.3.2 Nonfunctional utility and elasticity of demand 279
13.3.3 Elasticity of demand across sizes 280
13.4 Rationality versus irrationality 282
Summary 282
Problem solving 283
Bibliography 284

14 Duopoly and product differentiation 285
14.1 Horizontal versus vertical product differentiation 285
14.2 Minimum product differentiation 287
14.2.1 Assumptions of the model 288
14.2.2 Location choice and price competition 289
14.2.3 Law of minimum product differentiation 291

14.3 Maximum product differentiation 291
14.3.1 What is maximum product differentiation? 291
14.3.2 Equilibrium price in maximum product differentiation 292
14.3.3 Sources of firm profit 296
14.4 Consumer preference and product differentiation 297
14.4.1 Dispersion of consumer preference 297
14.4.2 Intensity of consumer preference 298
14.4.3 Product differentiation beyond location 299
14.5 Product differentiation and market efficiency 300
Summary 301
Review questions 302
Problem solving 304
Bibliography 305

15 McDonald's versus Burger King in product differentiation 306
15.1 Firms in the fast food industry 306
15.2 Location affecting price and profit 309
15.2.1 McDonald's price and profit 309
15.2.2 Burger King's price and profit 310
15.2.3 McDonald's versus Burger King in pricing 311
15.3 Competition and location choice 313
15.3.1 McDonald's responds to Burger King's location 313
15.3.2 Burger King responds to McDonald's location 314
15.4 What affects location equilibrium 315
15.4.1 Firm asymmetry and location choice 315
15.4.2 Market size, the "center," and location choice 316
Summary 317
Problem solving 318
Bibliography 319

MODULE 5 Transaction and Institution 321

16 Intermediation and the bid-ask spread 323
16.1 Transaction costs and the firm 323
16.1.1 Walrasian auction and transaction costs 323
16.1.2 The firm and the intermediary 324
16.2 Bilateral search versus intermediation 326
16.2.1 Buyers and sellers 326
16.2.2 Bilateral search 327
16.2.3 Intermediation 328
16.3 Determining the bid-ask spread 329
16.3.1 Search costs and intermediary profit 329
16.3.2 Bid-ask spread without search 331
16.3.3 Bid-ask spread with search 333
16.4 Intermediation versus disintermediation 336
16.4.1 The emergence of intermediaries 336
16.4.2 Disintermediation 337

Summary 339
Review questions 340
Problem solving 341
Bibliography 343

17 The two-sided market and price structure 344
17.1 Externality and the platform 344
17.1.1 A descriptive framework 344
17.1.2 Cross-side network externality 346
17.2 What makes a two-sided market? 346
17.2.1 The implicit market for interactions 346
17.2.2 Demands for the platform 347
17.2.3 Defining two-sidedness 349
17.3 Price decision of the platform 350
17.3.1 Profit maximization 350
17.3.2 Implicit price of interactions 351
17.3.3 Price structure on two sides 352
17.4 The Coase theorem and platformization 356
17.4.1 The failure of the Coase theorem 356
17.4.2 Internalization of externality 357
Summary 358
Review questions 359
Problem solving 360
Bibliography 362

18 The platformization of OpenTable 364
18.1 What is OpenTable? 364
18.2 OpenTable as a platform 366
18.2.1 The platform 366
18.2.2 Cross-side network effects 366
18.2.3 Same-side network effects 367
18.3 Structure of fees and user response 368
18.3.1 Structure of fees 368
18.3.2 Restaurants' response 370
18.3.3 Diners' response 371
18.4 Firm revenue and growth 372
18.5 Platform competition and multi-homing 374
Summary 375
Problem solving 376
Bibliography 377

Author Index 379
Subject Index 380

Figures

1.1	Breadth and depth of the tourism and hospitality industry	7
1.2	UNWTO classification of the purposes of visit	12
1.3	Global tourism growth and distribution (1950–2018)	15
1.4	Chinese outbound tourist departures in comparison	16
1.5	Chinese outbound tourist expenditures in comparison	16
1.6	Direct, indirect, and induced effects of tourism	17
1.7	Share of international tourism receipts in total exports	18
1.8	Share of tourism direct GDP in selected OECD countries	19
2.1	Demand and supply curves	25
2.2	Demand, supply, and market equilibrium	28
2.3	Shifts in demand and supply curves	30
2.4	Consumer surplus, producer surplus, and social surplus	32
2.5	Price ceiling, price floor, and deadweight loss	33
2.6	Push and pull factors in the tourism market	35
2.7	Changes in either demand or supply	36
2.8	Changes in both demand and supply	37
2.9	Demand drives supply	39
2.10	Supply creates demand	40
3.1	Interfaces of Uber app for riders and drivers	50
3.2	Uber ride requests and driver supply in the surge period	51
3.3	Uber's surge pricing works	52
3.4	Surge multiplier and surge outage	53
3.5	Uber's surge pricing fails	54
3.6	Economic surplus in the failure of surge pricing	55
3.7	Market outcome with surge pricing	56
3.8	Market outcome without surge pricing	57
4.1	Total utility and diminishing marginal utility	67
4.2	Indifference curves	70
4.3	Indifference curve, perfect substitutes, and perfect complements	71
4.4	Budget line and marginal rate of transformation	73
4.5	Budget line, indifference curve, and consumer optimization	74
4.6	Consumer optimization and the demand curve	76
4.7	Substitution effect and income effect	79
4.8	GDP per capita and leisure preference across countries	81
4.9	Decrease in work hours in developed countries	82

