

Wholesalers and Caribbean Resort Hotels

Although wholesalers play an important role in the Caribbean resort industry, hotel operators need to have more control over managing their own capacity.

by **Sheryl E. Kimes** and
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CAPACITY MANAGEMENT in Caribbean resort hotels is difficult because of highly seasonal demand. To solve the capacity-management problem, a better match between supply and demand patterns must be made. Hotel supply is essentially constant, and seasonality cannot be eliminated, but reducing fluctuations in demand will make the hotels easier to manage.

Wholesale tour operators play an important role in the resort-hotel industry. They make it possible to reach many potential clients in a low-cost manner. During the low season they make it possible to fill otherwise empty rooms. At the same time, because of wholesalers, hotels may run the risk of selling too many rooms at too low a price. During the high season hotels may displace high-paying transient guests with low-paying wholesaler guests. In areas heavily dependent on tourism, such as the Caribbean, the relationship between whole-

salers and hotels is even more important because of the effect tourism can have on the economic health of the region.

The relationship between wholesalers and resort-hotel

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managers can be problematic. Negotiations occur many months before the guest arrives. Both sides face uncertainties: the hotel doesn't know how many rooms will be sold, and the wholesaler doesn't know what the hotel's rate will be at the time of occupancy.

This study assesses the relationship between wholesale-tour operators and resort hotels in the Caribbean. It includes an introduction to tourism in the Caribbean, a discussion of the structure and economics of the wholesale-tour industry, a presentation of the results of a survey of the members of the Caribbean Hotel Association, and a discussion of the implications for resort hotels and tourism.

Tourism in the Caribbean

Tourism plays an important role in the Caribbean. Estimates vary, but in 1990 tourism accounted for 8–10 percent of all employment, or about 420,000 jobs, in the Caribbean. Tourism, the only sector of the regional gross domestic product to increase in share of total income during the 1980s, rose from 18 percent of current account receipts in 1980 to 37 percent in 1990. About 10 million stopover visitors were recorded in 1990, and 15 million are forecast for the year 2000. The United States is a major source of business for the Caribbean and accounts for 57 percent of all arrivals.¹

There are now 1,100 hotels with about 100,000 rooms in the Caribbean. Hotels charge high prices, but because of their high operating costs, the profitability of Caribbean hotels is among the lowest in the world. In addition, competition from cruise ships and less-expensive destinations has

¹Sue Mather and Graham Todd, *Tourism in the Caribbean* (New York: Economist Intelligence Unit, 1993), pp. i–ii.

increased. Given the dependence of the local economies on tourism, an unprofitable hotel industry could prove disastrous to future economic development.

Caribbean hotels face highly seasonal demand. During the winter, the high season, both occupancies and prices are high, while during the summer, both occupancies and prices are low. The fluctuating demand pattern causes seasonal unemployment and makes it difficult for countries to establish a stable economy.

Caribbean Resort Hotels

Caribbean resort hotels face strong competitive pressures. When Porter's model is used to analyze Caribbean resort hotels, the competitive nature of the industry becomes apparent.² According to Porter, five forces drive industry competition: suppliers, substitutes, buyers, potential entrants, and rivalry among existing firms.

Suppliers. Suppliers such as airlines can seriously affect resort hotels by raising their prices. Caribbean hotels face constant problems with airlines not providing adequate numbers of seats at reasonable prices.³ The problem has intensified as the number of airlines providing service to the Caribbean from the United States and Canada has decreased. If customers cannot get affordable flights to the Caribbean, the hotel rooms may go empty.

Substitutes. Caribbean resort hotels face competition from cruise lines and other resort

²Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: The Free Press, 1980).

³Jean S. Holder, "The Caribbean Tourism Organization's Role in Caribbean Tourism Development towards the Year 2000," in *Tourism Marketing and Management in the Caribbean*, ed. Dennis J. Gayle and Jonathan N. Goodrich (London: Routledge, 1993), pp. 205–219.

destinations.⁴ Cruise lines, seen as a growing threat, have been the subject of much discussion and face possible government regulation.

Buyers. Wholesalers constitute a powerful group of buyers of Caribbean resort-hotel services. Porter found that strong buyers attempt to force down prices, bargain for more services, and play competitors against each other, all at the expense of industry profitability.

Barriers to entry. Although the cost of building a hotel is high, the supply of rooms in the Caribbean increased from 65,460 in 1988 to 83,012 in 1992 as many international competitors entered the Caribbean market.⁵ The increased number of rooms has led to overcapacity and has placed pressure on competitors to sell their rooms at a low rate.