5.1	Marginal demand with respect to price	91
5.2	Arc elasticity, midpoint elasticity, and point elasticity	96
5.3	Perfectly inelastic and perfectly elastic demand	98
5.4	Income elasticity of demand	102
5.5	Income distribution and beer consumption (1961–2012)	103
5.6	Cross-price elasticity of demand	105
5.7	Substitutes, complements, and cross-price elasticity	105
5.8	Price elasticity and linear demand	107
5.9	Price elasticity of demand and firm revenue	109
6.1	Additivity in market demand	118
6.2	Non-additivity in market demand	119
6.3	Demand for the bandwagon good	121
6.4	First package tour in England in 1841	122
6.5	Demand for the snob good	123
6.6	Travel brochure archives from Thomas Cook & Son	125
6.7	Women dressed extravagantly in Victorian England	126
6.8	Demand for the Veblen good	127
6.9	Network effects and nonfunctional demand	129
7.1	Indexed case volume of the wines sold	140
7.2	Indexed ratios of case volume of the wines sold	142
7.3	Indexed real prices of the wines	143
7.4	Sideways effect on quantity and price	144
7.5	Sideways effect with varying prices and quantities	146
7.6	Indexed ratios of case volume sold: Low-priced	148
7.7	Indexed ratios of case volume sold: Medium-priced	148
7.8	Indexed ratios of case volume sold: High-priced	149
8.1	Production function and diminishing marginal product	157
8.2	Production function and variable cost curve	162
8.3	Variable cost curve and average cost curve	163
8.4	Variable cost curve and marginal cost curve	164
8.5	Revenue, cost, and profit curves	166
8.6	Long-run average cost curve	168
8.7	Long-run average cost and economies of scale	169
9.1	Firm number, competition, and market structure	179
9.2	Market demand and firm demand in perfect competition	182
9.3	Positive profit, zero profit, and shutdown	184
9.4	Marginal cost curve and the supply curve	186
9.5	Marginal revenue and demand in monopoly	187
9.6	Profit maximization of monopoly	189
9.7	Outputs in perfect competition and monopoly	190
9.8	Output in the short run versus in the long run	191
9.9	Firm demand in Bertrand competition	194
9.10	Price response in Bertrand competition	195

10.1	Product boundary and market share of firms	204
10.2	Domestic market share of U.S. airlines in 2019	208
10.3	Market concentration in U.S. industries in 2012	209
10.4	Market concentration in U.S. manufacturing	212
10.5	Lorenz curve and market concentration	213
10.6	Lorenz curves of the U.S. industries	214
10.7	Lerner index of Chinese airlines	218
10.8	Concentration ratios in accommodation versus catering	220
11.1	ADR and occupancy of Airbnb versus hotels in Paris	231
11.2	ADR and occupancy of Airbnb versus hotels across U.S. cities	232
11.3	ADR and occupancy of Airbnb versus hotels by day of week	233
11.4	Monthly and annual growth of hotel supply in the U.S.	235
11.5	Supply growth of Airbnb versus hotels in Paris	236
11.6	Demand seasonality and hotel ADR and occupancy	237
11.7	Demand seasonality and Airbnb ADR and occupancy	239
12.1	Airline pricing and booking window	249
12.2	Third-degree price discrimination	250
12.3	Second-degree price discrimination	255
12.4	Deadweight loss in second-degree price discrimination	256
12.5	First-degree price discrimination	258
12.6	Perfect competition and first-degree price discrimination	259
13.1	Starbucks coffee menu	271
13.2	Unit prices of Tall, Grande, and Venti	273
13.3	Unit prices of Grande and Venti	274
13.4	Optimal size and price of Tall	276
13.5	Optimal sizes and prices of Grande and Venti	277
13.6	Receptacle size and pricing on consumer segments	279
13.7	Nonfunctional demand and price elasticity of demand	281
14.1	Horizontal versus vertical product differentiation	286
14.2	Location equilibrium and minimum product differentiation	288
14.3	Maximum product differentiation and pricing	292
14.4	Price responses in maximum product differentiation	295
14.5	Dispersion of consumer preference	297
14.6	Intensity of consumer preference	298
14.7	Social optimum and product differentiation	301
15.1	McDonald's price and profit with varying distances	309
15.2	Burger King's price and profit with varying distances	311
15.3	Price-response elasticity of McDonald's versus Burger King	312
15.4	McDonald's responds to Burger King's location	314
15.5	Burger King responds to McDonald's location	315
16.1	Walrasian equilibrium and intermediation	327
16.2	The bid-ask spread and intermediary profit	331
16.3	Optimal bid-ask spread without bilateral search	332

16.4	Optimal bid-ask spread with bilateral search	334
16.5	Market share of indirect booking in Swiss hotel industry	338
16.6	Commission growth in the U.S. hotel industry	338
17.1	Uber in the two-sided market	345
18.1	Growth of participating restaurants on OpenTable	370
18.2	Growth of seated diners on OpenTable	372
18.3	Revenue composition of OpenTable	373
18.4	Growths of restaurants, diners, and revenue	374

Tables

1.1	International tourist arrivals and tourism receipts in Western Europe	14
5.1	Price elasticities of demand for various goods and services	100
5.2	Elasticities of tourism demand for Hong Kong	101
9.1	Assumptions and characteristics of market structures	180
10.1	CR_4 versus *HHI* in measuring market concentration	211
10.2	Convergence and divergence of hotel rates	217
10.3	Accommodation versus catering	220
11.1	Monthly hotel room days available and sold	228
13.1	Comparison of size and price of Café Latte	272
13.2	Compositions of size and price of Café Latte	273
13.3	Comparison of functional and nonfunctional demand	281
15.1	McDonald's versus Burger King in fast food dining	308
18.1	Previous fee structure of OpenTable	369
18.2	Current pricing plan of OpenTable	369

Acronyms

ADR	average daily rate
AFC	average fixed cost
ATC	average total cost
AVC	average variable cost
BL	budget line
CPI	consumer price index
CR	concentration ratio
CS	consumer surplus
CTO	Caribbean Tourism Organization
DWL	deadweight loss
ERB	electronic reservation book
FAO	Food and Agriculture Organization of the United Nations
FC	fixed cost
GDP	gross domestic product
GDS	global distribution system
GVA	gross value added
HHI	Herfindahl-Hirschman Index
IPO	initial public offering
KFC	Kentucky Fried Chicken
LRAC	long-run average cost
MC	marginal cost
MR	marginal revenue
MRS	marginal rate of substitution
MRT	marginal rate of transformation
MU	marginal utility
NAICS	North American Industry Classification System
OECD	Organisation for Economic Co-operation and Development
OTA	online travel agency
PS	producer surplus
RevPAR	revenue per available room
SIC	Standard Industrial Classification
SIDS	small island developing state

SRAC	short-run average cost
SS	social surplus
STR	Smith Travel Research
TC	total cost
TCE	international tourist arrivals at collective tourism establishments
TF	international tourist arrivals at frontiers
THS	international tourist arrivals at hotels and similar establishments
TR	total revenue
UNWTO	World Tourism Organization (since 2005)
USCB	United States Census Bureau
USHG	Union Square Hospitality Group
VC	variable cost
WDI	World Development Indicators
WTO	World Tourism Organization (before 2005)
WTTC	World Travel & Tourism Council

Symbols

a	ask price, coefficient of quantity demanded or supplied
b	bid price, y-intercept of demand or supply curve
c	marginal cost, average cost
C	total cost
d	firm demand, firm demand curve
D	market demand, market demand curve
E	market equilibrium
F	firm, product of a firm
i	individual buyer, individual firm
I	consumer budget
j	individual seller, individual firm
K	capital
l	labor input of a firm, leisure
L	labor, Lerner index, length of street
N	number of firms, quantity of interactions
p	price set by a firm
P	market price
q	quantity demanded by a consumer, quantity supplied by a firm
Q	quantity demanded in the market, quantity supplied in the market
r	willingness to pay
R	firm revenue
s	willingness to sell, market share
S	market supply, market supply curve
t	time, transportation cost
T	time
U	utility, indifference curve
w	wage
Y	income
η	elasticity
λ	matching probability
π	firm profit

Preface

Perhaps nobody would deny the beauty of economics that by and large lies in its regularity and generality. Regularity represents the ethereal form in which economic models and theories are manifested. It demonstrates a great deal of precision, sophistication, and rigor, leaving no room for any misinterpretation or sophistry caused by the ignorance of economic assumptions. Such regularity is attributed to the mathematization of economic models which, ironically, is also the reason that economics has been criticized by many both in and outside the profession of economics for being insulated from explaining real-world phenomena. However, economists make no attempt to replicate the real world or the way it functions by developing economic models, nor would they claim to change the world, a mission that Karl Marx thinks is bestowed on philosophers. In fact, a scientific approach to explaining the real world is to know how to simplify its complexity in the first place, thereby distilling principles that can represent, rather than replicate, reality. This comes with the generality of economics, a set of general principles that are abstracted from one aspect of human behavior but are universally applicable. This is the first piece of information that this book aims to communicate to its readers besides the content per se.

The edifice of economics can be built little by little in one context and grounded on evidence piece by piece in another, but the context itself is not self-explanatory and needs to be interpreted. Tourism and hospitality are contexts, and thus need to be interpreted. There have been many attempts made and initiatives advocated by tourism pundits, surprisingly more in China than in other countries, to professionalize the study of tourism as a discipline. Many of them lament that the lack of a general theory of tourism, or a discipline for that matter, has encumbered tourism education and research which would otherwise be elevated to a status as widely admired as economics, for instance. I think it is the very opposite. Ignoring the contextual nature of tourism and hospitality would not only delude educators and researchers into thinking that the nonexistent general theory will be invented anyway, but would have also led young students who are passionate about studying tourism and hospitality astray from obtaining a genuine understanding of it. For tourism education and research, the key is to resort to a discipline, whatever it might be, for the discipline is *the* common language through which scholars with various academic training can converse scientifically with each other on subjects related to tourism and hospitality.

Economics is one of the disciplines. That said, I have no intention to downplay the significance of tourism and hospitality as a context that can help us better expound economic theories. On the contrary, tourism and hospitality education has rooted

deeply in the industry context, beginning with serving the British leisure class in the late nineteenth century. This was also a pivotal time that resonated with the shift in research paradigm from classical economics to neoclassical economics. The context of tourism and hospitality is still pertinent today not only to running hospitality businesses but also to furnishing evidence for economics. Above all else, this context has tremendous implications for the study of behavioral economics because tourism consumption to some extent deviates from what rational choice theory would predict. For this reason, tourism and hospitality constitute the best context not only for us to apply economic theories but perhaps to generate economic theories that could benefit mainstream economics. Therefore, the present book explores this context from as far back as the 1840s when the first package tour was carried out in England to what is known as the sharing economy that has revolutionized world business since the 2000s. I hope this book can be an intriguing narrative of tourism and hospitality using the intriguing language of economics.

While the current book focuses on the application of microeconomic theories, it does not prescribe any course of action for operating businesses in tourism and hospitality. It is a positive economics text that aims to explain microeconomic foundations of tourism consumption, production, and transaction. What this book does convey is my belief in the principle of the free market and competition that can eventually lead to economic efficiency in tourism and hospitality. Tourism consumption and production are completely private economic activities except in those countries where the national economy depends heavily on tourism, and hence governmental intervention could be justified. However, this exception should not be seen as a norm in developing the tourism economy. The norm is that the industry is highly competitive, and the only way for businesses in tourism and hospitality to survive is through market competition, and to thrive is through constantly providing better goods and services to consumers at lower costs. This is where the well-being of both consumers and firms lies.

Lausanne, Switzerland
September 13, 2020

Instruction to readers

This book has primarily been written for students and teachers who study and teach the microeconomics of tourism and hospitality. If you are a student majoring in tourism and hospitality, this book provides you with a microeconomic analysis of the tourism and hospitality industry, including application of the market mechanism, analysis of tourism demand and supply, firm behavior and strategy as well as transaction and institution in tourism and hospitality. If you major in economics or other business disciplines, this book is a reference for you to understand where microeconomics and the tourism and hospitality industry meet and how to apply microeconomic theories in the industry. If you are an undergraduate, a perquisite for this book is rudimental microeconomics knowledge; even though this book expounds basic microeconomic theories in great detail, it does so in an analytical way. If you are a master's student, this book can help you sharpen your analytical skills of using economics to explain real-world problems. If you are a teacher wishing to adopt this book or take the approach of this book in your teaching, I provide detailed teaching notes, analytical diagrams as well as data and statistics in the industry, which can be tailored and integrated in your own teaching. These materials are available for download at www.routledge.com/9780367897352.