Rivalry. The rivalry among Caribbean hotels is keen. There are many different types of resort hotels, the fixed costs are high, and the capacity is augmented in large increments (entire resorts come on line at once, instead of a few rooms at a time being added). Each of those factors can lead to an intensification of rivalry. Firms with high fixed costs and perishable inventory may feel great pressure to sell all their inventory, even at low prices, so that they can be sure that they will at least break even.

Wholesale-Tour Operators

Published research on the wholesale-tour-operator industry is scarce. Several years ago, Touche-Ross funded a survey of tour wholesalers to learn more about the industry structure. More recently, Sheldon studied the economics and structure of the

⁴John Bell, "Caribbean Tourism in the Year 2000," in Gayle and Goodrich, pp. 220–235.

⁵Mather and Todd, p. 76.

The rivalry among Caribbean hotels is keen, with many different types of resorts, an oversupply of rooms, and high fixed costs.

industry and analyzed the consumer demand for tours. Other research has primarily modeled the demand for tours.⁶

In 1986 there were over 1,500 tour operators in the United States.⁷ Most tours (65 percent) were sold by one of the 32 members of the U.S. Tour Operator Association. Tour operators, or wholesalers, negotiate with suppliers such as hotels and airlines to obtain a volume discount and then bundle those services into packages. Wholesalers reduce information and transaction costs for the consumer, increase hotels' occupancy rates, and reduce promotional expenses for hotels.

Wholesaler contracts with hotels generally take one of two forms: block reservations or block purchases. The block reservation, in which a wholesaler reserves a block of rooms with a hotel without actually taking title to or paying for the rooms, is most common. The wholesaler is not required to sell all the rooms reserved but must notify the hotel of the number of rooms required a specific number of days ahead of customer arrival.

When a wholesaler makes a block purchase, the wholesaler takes title to and purchases a certain number of rooms, typically paying a very low price but also assuming great risk. Block purchases occur infrequently in

the Caribbean resort-hotel market; they are more common when high demand puts a hotel in a strong bargaining position.

Negotiations between wholesalers and resort hotels usually take place about a year ahead of time. The negotiated rates depend on the supplier's expected use (the percentage of their room allotment suppliers actually use), on expected volume (the total number of rooms suppliers use annually), and on economic conditions. Estimates of volume are often based on the past performance of the wholesaler. The financial stability of the wholesaler and the scope of its marketing plans also affect the rate. The negotiated rates are well-kept secrets; discounts vary from 10 to 50 percent off the rack rate. Although the wholesalers receive payment from consumers in advance, their relative power allows them to delay paying a hotel until well after the customer's stay is over.

A strategic view. When Porter's model is used to analyze the role of wholesalers in the Caribbean resort-hotel market, the results are enlightening. Wholesalers are considered a powerful buyer group for a number of reasons, including the following:

- Wholesaler purchases of rooms constitute a large part of total hotel-room sales.
- The services wholesalers purchase from hotels constitute a significant part (52 percent) of overall tour costs, and the average profit for wholesalers is only 3 percent.⁸ Wholesalers therefore must shop for favorable prices and must be selective in their purchases.
- Wholesalers may not perceive

⁶ Touche-Ross and Company, *Tour Wholesaler Industry Study* (New York: Touche-Ross, 1976); Pauline J. Sheldon, "Economics of Tour Packaging" (unpublished doctoral dissertation, University of Hawaii, 1984); Pauline J. Sheldon, "The Tour Operator Industry: An Analysis," *Annals of Tourism Research*, Vol. 13 (1986), pp. 349-365; Hossein Askari, "Demand for Package Tours," *Journal of Transport Economics and Policy*, January 1972, pp. 40-51; and Climent Guitart, "UK Charter Flight Package Holidays to the Mediterranean: 1970-1978," *Tourism Management*, Vol. 3 (1982), pp. 16-39.

⁷ Chuck Y. Gee, James C. Makens, and Dexter J.L. Choy, *The Travel Industry* (New York: Van Nostrand Reinhold, 1989), p. 211.

⁸ Touche-Ross, p. 26.

differences between the rooms they purchase from different resort hotels, and they may play hotels against one other.

- Wholesalers in the Caribbean face few switching costs; it is easy for them to switch from one hotel to another.

Survey

To obtain more information about the role of wholesalers in the Caribbean resort-hotel industry, we conducted a survey in the fall of 1993.