Throughout this book I underscore the linkage between the *context* and the *concept* in analyzing economics of tourism and hospitality. The context is industry evidence, or anything related to an economic problem or phenomenon in the tourism and hospitality industry. The concept is economic concept on which economic models and theories are developed in the first place. This book synthesizes core microeconomic theories that are required for undergraduates and master's students to develop an analytical understanding of the industry of tourism and hospitality. This book focuses on economic analysis of tourism and hospitality that progresses from economic intuition, graphical representation to mathematical inference. The analysis is structured in five modules. Module 1 lays down the empirical and theoretical foundations of economic analysis in which the market mechanism is articulated. Then, the analysis bifurcates between demand theory in Module 2 and supply theory in Module 3, on which firm behavior and strategy are grounded and expounded in Module 4. I conclude the book by touching on transaction and institution in Module 5 which resonate with the key empirical and theoretical issues outlined in Module 1. Each module concludes with a case-study chapter that applies theories in the module to an industry case except for Module 4, in which two case-study chapters are designed.

From a pedagogical point of view, I recommend allocating between 35 and 40 teaching hours for the whole book. Each of the 12 theoretical chapters is suggested as a 2- or 2.5-hour lecture; and each of the six case-study chapters can take 1 or 1.5 hours to complete. I provide two types of questions which enable students not only to grasp the content of each theoretical chapter but also to apply the concepts and models in each chapter. First are "review questions" designed for the 12 theoretical chapters. There are 10 multiple-choice questions for each chapter, aiming at testing students' understanding of key economic concepts, models, and theories. These questions can be assigned to students as homework or facilitated by instructors during or after class. I do not design chapter review questions for the six case-study chapters because these chapters focus on applications instead of introducing new concepts or theories. Second are "problem solving" questions designed for each chapter that aim to test students' competencies in applying economic theories into industry practices. Problem solving questions are open-ended, and can thus be used in tutorials, if any. Solutions are available for download at www.routledge.com/9780367897352.

This book is also a useful reference for practitioners or readers with an industry background either in tourism, hospitality, or in other industries that render goods and services to tourists. If you are the reader I'm referring to, you can simply disregard the analytical part of the book without compromising your understanding of the economic aspect of tourism and hospitality. While you can also disregard chapter review questions, problem solving questions might be of interest to you, because these questions pertain either to the industry practice or to the economic phenomena that might have long baffled you as a practitioner. That said, I have no intention to prescribe a course of action despite the fact that Modules 4 and 5 are exclusively dedicated to explaining firm behavior and strategy in tourism and hospitality. Economics, after all, differs fundamentally from action-oriented business subjects. It is grounded on a certain degree of abstraction which, in my opinion, is a cornerstone in learning and teaching economics. For this reason, I intentionally do not evade abstractions in this book despite the fact that abstraction is usually unpalatable to many.

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Yong Chen
Lausanne, Switzerland
September 13, 2020

MODULE 1

The market



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1 Economic approach to tourism and hospitality

We begin the economic analysis of tourism and hospitality by, first and foremost, providing an economic description of the industry from both demand and supply sides. On the one hand, we regard modern tourism as an economic phenomenon dating back to Thomas Cook's tour operating business in England in the 1840s. On the other, the legitimation of tourism in the national economy depends on its contribution to gross domestic product (GDP), among others. The economic approach to tourism and hospitality allows us to elicit the demand and supply forces that drive the tourist economy and are subject to economic analysis. The economic description of tourism and hospitality is not only set up for this book, but applies to the tourism and hospitality industry as a whole insofar as the economic aspect of the industry is concerned. Throughout the book we shall adhere to the economic description outlined in this chapter, and analyze the key components of the industry for both demand and supply.

AFTER STUDYING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- Understand what makes up modern tourism and hospitality;
- Describe the supply side of tourism and hospitality, referred to as the breadth and depth of the industry;
- Describe the demand side of tourism and hospitality, namely the tourist and the tourist economy; and
- Appreciate the economic significance of tourism at both national and international levels.

1.1 Tourism and hospitality

1.1.1 The making of modern tourism

The making of modern tourism was, above anything else, an entrepreneurial endeavor. It began in England on July 5th, 1841 when Thomas Cook (1808–1892) chartered a train taking some 500 people on a one-day excursion between Leicester

and Loughborough, two towns in central England merely eleven miles apart. Prior to his foray into what became known as the tourist business, Thomas Cook had been a preacher and social activist devoting his lifetime to the temperance movement prevailing in England in the second half of the nineteenth century for promoting complete abstinence from alcohol consumption. As a matter of fact, this excursion by and large was not only a byproduct of the temperance movement, but his later tourism business also had a more or less religious bent. It was not until 1845 that Thomas Cook inaugurated commercial package tours from Leicester to Liverpool and started to make profits from tourism.[1] In 1841 he founded Thomas Cook & Son in Leicester, a travel company specializing in the tour operating business, which to a large extent shaped the tourism industry in England and presaged mass tourism across Europe and North America. Over the decades in his tourism operation, Thomas Cook not only contracted with individual service providers, such as railway companies and hotels, to arrange package tours, but he himself would also escort tourists on their trips to Europe and beyond.

By today's standard the first package tour executed in 1841 was barely modern in terms of demand and supply. First of all, since the tourists were temperance activists, their travel had little bearing on the kind of leisure or recreation that underpins tourism in modern times. Second, the number of tourists was small and thus insufficient to entice suppliers in the majority of hospitality sectors such as accommodation and catering at the destination to deploy resources in producing goods and services for tourists. However, a series of these tours in the 1840s was a necessary prelude to modern tourism, because for the first time in history travel activities were commercialized in the form of package tours and institutionalized through the founding of tour operators. These revolutionary changes eventually allowed mass tourism to flourish in the late nineteenth and early twentieth centuries. The tour operating business did not only make tourism along with all sorts of hospitality products and services accessible and affordable to the burgeoning British leisure class, but it also unleashed the potential of tourism consumption far beyond Europe. For instance, in 1851, Thomas Cook was capable of organizing a whopping 150,000 visitors to attend the Great Exhibition in London.[2] During 1872–1873 he organized and escorted the first round-the-world tour, which took 222 days to complete and covered more than 29,000 miles.[3]

There is no doubt that massive human movement across England and beyond would not have been possible without the railroad revolution. By 1850 the United Kingdom already had 6,500 miles of railway line in operation, adding more than 500 miles per year in the decades that followed.[4] By the late nineteenth century, certain railway companies in England even started to operate package tours by themselves and competed with Thomas Cook. Above anything else, tour by train was not only a predominant travel mode but the very definition of tourism in the late nineteenth and early twentieth centuries. The technology brought about tremendous opportunities for tourism and hospitality businesses to flourish in England as it did for the whole economy as well. Yet the role that package tours had played in shaping the modern tourism industry was by no means in the shadow of the railroad revolution.

The business of package tours manifests the economic principle of mass and standardized production. As Thomas Cook put it:

> [t]he major cost of each train trip was the coaling and the 'steaming up,' so the idea was to pack it with people... I now see no reason why a hundred may not travel together as easily as a dozen.[5]

This principle is practiced by today's tour operating enterprises as well, including online travel agencies (OTAs). This business model would also mirror the mass production of automobiles by Henry Ford in the United States in the 1910s and 1920s through the assembly line in producing the Model T.

1.1.2 The essence of hospitality

Long before the nineteenth century when the word *tourism* entered the English language, a couple of synonyms, such as travel and hospitality, had been widely used to refer to one aspect of tourism or another. Nevertheless, these words are inadequate to capture the meaning of tourism even after tourism becomes mainstream in society. In modern connotations tourism is far beyond the displacement of people from their usual environment to an alien destination for subsistence, but instead it has a hedonic and utilitarian pursuit of well-being which can partially be fulfilled by travel. By no means is hospitality merely about offering food, shelter, and benevolence to friends at home or practicing the doctrine of Christianity that accommodates the needy and strangers in churches.[6] Because tourism in modern times encompasses recreational and hedonic experiences on the demand side, hospitality is accordingly morphed into a sophisticated business on the supply side. The business of hospitality aims to elevate various human needs and wants far beyond subsistence and material gratification in the pre-tourism era. Regardless of the context in which specific hospitality products and services are delivered, at the heart of hospitality is the amicable relationship between hosts as hospitality providers and guests as the receivers.

In common parlance, tourism suggests that anyone could be a stranger sometime and somewhere as long as he or she is exposed to an alien environment. This was the case for the first cohort of tourists traveling from Leicester to Loughborough who would desperately crave hospitality services and warmth rendered by their hosts in Loughborough. The separation between tourists' place of residence and a destination creates curiosity for tourists on the one hand, and on the other brings about uncertainty and insecurity. Since tourists are vulnerable to numerous adverse events and mishaps that may occur at a destination both geographically and culturally distant from their usual environment, they would crave safety and security more than they do at home. There is no question that today's hospitality industry needs to build up the amicable host–guest relationship that has been rooted deeply not only in the Christian doctrine of serving the needy but also in human nature at large. Nurturing such a relationship has opened up tremendous business opportunities for enterprises at destinations to proactively meet various needs of tourists. Therefore, we have seen

miscellaneous hospitality products and services in the marketplace, ranging from shelter and accommodation provided by hotels, strength and energy restoration at restaurants to numerous amenities handed to tourists on a platter by today's splendid tourism and hospitality industries.

1.1.3 Tourism versus hospitality

When it comes to the analysis of tourism and hospitality, a predicament is how to distinguish between the words *tourism* and *hospitality* as they are sometimes used interchangeably both in the industry and in academia. Some distinctions have been made by academics attempting to exhaust all tourism- and hospitality-related businesses in the market, aiming to piece together a holistic picture of the tourism and/or hospitality industries. The fact is that travel-, tourism-, and hospitality-related sectors are not only fragmented with regard to their distinct functionalities but are also evolving as new businesses burgeon to meet the needs of tourists as well as locals. As far as supply is concerned, the tourism industry itself cannot be sustained in its own right because it is, by nature, a combination of a wide range of sectors, primarily hotels, airlines, restaurants, and so on. Hence tourism cannot be decoupled from hospitality. At the same time, however, many hospitality establishments, such as guest houses, inns, and taverns to name a few, long predated what became known as modern tourism in the mid-nineteenth century. As an economic phenomenon in the nineteenth century, tourism was restricted, if not exclusively, to recreational travel. Therefore, on the supply side, hospitality can be largely independent of recreational travel and mass tourism. However, as tourist demand expands, so does the supply of hospitality, and hence they become inseparable.

1.2 Breadth and depth of tourism and hospitality

There are many definitions of the tourism and/or hospitality industries based on the disciplinary perspective that one holds or the purpose of classification between tourism and hospitality. In fact, it would not be possible to propose *the* definition of the tourism and/or hospitality industries that suits various practical needs and theoretical explanations of the tourism phenomenon. A meaningful and feasible approach is to adopt *a* definition that is consistent with the generally accepted industry belief of what ought to be incorporated in tourism and hospitality and meanwhile serves the purpose of economic analysis. On the practical side, the tourism industry is not a single industry entity but a conglomerate of various travel-, tourism-, and hospitality-related sectors, such as hotels, restaurants, airlines, casinos, and so on. Insofar as economic analysis is concerned, we need to articulate the demand and supply sides of the industry. Because no such product as tourism really exists, the supply of tourism by which it can be compared with agriculture and manufacturing becomes elusive and undefinable. Perhaps not so perplexing is to explain tourism from the demand

side. After all, each of these sectors mentioned above meets at least one aspect of tourist needs. This allows us to turn to the mechanism by which these sectors are organized to bridge the chasm between demand and supply that are geographically isolated in tourism.

In this book we subscribe to a definition proposed by Bill Carroll and his colleagues in their online course "Introduction to Global Hospitality Management" delivered on edX in 2015. Their approach aims to link the demand and supply of the whole industry through travel intermediaries, and thus the industry can be addressed on two dimensions, *breadth* and *depth*. We refer to this definition as the breadth-depth framework of the tourism industry (Figure 1.1). The breadth dimension addresses the supply side of the industry, which by and large incorporates all industrial sectors primarily at destinations that provide goods and services directly to tourists. In general, the breadth dimension summarizes all sectors related to either tourism, hospitality, or travel. Obviously, a majority of these sectors are hospitality sectors located at destinations. The depth dimension describes the linkage between demand and supply through travel intermediaries. Thus, the tourism industry is built up from one layer, namely suppliers, on another, namely various travel intermediaries that facilitate transactions between suppliers in all these sectors and tourists as end consumers. The breadth-depth framework not only integrates travel-, tourism-, and hospitality-related sectors on the supply side but also articulates the relationship between demand and supply.