The Caribbean Hotel Association provided us with a list of its members. We sent a two-page survey to the 391 hotels on the list with over 50 rooms. The survey consisted of 14 questions about wholesaler use during 1991-92. We used that time period because complete operating data from 1993 was not yet available. We excluded smaller hotels because they would be less likely to use wholesalers. The first mailing was in August, and there was a follow-up mailing in October.

We received 81 usable responses, a response rate of 21 percent. Some hotels indicated that they could not participate because of the proprietary nature of some of the information requested. The respondents represented a broad range of islands (Exhibit 1), and the hotels ranged from 30 to 1,586 rooms (despite an intention to limit the survey to hotels with more than 50 rooms); the median was 120 rooms.

Use of Wholesalers

The respondents indicated that 57 percent of their room revenues came from wholesalers during 1991-92. Hotels relied more on wholesalers during the high season than during the low.

Fifty-seven percent of the respondents reported that they

typically contracted with wholesalers on a run-of-house basis; that is, they don't promise a certain type of room before the customer arrives. The hotels reported selling rooms to a number of wholesalers (Exhibit 2); 63 percent reported that they did business with 12 or more wholesalers.

Agreements with Wholesalers

The hotels used a variety of ways for determining the contract room rate for wholesalers, and some used more than one method: 53 percent used a set percentage below published rates, 45 percent used a rate that their competition had set, 40.5 percent used past experience, and 40.5 percent used a cost structure and expected level of demand. Fewer than 10 percent used the rate the wholesaler offered them as the basis for setting their price.

Most of the hotels had written contracts with wholesalers. Seventy-five percent reported using written contracts drawn up by the hotel, and 43 percent used contracts drawn up by the wholesalers. Only 3 percent based their agreements on past dealings, and 5 percent based their agreements on oral commitments. The responses sum to over 100 percent because many hotels used multiple methods for dealing with their wholesalers.

Most of the hotels (63 percent) responded that they typically commit rooms to wholesalers seven to twelve months in advance; 25 percent, six months in advance; and 12 percent, 13 to 24 months in advance. No resort committed rooms more than two years in advance.

Almost all hotels (93 percent) set a release period for wholesalers to return unsold rooms. The median release period for the high season was fourteen days, and the

EXHIBIT 1 *Geographic distribution of responding hotels*

Location	Number of hotels
Bahamas	11
Barbados	3
Belize	1
Bermuda	4
Cancún	14
Dominican Republic	6
Dutch Antilles	4
Jamaica	9
Leeward Islands	10
Puerto Rico	4
U.S. Virgin Islands	10
Windward Islands	5
Total	81

EXHIBIT 2
Number of wholesalers
used by hotels

Number of wholesalers	Percentage of hotels
1-3	2.6
4-7	18.4
8-11	15.8
12-15	15.8
15 or more	47.4

median release period for the shoulder and low seasons was seven days.

Half the hotels waited at least 60 days after guest arrival for payment from the wholesalers. Some hotels (36 percent) waited only 30 days, but others faced a longer wait (12 percent waited 90 days, and 1 percent, 120 days).

Operating Statistics

Reported occupancies showed the expected seasonal variation, with a mean occupancy of 77 percent during the high season, 70 percent during the shoulder season, and 58 percent during the low season. As mentioned above, the percentage of occupancy attributed to wholesalers also varied, with greater dependence during the high and shoulder seasons (57 percent and 56 percent, respectively) than during the low season (49 percent). Because of the variations in demand, rates also varied by season (see Exhibit 3).

The percentage of room revenue obtained from wholesalers by a hotel and the rates offered by the hotel were negatively correlated. That is, the hotels that offer lower rates to wholesalers do more business with wholesalers.

Risky Business

Caribbean resort hotels are dependent on wholesale tour operators. In fact, over half their business is provided by wholesalers. In return, they give the wholesalers substantial discounts, liberal payment terms, commitments far in advance of arrival, and short release periods.

Discounting. As mentioned above, hotels provide substantial discounts to wholesalers in return for their business. For our study, we asked hotels to report their rack rate, their average daily rate (ADR), and their average whole-

sale rate (see Exhibit 3). These data were used to derive the average rate for non-wholesale business, and from this we determined the average discount offered to wholesalers.

Resort hotels offered wholesalers a higher discount off rack rate in the shoulder and low seasons (40.6 percent and 40.2 percent, respectively) than in the high season (34.6 percent). Similarly, the ADR was approximately 31 percent off the rack rate during the shoulder and low seasons, but only 24.7 percent less than the rack rate during the high season. This discounting seems logical, since higher discounts were offered during times of lower demand.