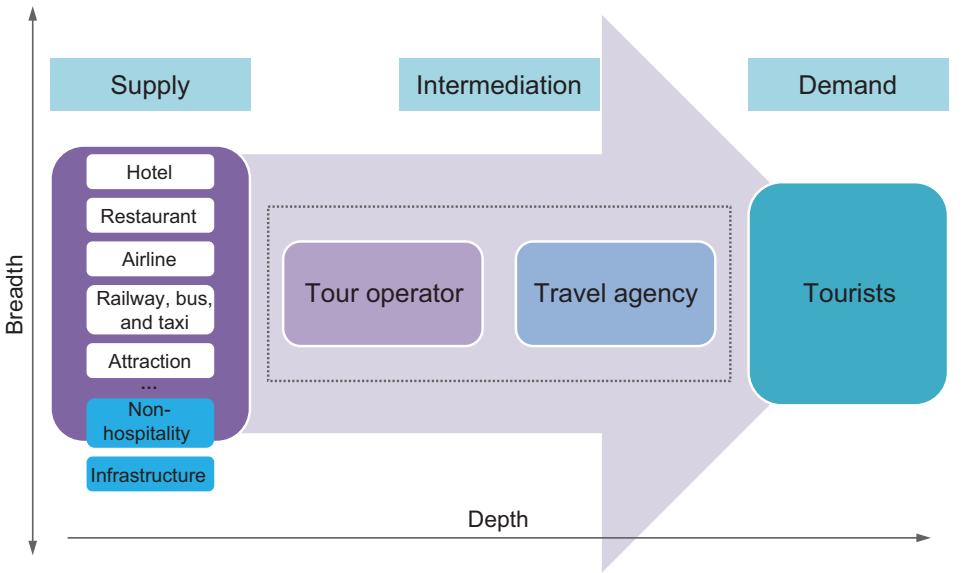


Figure 1.1
Breadth and depth of the tourism and hospitality industry

Note: This framework is produced based on the ideas of Bill Carroll, Jan deRoos, Cathy Enz, and Bruce Tracey in their 2015 online course "Introduction to Global Hospitality Management" on edX.

1.2.1 Breadth of the tourism industry

The breadth of the tourism industry addresses the wide scope of supply, ranging from hotels, restaurants, airlines, casinos to various destination attractions that render a plurality of products, services, and experiences to tourists. Besides conventional hospitality supply, the breadth of the industry may encompass infrastructure and other amenities that are not hospitality-oriented or do not serve tourists. However, they facilitate tourists' travel activity and for this reason also earn revenues from tourist expenditure at destinations. Therefore, the breadth of the industry is grounded on the fact that tourist needs are broad and heterogeneous. In addition to being met by conventional hospitality supply, these needs are met by peripheral infrastructure and public services, such as airports, highways, and consumer information. As a matter of fact, high-quality infrastructure and public services are instrumental in boosting tourism demand in the first place through attracting suppliers to produce in tourism and hospitality. From a practical point of view, tourist spending on peripheral services is counted as tourism receipts by destination countries, despite the fact that such expenditure is irrelevant to conventional tourism or hospitality products and services. Since peripheral businesses earn tourist dollars through facilitating tourism consumption, they are included in the tourist economy as far as the demand side of tourism is concerned.

The breadth of the industry also suggests that the scope of supply is extensive and dynamic. The supply of tourism and hospitality keeps expanding as new hospitality businesses or a hybrid of incumbent tourism or hospitality businesses emerge. For instance, a startup called NapCity in Germany provides sleep capsules at airports for travelers who have missed their flight or are waiting during long layovers.[7] These sleep capsules cannot be classified in the hotel sector nor in other incumbent lodging facilities, but they address unsatisfied accommodation needs of travelers in the market in the same way as other accommodation facilities. Another example is the Cleveland Clinic in the United States which integrates hospitality into health care to increase patient experience and well-being.[8] This example could herald a hybrid hospitality–hospital solution in the near future that combines hospitals and hotels for those who need professional medical care while at the same time craving impeccable hospitality services during their recuperation. Thus, the scope of hospitality supply is expanded despite the fact that many of these businesses may have little to do with tourism on the demand side. Moreover, sharing economy businesses, such as Airbnb and Uber, which rely on massive grassroots suppliers instead of traditional enterprises, are not conventional hospitality, but they are important alternatives to hotels and taxis, respectively, thereby expanding the supply of tourism and hospitality.

1.2.2 Depth of the tourism industry

The depth of the tourism industry addresses the organization of travel-, tourism-, and hospitality-related sectors downstream to bridge the gap between tourism demand and supply through travel intermediaries. Since tourism and hospitality supply at destinations is geographically separated from demand in source markets,

it is travel intermediaries, including tour operators and travel agencies, that channel tourists from their home to destinations and even to specific hospitality suppliers. This is accomplished through travel intermediaries furnishing tourists with market information such as price among others. In the 1840s it was Thomas Cook who institutionalized the relationship between tourism demand and supply through his tour operating enterprise. On the one hand, it is travel intermediaries that operate and produce package tours through contracting with various hospitality businesses either at destinations, in source markets, or from a third country. On the other hand, they establish retailing outlets, known as travel agencies, to promote and sell package tours in source markets, thereby expanding the demand side of the industry. Tourists can reduce tremendous costs in information search and market transaction when purchasing tourism products from travel intermediaries instead of contacting service providers separately.

The intermediating role of travel agencies cannot be underestimated in institutionalizing the consumption and production of tourism. The advent of modern tourism was marked by Thomas Cook because of the establishment of tour operators, which render travel intermediaries indispensable in the mass production and consumption of tourism in the late nineteenth and early twentieth centuries. Yet this is not to say that the intersection of tourism demand and supply did not exist prior to Thomas Cook's tour operating business. The intersection, if any, would have occurred not only sporadically but also on a small scale without the engagement of tour operators. Historical evidence has shown that recreational tours prior to Thomas Cook were largely a privilege of the nobility and aristocrats because of the exorbitant prices of transportation and inconvenience in traveling. For instance, the Grand Tour in Europe was popularized among British aristocrats in the late seventeenth and early eighteenth centuries but never made its way to working classes, let alone became mainstream. The impediment to the mass consumption of tourism was less about social or political reasons but more about economic constraints. Costs impeded tourism consumption from trickling down from the elite to the masses. The costs were not only people's expenditure on goods and services at destinations but more importantly all expenses related to communication and transactions between tourists on one side and various suppliers on the other.

1.2.3 Supply expansion in tourism and hospitality

Given the tourism industry described in the breadth-depth framework, the expansion of the tourism industry can be attributed to structural changes on both breadth and depth dimensions. On the breadth dimension, the tourism industry has been growing through widening the supply scope to address various needs of tourists. It has also been evolving over time with incumbent sectors or products being supplanted by better alternatives. Historically, the breadth of the tourism industry was expanded as soon as air travel supplanted railways in the 1960s, which paved the way for mass tourism at a global level. As a consequence, British seaside tours via train were partly replaced by Mediterranean vacations via air travel in the second half of the twentieth century. While the accommodation sector has been relatively stable and less affected

by technological advancement, its scope has been expanding when accommodation sharing businesses entered the market around 2008. Instead of relying on enterprises such as hotels, Airbnb creates accommodation supply through millions of grassroots hosts renting out their spare apartments or rooms. In city tours alike, Uber creates more affordable and convenient transportation services by reorganizing and redeploying resources that have already existed for tourism uses.

On the depth dimension, the contribution of Thomas Cook did not only lie with the use of railways to make destinations accessible but with the invention of package tours to make tourism more affordable than ever. The business model of package tours reduces costs associated with trading tourism products and services between tourists and various service providers that are geographically distant. The costs would be astronomical at a time when modern communication technologies such as telephones had not been widely used to transmit information in business until the early twentieth century. This can also explain why the tourism and hospitality industry has been a trailblazer to embrace technological innovations in the second half of the twentieth century. In particular, structural changes occurred in the airline industry in the 1970s when the global distribution system (GDS) and computerized booking made their debut. This further facilitated the transactions between airlines, travel intermediaries, and tourists by reducing transaction costs, particularly concerning information search. The same holds true for the advent of online travel agencies (OTAs) via the Internet in the 1990s. In recent decades sharing economy enterprises, such as Airbnb and Uber, have not only furnished tourists with alternative tourism products and services but more fundamentally established a new institutional arrangement to expand market transactions.

1.3 The tourist and the tourist economy

1.3.1 Tourism and the tourist

Now we turn to the demand side of the tourism and hospitality industry by centering on end consumers in the market. Since hospitality supply long predated modern tourism, the demand side of hospitality does not necessarily entail tourists as consumers. In fact, in developed economies local residents make up a substantial proportion of demand for hospitality services, particularly for restaurants, bars and pubs, to name a few. Nevertheless, tourists constitute the principal demand for all sorts of hospitality products and services in modern tourism era, especially for countries in which tourism makes up a large proportion of GDP. Some hospitality supply, such as hotels, is set up solely for serving tourists, and its growth is largely fueled by tourist demand from outside of destinations. Despite the fact that local residents' expenditure at a restaurant, for instance, or for domestic travel as a whole is indistinguishable from tourist expenditure in the same regard, the two expenditures bifurcate when it comes to assessing their contribution to GDP. As far as a destination country or economy is concerned, local residents' expenditure in hospitality sectors within the country is part of domestic consumption while tourist expenditure is part of exports of the country. In other words, international tourism is part of international trade.

Therefore, distinguishing tourists from local residents and identifying who is a tourist helps trace where tourism demand is originated as well as the extent to which tourism contributes to the national economy. As a matter of fact, defining the *tourist* would have been as difficult as defining the tourism industry because the purposes of definitions vary from one to another. Again, as far as economic analysis is concerned, we need to ensure that a definition should help us to quantify the number of tourists as end consumers of tourism products and services. On the other hand, it must be consistent as much as possible with the consensus among practitioners and policy makers with regard to what the tourism industry should incorporate. The United Nations Statistical Commission approved provisional guidelines on the statistics of international tourism as early as 1976. Yet it was not until 1993 that a statistical definition of tourism was officially adopted based on the recommendations of the World Tourism Organization (UNWTO).[9] According to this definition, tourism "comprises the activities of persons traveling to and staying in places outside their usual environment for not more than 12 consecutive months for leisure, business or other purposes not related to the exercise of an activity remunerated from within the place visited."[10] While this definition seems to define tourism, it does draw a line between who is and is not a tourist in relation to the nature and magnitude of a person's activity performed at a destination.

This definition stipulates three quantifiable criteria specific to tourism and tourist: distance, temporality, and consumption. In the first place, the distance criterion sets a boundary whereby tourism can be distinguished from excursions or other leisure activities that are undertaken in a person's usual environment, or staycation for short. Obviously, it makes little sense to set a universal threshold that can apply to all distance situations. A distance of 50 miles might be sufficient for Swiss people to separate their place of residence from a destination but is perhaps insufficient for most Chinese and Americans living in a metropolis to do so. In Thomas Cook's time, a distance of eleven miles was sufficient to set a person's usual environment in Leicester apart from the destination Loughborough. It is certainly not possible nowadays due to a drastic reduction in travel time that would make the two places within a person's usual environment. The usual environment also suggests places that are geographically distant but highly frequented by people. For instance, if a person commutes hundreds of miles between his home and workplace, his travel is not tourism because his workplace would be seen as his usual environment. However, the distance criterion becomes less confusing as far as international tourism is concerned. Other things being equal, citizens crossing national borders would be naturally regarded as international tourists. By and large tourism involves the displacement of people to a destination that is geographically and socially distant from their usual environment in the first place.