The relationship is reversed when the rate charged wholesaler business is compared to the rate charged other business. The discount given to wholesalers relative to the non-wholesaler rate was slightly higher during the high and shoulder seasons (26.0 percent and 26.1 percent, respectively) than during the low season (23.2 percent). In effect, resort hotels gave wholesalers the same discount regardless of the season. They offered a slightly higher discount during the high season than during the low season. If a larger discount could be offered during the low season, additional wholesaler business should be generated, and the hotel's profit should increase. Similarly, a smaller discount during the high season should not seriously dampen wholesaler demand and may reduce the transient displacement that often occurs during this time.

Financial risk. Most of the hotels surveyed commit rooms to wholesalers seven to twelve months in advance. Although wholesalers collect payment from customers about three to six

months before the guests arrive at the resort hotel, most of the hotels studied waited over 60 days for payment from wholesalers. The result can be serious cash-flow problems for the resort hotels.

Short release periods are another source of financial risk. The hotel might not be able to sell the returned rooms. And because the hotel is never certain how many rooms will be occupied, it is difficult to determine proper staffing and purchasing needs. The shorter the release period, the more difficult it is for the resort hotel managers to manage their properties effectively.

Taking Control

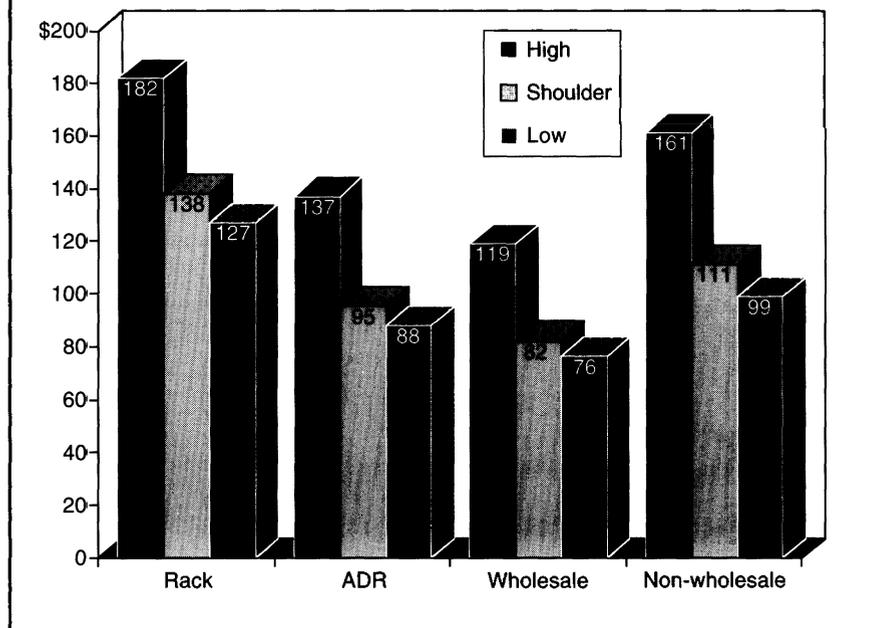
Wholesalers play a valuable role in the Caribbean resort hotel industry by helping hotels market and sell their rooms. But in recent years wholesalers' power has increased, causing operational and financial problems for some Caribbean resort-hotel operators.

Hotels should adopt a more logical discount policy. Hotels could offer higher wholesaler discounts during the low season, or lower discounts during the high season, or both. The current discount structure may displace high-paying guests during the high season and may not offer sufficient incentive to wholesalers during the low season.

The contract agreement between hotels and wholesalers should be standardized. Hotels currently use a variety of contract types when working with wholesalers. If a standard, yet flexible, contract agreement could be designed, both wholesalers and hotels would benefit.

The power of wholesalers has led to a short release period and a long payment time, both of which make it difficult for hotel managers to manage their properties. Resort hotels should work to-

EXHIBIT 3
Average room rates by season, in U.S. dollars



gether, perhaps through an organization such as the Caribbean Hotel Association, to lengthen the release period and shorten the time for payment.

Hotels should pursue other distribution channels to reduce their dependence on wholesalers. For example, all-inclusive resorts bypass wholesalers and market their business directly to retail travel agents and consumers. As global-distribution systems grow in importance, the relative strength of wholesalers is expected to decline. If hotels can successfully develop alternative distribution channels, their profits should increase.

Hotels, like other service businesses, need to be able to manage their own capacity. Wholesale tour operators currently control over half the capacity of Caribbean resort hotels. When a hotel loses control of its capacity, it also loses the ability to effectively manage that capacity. **CQ**