Second, on the time dimension tourism is a temporary activity undertaken by a person at a destination whereby we can exclude permanent population displacement, such as migrants, immigrants, refugees, and so on. While the time criterion is less ambiguous than the distance criterion, the 12-month length of stay in many countries or regions could sufficiently entitle a person to obtain a residential permit from the place he visited. For instance, foreign travelers who have been permitted to stay in Hong Kong for more than six months are required to register for an identity card

and therefore are no longer regarded as tourists during their visit. In this aspect, the UNWTO states that "from a tourism standpoint any person who moves to another place in the same or in another country and intends to stay there for more than one year is immediately assimilated with the residents of that place."[11] Thus, the 12-month period can take into account almost all different situations pertaining to tourism. Third, tourism is exclusively associated with people's consumption at a destination, and therefore disqualifies any production activities undertaken by the displaced persons at the destination. That is, tourism excludes any work at an occupation remunerated from a destination that a person visits. This suggests that tourism makes a contribution to the destination economy through tourist consumption at a destination in the first place.

As long as the three criteria are met, tourism does not have to be leisure- or recreation-oriented. Thus, the UNWTO's framework of tourism statistics encompasses visit purposes ranging from holiday, visiting friends and relatives, business to religion (Figure 1.2).[12] The definition of tourism does not opine on exhausting all travel purposes that people may have. From a statistical point of view, it aims to elicit the most representative and vast majority of travelers whose activities are most likely to be leisure- or recreation-oriented and therefore economically significant to the destination economy. Tourism consumption can be associated with travelers from outside a destination, regardless of whether the destination is a town, city, or a country. Thus, tourism can be seen as displaced consumption if we take an economic point of view while ignoring the experiential and hedonic nature of tourism. On the one hand, the statistical definition

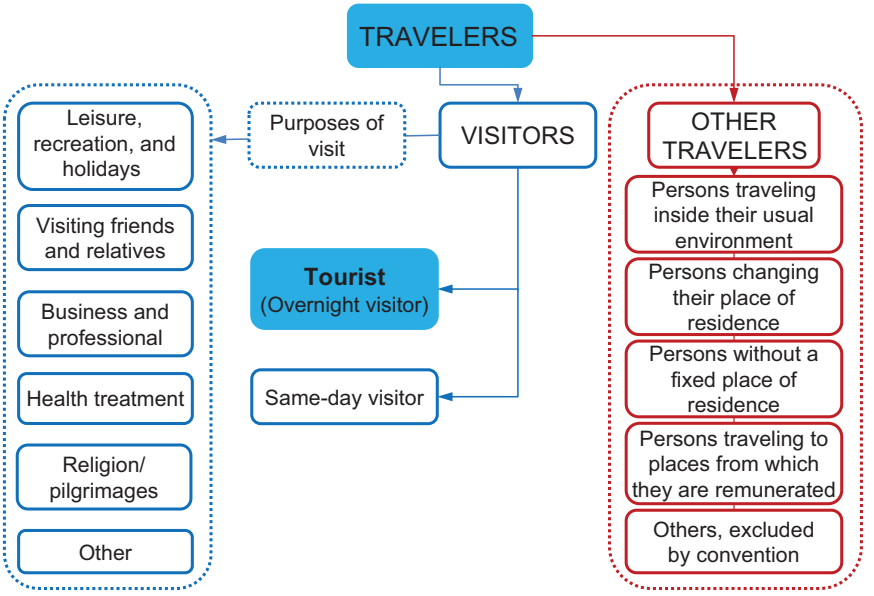


Figure 1.2
UNWTO classification of the purposes of visit

Source: WTO (1995). Concepts, Definitions and Classifications for Tourism Statistics. Madrid, Spain: UNWTO, p. 22. Reproduced from the UNWTO.

provides a yardstick to quantify tourism demand, with which tourism contribution to GDP is associated. On the other hand, it could overestimate the tourist economy by incorporating business travel or other forms of flows of people with no regard to recreation-based consumption. For instance, the flow of businesspersons between two trading partners could be substantial, but their activity may have little to do with recreational tourism. In this case, the effect of tourism on the national economy will be overstated.

1.3.2 Tourism consumption

On the supply side, the outputs in the tourism industry can be assessed by referring to the amount of goods and services produced in tourism- and hospitality-related sectors in a certain period of time. For instance, these outputs are measured by occupancy in the hotel sector, the number of meals sold in the restaurant sector, and passenger miles or loading factor in the airline sector, and so on. In addition to these specific measures, these outputs differ from one another in terms of the production process and technology that are adopted in producing these goods and services. There is no such universal measure that can be applied to all sectors because tourism product as a single entity does not exist. The tourism product is, in principle, an amalgamation of a variety of goods and services produced both in the hospitality and non-hospitality sectors so long as they are purchased by tourists. In other words, if these products were purchased by local residents, the output would have nothing to do with the tourist economy. Therefore, tourism depends much on who the end consumers are rather than what goods and services are consumed. Thus, tourism consumption can be estimated by aggregating the market values of all final goods and services consumed by tourists in all sectors of an economy, but such an aggregation is practically difficult, if not impossible.

As long as we can identify tourists and obtain information about how much they spend at a destination, the size of the tourist economy can be measured by tourist expenditure. Tourism can be decoupled from other economic activity at a destination by examining consumption from tourists. In order to assess tourist expenditure we need to know the number of visits made by tourists at the destination, referred to as tourist arrivals, and how much they spend on each visit. Total tourist expenditure is tourist arrivals multiplied by the expenditures per visit at the destination. Since a tourist may make multiple trips to the same destination in a given period of time, tourist arrivals would usually outpace the sheer number of tourists. Other things being equal, as tourist arrivals increase, so do goods and services sold for tourism consumption. In situations where tourist activity at a destination is not so connected to the destination economy, tourist arrivals may not correlate with tourist expenditures. For instance, natural destinations with beautiful beaches and mountains would entice tourists to come in droves, yet very little expenditure would be made because these resources are not transacted in the market. Once tourists are accommodated by their friends and relatives at a destination, they would also have little contact with commercial supply at the destination. Thus, the positive relationship between tourist arrivals and expenditure would become negligible.